

SCHNITZER STEEL INDUSTRIES INC

Form 10-Q

July 01, 2010

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**x Quarterly Report Pursuant to Section 13 or 15(d)**

**of the Securities Exchange Act of 1934**

For the Quarterly Period Ended May 31, 2010

**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 0-22496

**SCHNITZER STEEL INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

**OREGON**  
(State or other jurisdiction of

incorporation or organization)

**3200 NW Yeon Ave.**

**Portland, OR**  
(Address of principal executive offices)

**93-0341923**  
(I.R.S. Employer

Identification No.)

**97210**  
(Zip Code)

**(503) 224-9900**

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller Reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The Registrant had 23,018,898 shares of Class A common stock, par value of \$1.00 per share, and 4,783,833 shares of Class B Common Stock, par value of \$1.00 per share, outstanding at June 24, 2010.

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## SCHNITZER STEEL INDUSTRIES, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share amounts)

|   | May 31, 2010 | August 31, 2009 |
|---|--------------|-----------------|
| <b>Assets</b>   |              |                 |
| Current assets:   |              |                 |
| Cash and cash equivalents   | \$ 31,524    | \$ 41,026       |
| Accounts receivable, net  | 138,371      | 117,666         |
| Inventories, net  | 291,273      | 184,455         |
| Deferred income taxes   | 7,333        | 10,027          |
| Refundable income taxes   | 7,940        | 46,972          |
| Prepaid expenses and other current assets   | 11,693       | 10,868          |
| Total current assets  | 488,134      | 411,014         |
| Property, plant and equipment, net  | 438,354      | 447,228         |
| Other assets:   |              |                 |
| Investment in and advances to joint venture partnerships  | 12,339       | 10,812          |
| Goodwill  | 380,719      | 366,559         |
| Intangibles, net  | 21,164       | 20,422          |
| Other assets  | 9,448        | 12,198          |
| Total assets  | \$ 1,350,158 | \$ 1,268,233    |
| <b>Liabilities and Equity</b>   |              |                 |
| Current liabilities:  |              |                 |
| Short-term borrowings and capital lease obligations   | \$ 1,238     | \$ 1,317        |
| Accounts payable  | 90,972       | 72,289          |
| Accrued payroll and related liabilities   | 28,060       | 23,636          |
| Environmental liabilities   | 2,564        | 3,148           |
| Accrued income taxes  | 14,001       | 776             |
| Other accrued liabilities   | 33,698       | 38,963          |
| Total current liabilities   | 170,533      | 140,129         |
| Deferred income taxes   | 51,004       | 44,523          |
| Long-term debt and capital lease obligations, net of current maturities   | 99,371       | 110,414         |
| Environmental liabilities, net of current portion   | 39,180       | 38,760          |
| Other long-term liabilities   | 10,004       | 11,657          |
| Commitments and contingencies (Note 7)  |              |                 |
| Schnitzer Steel Industries, Inc. ( SSI ) shareholders' equity:  |              |                 |
| Preferred stock 20,000 shares authorized, none issued   | 0            | 0               |
| Class A common stock 75,000 shares \$1.00 par value authorized, 22,999 and 21,402 shares issued and outstanding | 22,999       | 21,402          |
| Class B common stock 25,000 shares \$1.00 par value authorized, 4,784 and 6,268 shares issued and outstanding   | 4,784        | 6,268           |
| Additional paid-in capital  | 6,355        | 0               |
| Retained earnings   | 942,170      | 894,243         |
| Accumulated other comprehensive loss  | (925)        | (2,546)         |
| Total SSI shareholders' equity  | 975,383      | 919,367         |
| Noncontrolling interests  | 4,683        | 3,383           |

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|                              |              |              |
|------------------------------|--------------|--------------|
| Total equity                 | 980,066      | 922,750      |
| Total liabilities and equity | \$ 1,350,158 | \$ 1,268,233 |

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

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## SCHNITZER STEEL INDUSTRIES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share amounts)

|  | Three Months Ended<br>May 31, |            | Nine Months Ended May 31, |              |
|--|-------------------------------|------------|---------------------------|--------------|
|  | 2010                          | 2009       | 2010                      | 2009         |
| Revenues   | \$ 703,539                    | \$ 382,029 | \$ 1,662,150              | \$ 1,260,672 |
| Operating expense:   |                               |            |                           |              |
| Cost of goods sold   | 598,721                       | 347,434    | 1,446,241                 | 1,217,561    |
| Selling, general and administrative                                    | 42,779                        | 38,721     | 116,886                   | 118,320      |
| Environmental matters  | 141                           | 0          | (241)                     | (6,080)      |
| (Income) loss from joint ventures                                      | (1,877)                       | 116        | (2,330)                   | (2,196)      |
| Operating income (loss)  | 63,775                        | (4,242)    | 101,594                   | (66,933)     |
| Other income (expense):  |                               |            |                           |              |
| Interest expense   | (503)                         | (629)      | (1,816)                   | (2,823)      |
| Other income, net  | 201                           | 5,634      | 1,091                     | 6,785        |
| Total other income (expense)   | (302)                         | 5,005      | (725)                     | 3,962        |
| Income (loss) from continuing operations before income taxes           | 63,473                        | 763        | 100,869                   | (62,971)     |
| Income tax (expense) benefit   | (21,715)                      | (723)      | (33,315)                  | 25,154       |
| Income (loss) from continuing operations                               | 41,758                        | 40         | 67,554                    | (37,817)     |
| Income (loss) from discontinued operations, net of tax                 | 23                            | (1,058)    | (15,023)                  | (4,485)      |
| Net income (loss)  | 41,781                        | (1,018)    | 52,531                    | (42,302)     |
| Net income attributable to noncontrolling interests                    | (1,328)                       | (509)      | (3,188)                   | (192)        |
| Net income (loss) attributable to SSI                                  | \$ 40,453                     | \$ (1,527) | \$ 49,343                 | \$ (42,494)  |
| Basic:   |                               |            |                           |              |
| Income (loss) per share from continuing operations attributable to SSI | \$ 1.45                       | \$ (0.01)  | \$ 2.31                   | \$ (1.35)    |
| Loss per share from discontinued operations attributable to SSI        | 0.00                          | (0.04)     | (0.54)                    | (0.16)       |
| Net income (loss) per share attributable to SSI                        | \$ 1.45                       | \$ (0.05)  | \$ 1.77                   | \$ (1.51)    |
| Diluted:   |                               |            |                           |              |
| Income (loss) per share from continuing operations attributable to SSI | \$ 1.43                       | \$ (0.01)  | \$ 2.28                   | \$ (1.35)    |
| Loss per share from discontinued operations attributable to SSI        | 0.00                          | (0.04)     | (0.53)                    | (0.16)       |
| Net income (loss) per share attributable to SSI                        | \$ 1.43                       | \$ (0.05)  | \$ 1.75                   | \$ (1.51)    |
| Weighted average number of common shares:                              |                               |            |                           |              |
| Basic  | 27,898                        | 28,280     | 27,856                    | 28,173       |
| Diluted  | 28,211                        | 28,280     | 28,177                    | 28,173       |
| Dividends declared per common share                                    | \$ 0.017                      | \$ 0.017   | \$ 0.051                  | \$ 0.051     |

The accompanying notes to the unaudited condensed consolidated financial statements

are an integral part of these statements.

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## SCHNITZER STEEL INDUSTRIES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

|  | Nine Months Ended May 31,<br>2010 | 2009        |
|--|-----------------------------------|-------------|
| Cash flows from operating activities:                                    |                                   |             |
| Net income (loss)  | \$ 52,531                         | \$ (42,302) |
| Adjustments to reconcile net earnings to cash from operating activities: |                                   |             |
| Depreciation and amortization  | 47,023                            | 45,849      |
| Inventory write-down   | 368                               | 51,968      |
| Deferred income taxes  | 4,517                             | (2,179)     |
| Undistributed equity in earnings of joint ventures                       | (2,390)                           | (1,659)     |
| Share-based compensation expense   | 7,886                             | 5,428       |
| Excess tax benefits from share-based payment arrangements                | (110)                             | (900)       |
| (Gain) loss on disposal of a business and other assets                   | 16,613                            | (1,919)     |
| Environmental matters  | 460                               | (2,844)     |
| Voluntary incentive award forfeitures                                    | 0                                 | (5,504)     |
| Unrealized (gain) loss on derivatives                                    | (3,337)                           | 2,682       |
| Bad debt expense, net of recoveries                                      | 123                               | 8,553       |
| Gain on settlement of joint venture separation and termination agreement | 0                                 | (6,761)     |
| Changes in assets and liabilities:                                       |                                   |             |
| Accounts receivable  | (24,083)                          | 221,782     |
| Inventories  | (133,017)                         | 172,196     |
| Refundable income taxes  | 39,171                            | (36,749)    |
| Prepaid expenses and other current assets                                | (1,194)                           | 1,730       |
| Intangibles and other long term assets                                   | 1,346                             | (1,825)     |
| Accounts payable   | 15,420                            | (78,217)    |
| Accrued payroll liabilities  | 5,900                             | (40,491)    |
| Other accrued liabilities  | 856                               | (7,170)     |
| Accrued income taxes   | 12,900                            | (42,438)    |
| Environmental liabilities  | (924)                             | (534)       |
| Other long-term liabilities  | (215)                             | (391)       |
| Distributed equity in earnings of joint ventures                         | 430                               | 2,825       |
| Net cash provided by operating activities                                | 40,274                            | 241,130     |
| Cash flows from investing activities:                                    |                                   |             |
| Capital expenditures   | (35,373)                          | (50,585)    |
| Acquisitions, net of cash acquired                                       | (40,933)                          | (93,029)    |
| (Advances to) payments from joint ventures, net                          | 433                               | (2,197)     |
| Proceeds from sale of business and other assets                          | 41,260                            | 3,215       |
| Net cash used in investing activities                                    | (34,613)                          | (142,596)   |
| Cash flows from financing activities:                                    |                                   |             |
| Proceeds from line of credit   | 307,500                           | 238,700     |
| Repayment of line of credit  | (307,500)                         | (263,700)   |
| Borrowings from long-term debt   | 542,000                           | 400,529     |
| Repayment of long-term debt  | (553,143)                         | (437,166)   |
| Stock withheld for taxes under employee share-based compensation plan    | (2,421)                           | (2,596)     |
| Excess tax benefits from share-based payment arrangements                | 110                               | 900         |
| Stock options exercised  | 892                               | 1,209       |
| Distributions to noncontrolling interests                                | (1,888)                           | (996)       |
| Dividends paid   | (944)                             | (1,435)     |



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|  |           |           |
|--|-----------|-----------|
| Net cash used in financing activities            | (15,394)  | (64,555)  |
| Effect of exchange rate changes on cash          | 231       | (297)     |
| Net decrease in cash and cash equivalents        | (9,502)   | 33,682    |
| Cash and cash equivalents at beginning of period | 41,026    | 15,039    |
| Cash and cash equivalents at end of period       | \$ 31,524 | \$ 48,721 |

### SUPPLEMENTAL DISCLOSURES:

Cash paid (received) during the period for:

|   |             |           |
|---|-------------|-----------|
| Interest                                  | \$ 1,821    | \$ 2,739  |
| Income taxes paid (refunds received), net | \$ (25,657) | \$ 51,670 |

The accompanying notes to the unaudited condensed consolidated financial statements

are an integral part of these statements.

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SCHNITZER STEEL INDUSTRIES, INC.

**Note 1 - Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements of Schnitzer Steel Industries, Inc. (the Company) have been prepared pursuant to generally accepted accounting principles in the United States of America (U.S. GAAP) for interim financial information and the rules and regulations of the United States Securities and Exchange Commission (the SEC) for Form 10-Q, including Article 10 of Regulation S-X. The year-end condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP for annual financial statements. Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all normal, recurring adjustments considered necessary for a fair presentation have been included. Although management believes the disclosures made are adequate to ensure the information presented is not misleading, management suggests that these unaudited condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2009. The results for the three and nine months ended May 31, 2010 and 2009 are not necessarily indicative of the results of operations for the entire year.

***Cash and Cash Equivalents***

Cash and cash equivalents include short-term securities that are not restricted by third parties and have an original maturity date of 90 days or less. Included in accounts payable are book overdrafts of \$30 million as of May 31, 2010 and \$23 million as of August 31, 2009.

***Accounts Receivable, net***

Accounts receivable represent amounts due from customers on product and other sales. The allowance for doubtful accounts was \$7 million at May 31, 2010 and \$8 million at August 31, 2009.

***Goodwill and Other Intangible Assets, net***

On September 1, 2009, the Company adopted the accounting standard for non-recurring, non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. Non-recurring, non-financial asset fair value measurements include those used in the Company's test of recoverability of goodwill and indefinite-lived intangible assets, in which the Company determines whether fair values of its applicable reporting segments exceed their carrying values. This standard will also impact the accounting for business combinations by using an exit price model when determining the fair values of acquired assets and assumed liabilities.

***Accrued Workers' Compensation Costs***

The Company is self-insured up to a maximum amount for workers' compensation claims and as such, a reserve for the costs of unpaid claims and the estimated costs of incurred but not reported claims has been estimated as of the balance sheet date. The Company's exposure to claims is protected by various stop-loss insurance policies. The estimate of this reserve is based on historical claims experience. At May 31, 2010 and August 31, 2009, the Company accrued \$7 million and \$6 million, respectively, for the estimated cost of workers' compensation claims.

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## SCHNITZER STEEL INDUSTRIES, INC.

**Changes in Shareholders' Equity and Comprehensive Income (Loss)**

The following is a summary of the changes in shareholders' equity and comprehensive income (loss) (in thousands):

|   | <b>Fiscal 2010</b>      |                       |                     | <b>Fiscal 2009</b>      |                       |                     |
|---|-------------------------|-----------------------|---------------------|-------------------------|-----------------------|---------------------|
|   | <b>SSI shareholders</b> | <b>Noncontrolling</b> | <b>Total equity</b> | <b>SSI shareholders</b> | <b>Noncontrolling</b> | <b>Total equity</b> |
|   | <b>equity</b>           | <b>interests</b>      |                     | <b>equity</b>           | <b>interests</b>      |                     |
| Balances - September 1 (Beginning of period)                          | \$ 919,367              | \$ 3,383              | \$ 922,750          | \$ 978,152              | \$ 4,399              | \$ 982,551          |
| Net income (loss) attributable to SSI                                 | 49,343                  | 3,188                 | 52,531              | (42,494)                | 192                   | (42,302)            |
| Components of other comprehensive income (loss), net of tax:          |                         |                       |                     |                         |                       |                     |
| Defined benefit pension plan and net actuarial loss                   | 607                     | 0                     | 607                 | 0                       | 0                     | 0                   |
| Foreign currency translation  | 730                     | 0                     | 730                 | (447)                   | 0                     | (447)               |
| Net unrealized gain (loss) on cash-flow hedges                        | 285                     | 0                     | 285                 | (681)                   | 0                     | (681)               |
| Comprehensive income (loss)   | 50,965                  | 3,188                 | 54,153              | (43,622)                | 192                   | (43,430)            |
| Distributions to noncontrolling interests                             | 0                       | (1,888)               | (1,888)             | 0                       | (996)                 | (996)               |
| Noncontrolling interest buyout  | 0                       | 0                     | 0                   | 0                       | (595)                 | (595)               |
| Stock withheld for taxes under employee share-based compensation plan | (2,421)                 | 0                     | (2,421)             | (2,596)                 | 0                     | (2,596)             |
| Share-based compensation expense                                      | 7,886                   | 0                     | 7,886               | 5,428                   | 0                     | 5,428               |
| Dividends declared  | (1,416)                 | 0                     | (1,416)             | (1,435)                 | 0                     | (1,435)             |
| Stock options exercised   | 892                     | 0                     | 892                 | 1,209                   | 0                     | 1,209               |
| Excess tax benefits from share-based payment arrangements             | 110                     | 0                     | 110                 | 900                     | 0                     | 900                 |
| Balances - May 31 (End of period)                                     | \$ 975,383              | \$ 4,683              | \$ 980,066          | \$ 938,036              | \$ 3,000              | \$ 941,036          |

**Net Income (Loss) and Dividends per Share**

Effective September 1, 2009, the Company adopted the accounting standard for noncontrolling interests in consolidated financial statements. Certain provisions of this accounting standard are required to be adopted retrospectively for all periods presented and include a requirement that the carrying value of noncontrolling interests (previously referred to as minority interests) be removed from the mezzanine section of the balance sheet and reclassified as equity. Further, as a result of adopting this accounting standard, net (income) loss attributable to noncontrolling interests is now deducted from the income (loss) from continuing operations to arrive at the net income (loss) from continuing operations attributable to SSI for purposes of calculating earnings per share (EPS).

Basic net income (loss) per share attributable to SSI is based on the weighted average number of outstanding common shares during the periods presented, including vested deferred stock units (DSUs) and restricted stock units (RSUs). Diluted net income per share attributable to SSI is based on the weighted average number of common shares outstanding, assuming dilution. Potentially dilutive common shares include the assumed exercise of stock options and assumed vesting of performance share, DSU and RSU awards using the treasury stock method. For the three and nine months ended May 31, 2010, 40,557 and 35,080 common stock equivalent shares, respectively, were considered anti-dilutive and were excluded from the calculation of diluted earnings per share, compared to 1,193,151 common stock units for the three and nine months ended May 31, 2009.

|  | <b>Three Months Ended May 31,</b> |             | <b>Nine Months Ended May 31,</b> |             |
|--|-----------------------------------|-------------|----------------------------------|-------------|
|  | <b>2010</b>                       | <b>2009</b> | <b>2010</b>                      | <b>2009</b> |
| Income (loss) from continuing operations | \$ 41,758                         | \$ 40       | \$ 67,554                        | \$ (37,817) |

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|   |           |            |           |             |
|---|-----------|------------|-----------|-------------|
| Net income attributable to noncontrolling interests   | (1,328)   | (509)      | (3,188)   | (192)       |
| Income (loss) from continuing operations attributable to SSI  | 40,430    | (469)      | 64,366    | (38,009)    |
| Income (loss) from discontinued operations, net of tax  | 23        | (1,058)    | (15,023)  | (4,485)     |
| Net income (loss) attributable to SSI   | \$ 40,453 | \$ (1,527) | \$ 49,343 | \$ (42,494) |
| Computation of shares:  |           |            |           |             |
| Weighted average common shares outstanding basic  | 27,898    | 28,280     | 27,856    | 28,173      |
| Incremental common shares attributable to dilutive stock options, performance share awards, DSUs and RSUs | 313       | 0          | 321       | 0           |
| Weighted average common shares outstanding diluted  | 28,211    | 28,280     | 28,177    | 28,173      |

### ***Recent Accounting Pronouncements***

In December 2008, a new accounting standard was issued regarding an employer's disclosures about the plan assets of a defined benefit pension or postretirement plan and will require additional disclosure regarding investment policies and strategies, fair value of each major asset category based on risks of the assets, inputs and valuations techniques used to estimate fair value, fair value

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## SCHNITZER STEEL INDUSTRIES, INC.

measurement hierarchy levels under pension accounting for each asset category and significant concentration of risk information. This standard will be effective for the Company for the fiscal year ending August 31, 2010 and will be applied prospectively and thus will not have any impact on previously issued financial information.

In January 2010, an accounting standards update was issued to improve disclosure requirements related to fair value measurement. This update requires additional disclosures relating to significant transfers in and out of Levels 1 and 2 fair value measurements, along with the reason for the transfer and separate presentation of purchases, sales, issuances and settlements in the reconciliation of Level 3 fair value measurements. The update was effective for the Company in the third quarter of the fiscal year ending August 31, 2010, except for disclosures relating to Level 3 activity, which will be effective for the fiscal year ending August 31, 2012 and will be applied prospectively and thus will not have any impact on previously issued financial information. See Note 11 Derivative Financial Instruments and Fair Value Measurements.

***Reclassifications***

Certain prior year amounts in the statement of cash flows have been reclassified within cash flows from operating activities to conform to the current year presentation. These changes had no impact on previously reported operating income, net income (loss) or net cash provided by operating activities.

**Note 2 - Inventories, net**

The Company's inventories primarily consist of ferrous and nonferrous processed and unprocessed scrap metal, used and salvaged vehicles and semi-finished (billets) and finished steel products, consisting primarily of rebar, merchant bar and wire rod. Inventories are stated at the lower of cost or market for all periods presented.

Inventories, net consisted of the following (in thousands):

|                                       | May 31, 2010 | August 31, 2009 |
|---------------------------------------|--------------|-----------------|
| Processed and unprocessed scrap metal | \$ 212,109   | \$ 77,607       |
| Semi-finished goods (billets)         | 6,088        | 9,600           |
| Finished goods                        | 42,799       | 66,936          |
| Supplies                              | 31,198       | 31,581          |
| Inventory reserve                     | (921)        | (1,269)         |
| Inventories, net                      | \$ 291,273   | \$ 184,455      |

Due to reduced production levels during fiscal 2009, the Company recognized \$3 million and \$19 million of expense for the three and nine months ended May 31, 2009 for production costs that could not be capitalized into inventory.

**Note 3 - Property, Plant and Equipment, net**

Property, plant and equipment, net consisted of the following (in thousands):

|                                    | May 31, 2010 | August 31, 2009 |
|------------------------------------|--------------|-----------------|
| Property, plant and equipment      | \$ 836,048   | \$ 812,997      |
| Less: accumulated depreciation     | (397,694)    | (365,769)       |
| Property, plant and equipment, net | \$ 438,354   | \$ 447,228      |



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## SCHNITZER STEEL INDUSTRIES, INC.

**Note 4 - Business Combinations**

On September 1, 2009, the Company adopted the revised accounting standard for business combinations issued by the Financial Accounting Standards Board in December 2007. This standard requires the Company to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, and requires acquisition costs to be expensed as incurred.

During the first nine months of fiscal 2010, the Company spent \$41 million to complete the acquisition of six self-service used auto parts stores which operate under the Company's Pick-n-Pull brand and a metals recycler. These acquisitions are as follows:

In October 2009, the Company completed the acquisition of four self-service used auto parts stores located near the Company's Metals Recycling Business (MRB) export facility in Portland, Oregon. This acquisition represented the Company's first used auto parts operations in the Pacific Northwest.

In January 2010, the Company completed the acquisition of two self-service used auto parts stores, which increased to four the number of used auto parts stores that the Company operates in the Dallas-Fort Worth Metroplex.

In April 2010, the Company completed the acquisition of a metals recycler in Montana to provide an additional source of scrap metal for the Company's Tacoma, Washington export facility.

These acquisitions were not material to the Company's financial position or results of operations, and thus proforma information is not presented.

**Note 5 - Discontinued Operations**

In October 2009, the Company sold its full-service used auto parts operation, which had been operated as part of the Auto Parts Business (APB) reporting segment. The Company concluded that the divestiture met the definition of a discontinued operation. Accordingly, the results of this discontinued operation have been reclassified for all periods presented. The sale resulted in a loss of \$15 million, net of tax, and included the write-off of \$12 million of goodwill that was allocated to the full-service operation from the APB reporting segment. Operating results of the discontinued operations are summarized below. The amounts exclude general corporate overhead previously allocated to the full-service used auto parts operation.

| (In thousands)   | Three Months Ended May 31, |            | Nine Months Ended May 31, |            |
|--|----------------------------|------------|---------------------------|------------|
|  | 2010                       | 2009       | 2010                      | 2009       |
| Revenues   | \$ 0                       | \$ 29,801  | \$ 9,991                  | \$ 83,325  |
| Income (loss) from discontinued operations before income taxes | \$ 36                      | \$ (1,627) | \$ (797)                  | \$ (6,900) |
| Loss on sale of full service operations, including adjustments | 0                          | 0          | (16,743)                  | 0          |
| Income taxes   | (13)                       | 569        | 2,517                     | 2,415      |
| Income (loss) from discontinued operations, net of tax         | \$ 23                      | \$ (1,058) | \$ (15,023)               | \$ (4,485) |

Assets and liabilities of discontinued operations consisted of the following (in thousands):

|                        | August 31, 2009 |
|------------------------|-----------------|
| Current assets         | \$ 41,670       |
| Noncurrent assets      | \$ 8,538        |
| Current liabilities    | \$ 8,740        |
| Noncurrent liabilities | \$ 5,167        |

**Note 6 - Goodwill and Intangibles, net**

In the second quarter of fiscal 2010, the Company performed its annual goodwill impairment testing by comparing the fair value of each reporting segment with its carrying value, including goodwill. As a result of this testing, the Company determined that the fair values of each of the reporting segments were significantly in excess of their respective carrying values and the goodwill balances and



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### SCHNITZER STEEL INDUSTRIES, INC.

indefinite lived intangible assets were not impaired as of February 28, 2010. There were no triggering events during the third quarter of fiscal 2010 requiring a goodwill impairment test. The Company will continue to monitor its goodwill and indefinite-lived intangible and long-lived assets for possible future impairment.

The gross changes in the carrying amount of goodwill by reporting segment during the first nine months of fiscal 2010 were (in thousands):

|   | Metals<br>Recycling<br>Business | Auto<br>Parts<br>Business | Total      |
|---|---------------------------------|---------------------------|------------|
| Balance as of August 31, 2009           | \$ 228,977                      | \$ 137,582                | \$ 366,559 |
| Foreign currency translation adjustment | 0                               | 798                       | 798        |
| Acquisitions                            | 3,091                           | 23,927                    | 27,018     |
| Divestitures                            | 0                               | (12,030)                  | (12,030)   |
| Purchase accounting adjustments         | (1,850)                         | 224                       | (1,626)    |
| Balance as of May 31, 2010              | \$ 230,218                      | \$ 150,501                | \$ 380,719 |

The following table presents the Company's intangible assets and their related lives (in thousands):

|                           | Life In<br>Years | May 31, 2010<br>Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | August 31, 2009<br>Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
|---------------------------|------------------|---|-----------------------------|--|-----------------------------|
| Identifiable intangibles: |                  |   |                             |  |                             |
| Tradename                 | Indefinite       | \$ 750                                      | \$ 0                        | \$ 750   | \$ 0                        |
| Tradename                 | 20               | 0   | 0                           | 972  | (227)                       |
| Tradename                 | 1 - 6            | 583   | (386)                       | 583  | (275)                       |
| Marketing agreement       | 5                | 563   | (131)                       | 0  | 0                           |
| Employment agreements     | 2                | 1,117                                       | (745)                       | 1,117  | (326)                       |
| Covenants not to compete  | 3 - 20           | 27,797                                      | (12,353)                    | 22,782   | (9,949)                     |
| Leasehold interests       | 4 - 25           | 862   | (258)                       | 1,550  | (540)                       |
| Lease termination fee     | 15               | 200   | (197)                       | 200  | (191)                       |
| Permits & licenses        | 3                | 80  | (33)                        | 80   | (13)                        |
| Supply contracts          | Indefinite       | 361   | 0                           | 361  | 0                           |
| Supply contracts          | 5 - 6            | 4,571                                       | (1,827)                     | 5,269  | (1,931)                     |
| Real property options     | Indefinite       | 210   | 0                           | 210  | 0                           |
| Total                     |                  | \$ 37,094                                   | \$ (15,930)                 | \$ 33,874                                      | \$ (13,452)                 |

Intangible assets with finite useful lives are amortized over their useful lives using methods that reflect the pattern over which the economic benefits are expected to be consumed or on a straight-line basis based on estimated lives. Amortization expense for identifiable intangible assets for the three and nine months ended May 31, 2010 was \$1 million and \$4 million, respectively, compared to \$1 million and \$3 million for the same periods in the prior year, respectively.

### Note 7 - Environmental Liabilities and Other Contingencies

The Company evaluates the adequacy of its environmental liabilities on a quarterly basis. Adjustments to the liabilities are made when additional information becomes available that affects the estimated costs to study or remediate any environmental issues or expenditures are made for

which reserves were established.

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## SCHNITZER STEEL INDUSTRIES, INC.

Changes in the Company's environmental liabilities for the first nine months of fiscal 2010 were (in thousands):

| Reporting Segment         | Beginning<br>Balance<br>September 1, 2009 | Reserves<br>Established,<br>Net | Payments | Ending<br>Balance<br>May 31, 2010 | Short-Term | Long-Term |
|---------------------------|---|---------------------------------|----------|-----------------------------------|------------|-----------|
| Metals Recycling Business | \$ 25,608                                 | \$ 760                          | \$ (924) | \$ 25,444                         | \$ 2,010   | \$ 23,434 |
| Auto Parts Business       | 16,300                                    | 0                               | 0        | 16,300                            | 554        | 15,746    |
| Total                     | \$ 41,908                                 | \$ 760                          | \$ (924) | \$ 41,744                         | \$ 2,564   | \$ 39,180 |

***Metals Recycling Business ( MRB )***

At May 31, 2010, MRB had environmental reserves of \$25 million for the potential remediation of locations at which it has conducted business and allegedly disposed of certain materials as well as for the potential future remediation at various acquired sites.

**Portland Harbor**

In fiscal 2006, the Company was notified by the U.S. Environmental Protection Agency ( EPA ) under the Comprehensive Environmental Response, Compensation and Liability Act ( CERCLA ) that it was one of at least 69 potentially responsible parties ( PRPs ) that own or operate or formerly owned or operated sites adjacent to the Portland Harbor Superfund site. The precise nature and extent of any clean-up of the Portland Harbor, the parties to be involved, the process to be followed for any clean-up and the allocation of any costs for the clean-up among responsible parties have not yet been fully determined, but the process of identifying additional PRPs and beginning allocation of the costs is underway. It is unclear to what extent the Company will be liable for environmental costs or damages associated with the Portland Harbor Superfund site or for natural resource damage claims or third party contribution or damage claims with respect to the site. While the Company participated in certain preliminary Portland Harbor study efforts, it is not party to the consent order entered into by the EPA with certain other PRPs, referred to as the Lower Willamette Group ( LWG ), for a remedial investigation/feasibility study.

During fiscal 2007, the Company and certain other parties agreed to an interim settlement with the LWG under which the Company made a cash contribution to the LWG Remedial Investigation/Feasibility Study. The Company has also joined with the LWG and more than 50 other PRPs in a voluntary process for establishing an allocation of costs at the site. These parties have selected an allocation team and are currently working on preparing an allocation process design agreement. The LWG has also moved forward with litigation seeking to bring additional parties into the allocation process; which litigation has been stayed.

The Oregon Department of Environmental Quality is performing investigations involving the Company's sites adjacent to the Portland Harbor, which are focused on controlling any current releases of contaminants into the Willamette River. Separately, in January 2008, the Natural Resource Damages Trustee Council ( Trustees ) for Portland Harbor invited the Company and other PRPs to participate in funding and implementing the Natural Resource Injury Assessment for the site. Following meetings among the Trustees and the PRPs, a funding and participation agreement was negotiated under which the participating PRPs agreed to fund the first phase of natural resource damage assessment. The Company joined in that agreement and agreed to pay \$100,000 of those costs. The parties are currently discussing funding and participation for the second phase of the natural resource damage assessment.

The cost of the investigations and remediation associated with these properties is not reasonably estimable until the completion of the data review and further investigations now being conducted by the LWG and the Trustees and the selection and approval of a remedy. However, given the size of the Portland Harbor Superfund Site and the nature of the conditions identified to date, the total cost of the remediation could be substantial. In addition, because there has not been a determination of how the costs of the ongoing investigations and any remedy will be allocated among the PRPs, it is not possible to estimate the costs which the Company might incur in connection with the ongoing investigations and remediation although such costs could be material to the Company's financial position or results of operations. In fiscal 2006, the Company recorded a liability for its then estimated share of the costs of the investigation incurred by the LWG to date. As of May 31, 2010, the Company's reserve for third party investigation costs of the Portland Harbor Superfund site was \$1 million.



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### SCHNITZER STEEL INDUSTRIES, INC.

#### **Other Metals Recycling Business Sites**

The Company's environmental reserves include \$24 million for potential future clean-up of other MRB locations at which the Company or its subsidiaries have conducted business or allegedly disposed of other materials. No environmental compliance enforcement proceedings are currently pending related to these sites.

#### **Auto Parts Business ( APB )**

At May 31, 2010, APB had environmental reserves of \$16 million for the potential remediation of APB locations at which it has conducted business and allegedly disposed of certain materials, as well as for the potential remediation at various acquired sites. No environmental compliance enforcement proceedings are currently pending related to these sites.

#### **Steel Manufacturing Business ( SMB )**

SMB's electric arc furnace generates dust ( EAF dust ) that is classified as hazardous waste by the EPA because of its zinc and lead content. As a result, the Company captures the EAF dust and ships it in specialized rail cars to a domestic firm that applies a treatment that allows the EAF dust to be delisted as hazardous waste so it can be disposed of as a non-hazardous solid waste.

SMB has an operating permit issued under Title V of the Clean Air Act Amendments of 1990, which governs certain air quality standards. The permit was first issued in 1990 and has since been renewed through 2012. The permit is based upon an annual production capacity of 950,000 tons.

SMB had no environmental reserves at May 31, 2010 or 2009.

#### **Contingencies - Other**

On October 16, 2006, the Company finalized settlements with the Department of Justice ( DOJ ) and the SEC resolving an investigation related to a past practice of making improper payments to the purchasing managers of the Company's customers in Asia in connection with export sales of recycled ferrous metal. Under the settlement, the Company agreed to a deferred prosecution agreement with the DOJ (the Deferred Prosecution Agreement ) and an order issued by the SEC instituting cease-and-desist proceedings, making findings and imposing a cease-and-desist order pursuant to Section 21C of the Securities Exchange Act of 1934, as amended (the Order ). The Deferred Prosecution Agreement ended on October 15, 2009 and the SEC's cease-and-desist order expired on April 17, 2010. The Company does not anticipate any further losses or material expenses associated with this settlement.

#### **Note 8 - Short-Term Borrowings**

The Company's short-term borrowings consist primarily of a one year, unsecured, uncommitted \$25 million credit line with Wells Fargo Bank, N.A that expires March 1, 2011. Interest rates on outstanding indebtedness under the unsecured line of credit are set by the bank at the time of borrowing. The Company had no borrowings outstanding under this facility at May 31, 2010 and August 31, 2009. The credit agreement contains various representations and warranties, events of default and financial and other covenants, including covenants regarding maintenance of a minimum fixed charge coverage ratio and a maximum leverage ratio. As of May 31, 2010 and August 31, 2009, the Company was in compliance with all such covenants.

#### **Note 9 - Long-Term Debt and Capital Lease Obligations**

The Company maintains a \$450 million revolving credit facility that matures in July 2012 pursuant to an unsecured committed bank credit agreement with Bank of America, N.A., as administrative agent, and the other lenders party thereto. Interest rates on outstanding indebtedness under the agreement are based, at the Company's option, on either the London Interbank Offered Rate



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### **SCHNITZER STEEL INDUSTRIES, INC.**

( LIBOR ) plus a spread of between 0.50% and 1.00%, with the amount of the spread based on a pricing grid tied to the Company's leverage ratio, or the greater of the prime rate or the federal funds rate plus 0.50%. In addition, annual commitment fees are payable on the unused portion of the credit facility at rates between 0.10% and 0.25% based on a pricing grid tied to the Company's leverage ratio. As of May 31, 2010 and August 31, 2009, the Company had borrowings outstanding under the credit facility of \$90 million and \$100 million, respectively. The weighted average interest rate on amounts outstanding under this facility was 0.81% at May 31, 2010. The carrying value of this debt approximates fair value as it primarily consists of variable interest rate notes.

The bank credit agreement contains various representations and warranties, events of default and financial and other covenants, including covenants regarding maintenance of a minimum fixed charge coverage ratio and a maximum leverage ratio. As of May 31, 2010 and August 31, 2009, the Company was in compliance with all such covenants.

As of May 31, 2010, the Company had capital lease obligations that expire at various dates through September 2015 for the use of equipment. As of May 31, 2010 and August 31, 2009, the Company had \$2 million and \$3 million, respectively, of assets accounted for as capital leases that were included in property, plant and equipment on the condensed, consolidated balance sheets. Additionally, as of May 31, 2010 and August 31, 2009, the Company had \$8 million of long-term bonded indebtedness that matures in January 2021.

#### **Note 10 - Related Party Transactions**

The Company purchases recycled metal from its joint venture operations at prices that approximate fair market value. These purchases totaled \$12 million and \$3 million in the third quarter of fiscal 2010 and 2009, respectively, and \$21 million and \$11 million for the first nine months of fiscal 2010 and 2009, respectively. Advances to (payments from) these joint ventures were less than (\$1) million and less than \$1 million in the third quarter of fiscal 2010 and 2009, respectively, and less than (\$1) million and \$2 million in the first nine months of fiscal 2010 and 2009, respectively. The Company owed \$2 million to joint ventures as of May 31, 2010 and August 31, 2009.

Thomas D. Klauer, Jr., President of the Company's Auto Parts Business, is the sole shareholder of a corporation that is the 25% minority partner in a partnership in which the Company is the 75% partner and which operates four self-service stores in Northern California. Mr. Klauer's 25% share of the profits of this partnership totaled \$1 million and \$2 million in the third quarter and first nine months of fiscal 2010, respectively, compared to less than \$1 million in the same periods of the prior year. The Company and a company owned by Mr. Klauer jointly own the real property at one of these stores, which is leased to the partnership. Mr. Klauer's share of the annual rent paid by the partnership is less than \$1 million. The term of this lease expires in December 2015, and the partnership has the option to renew the lease, upon its expiration, for multiple five-year periods. Rent under the lease is adjusted annually based on the Consumer Price Index. Also in 2009, Mr. Klauer, through a company of which he is the sole shareholder, acquired ownership of a contiguous parcel of real property, a portion of which is leased to the partnership. The term of this lease expires in December 2015, and the partnership has the option to renew the lease, upon its expiration, for multiple five-year periods. Rent under the lease is adjusted annually based on the Consumer Price Index. The rent paid by the partnership to Mr. Klauer's company in the third quarter and first nine months of fiscal 2010 for this parcel was less than \$1 million. In addition, during fiscal 2008, the Company loaned this partnership \$5 million to fund the exercise of an option to purchase another property occupied by the partnership from an unrelated third party. The loan incurred interest at 5% per annum, and the partnership was prohibited from making distributions to its partners (other than for taxes on the income of the partnership) until the loan was repaid. The principal balance was repaid in the first quarter of fiscal 2010, compared to a balance of \$1 million at August 31, 2009.

Gary Schnitzer and Gregory Schnitzer, each a member of the Schnitzer family, are employed by the Company. Joshua Philip, also a member of the Schnitzer family, was employed by the Company until his resignation effective January 8, 2010. For the third quarter and first nine months of fiscal 2010 and 2009, these members of the Schnitzer family collectively earned total compensation of less than \$1 million and \$1 million, respectively. Schnitzer family employees are considered related parties for financial reporting purposes because members of the Schnitzer family own significant interests in the Company.

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### **SCHNITZER STEEL INDUSTRIES, INC.**

Members of the Schnitzer family also own all of the outstanding stock of Schnitzer Investment Corp. ( SIC ), which is engaged in the real estate business and was a subsidiary of the Company prior to 1989. The Company and SIC are both potentially responsible parties with respect to Portland Harbor, which has been designated as a Superfund site since December 2000. The Company has incurred \$5 million, net of insurance reimbursements, in legal and consulting fees related to the investigation of this site, which includes the Company's Portland scrap operations. The Company and SIC have worked together in response to Portland Harbor matters, and the Company has paid all of the legal and consulting fees for the joint defense, in part due to its environmental indemnity obligation to SIC with respect to the Portland scrap operations property. As these costs have increased substantially in the last two years, the Company and SIC have agreed to an equitable cost sharing arrangement with respect to defense costs under which SIC will pay 50% of the legal and consulting costs, net of insurance recoveries. The Company has recorded \$3 million in reduced environmental expenses in fiscal 2010 for SIC's share of costs incurred to date. Amounts receivable from SIC under this agreement were \$1 million as of May 31, 2010.

It is the Company's policy that all transactions with the Schnitzer family (including Schnitzer family companies) require the approval of the Company's Audit Committee. The Company is in compliance with this policy.

### **Note 11 - Derivative Financial Instruments and Fair Value Measurements**

#### ***Natural gas price risk management***

In order to minimize the volatility of its natural gas costs, which represented 3% and 2% of SMB's cost of goods sold for the first nine months of fiscal 2010 and 2009, respectively, SMB entered into a take-or-pay natural gas contract that obligates it to purchase a minimum of 2,000 million British Thermal Units ( BTUs ) per day whether or not the amount is utilized. The contract expires on May 31, 2011 and obligates the Company to purchase minimum quantities through October 31, 2010, whether or not the amount is used.

#### ***Fair value measurement***

SMB's natural gas contract is classified as a derivative instrument and carried at fair value. Fair value for this instrument, the Company's only financial instrument carried at fair value, is determined using a forward price curve based on observable market price quotations at a major natural gas trading hub. The Company considers nonperformance risk in calculating fair value adjustments. This includes a credit risk adjustment based on the credit spreads of the counterparty when the Company is in an unrealized gain position or on the Company's own credit spread when the Company is in an unrealized loss position. This assessment of nonperformance risk is generally derived from the credit default swap market or from bond market credit spreads. The impact of the credit risk adjustments for the Company's outstanding derivative was not material to the fair value calculation as of May 31, 2010. Mark-to-market adjustments on this instrument resulted in a derivative liability of \$2 million at May 31, 2010, compared to \$6 million at August 31, 2009. This amount is classified as a Level 2 fair value measurement under the fair value hierarchy.

#### ***Derivative designated as a hedging instrument***

On September 1, 2008, the Company designated the entire remaining portion of the natural gas contract as a cash flow hedge. Due to changes in the expectation of the Company's future production as a result of changes in market conditions, the Company de-designated the contract as a hedge and re-designated only a portion, 20,000 million BTU per month, as a cash flow hedge in October 2008. The remaining portion of the contract is accounted for as a derivative not designated as a hedge.

Amounts included in accumulated other comprehensive income ( AOCI ) are reclassified to cost of goods sold when the forecasted purchase transaction is recognized in earnings and when ineffectiveness arises out of the hedge. Included in other accrued liabilities is the fair value of the designated hedge portion of the derivative of \$1 million and \$2 million as of May 31, 2010 and August 31, 2009, respectively. The effective portion of realized losses reclassified into cost of goods sold was less than \$1 million and \$1 million for the three and nine months ended May 31, 2010, respectively. The ineffective portion of unrealized losses included in cost of goods



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### **SCHNITZER STEEL INDUSTRIES, INC.**

sold was less than \$1 million for the three and nine months ended May 31, 2010. The unrealized loss, net of tax, for the effective portion of the hedge is less than \$1 million for the three and nine months ended May 31, 2010. Upon de-designation of the cash flow hedge in October 2008, \$1 million was reclassified from AOCI to cost of goods sold. Existing unrealized losses, net of tax, of less than \$1 million currently recorded in AOCI are expected to be reclassified into cost of goods sold within the next 12 months.

#### ***Derivative not designated as a hedging instrument***

For the portion of the natural gas contract not designated as a hedge, the Company recognizes the change in fair value in cost of goods sold in the period of change. Included in other accrued liabilities is the fair value of the derivative not designated as a hedge of \$1 million and \$4 million as of May 31, 2010 and August 31, 2009, respectively. Net gains of \$1 million and \$3 million were recognized in cost of goods sold for the three and nine months ended May 31, 2010, respectively, compared to net gains (losses) of \$1 million and (\$1) million for the three and nine months ended May 31, 2009, respectively.

#### **Note 12 - Share-based Compensation**

The Company recognized \$3 million and \$8 million for share-based compensation expense for the three and nine months ended May 31, 2010, compared to \$2 million and \$5 million for the same periods in the prior year, respectively.

#### ***Fiscal 2010-2012 Performance Share Awards***

On November 20, 2009, the Company's Compensation Committee approved performance-based awards under the Company's 1993 Stock Incentive Plan (the Plan) and entry by the Company into Long-Term Incentive Award Agreements evidencing the award of these performance shares. The Compensation Committee established performance targets based on the Company's earnings per share (weighted at 50%) and the average return on capital employed on a divisional basis (weighted at 50%) for the three years of the performance period, with award payouts ranging from a threshold of 50% to a maximum of 200% for each portion of the awards. A participant generally must be employed by the Company on the October 31 following the end of the performance period to receive an award payout, although adjusted awards will be paid if employment terminates earlier on account of death, disability, retirement, termination without cause after the first year of the performance period or on a sale of the Company. Awards will be paid in Class A common stock as soon as practicable after October 31 following the end of the performance period. The grant date for the fiscal 2010-2012 performance-based awards was November 20, 2009. Compensation expense for the fiscal 2010-2012 performance-based awards during the three and nine months ended May 31, 2010 was less than \$1 million and \$1 million, respectively.

#### ***Deferred Stock Units***

On January 27, 2010, each of the Company's non-employee directors received a DSU award equal to \$120,000 divided by the closing market price of the Class A common stock on January 27, 2010. John Carter, the Company's Chairman, and Tamara Lundgren, President and Chief Executive Officer, receive compensation pursuant to their employment agreements and do not receive DSUs. The DSUs granted on January 27, 2010 were for a total of 30,834 shares and the DSUs will become fully vested on the day before the Company's 2011 annual meeting, subject to continued Board service. The compensation expense related to these DSU awards for the three and nine months ended May 31, 2010 was less than \$1 million.

#### ***Restricted Stock Units***

On April 27, 2010, the Compensation Committee granted 25,000 RSUs to Tamara Lundgren, the Company's President and Chief Executive Officer. The RSUs have a two-year term and vest 100% on April 27, 2012. The estimated fair value of these RSUs granted was \$1 million based on the market closing price of the underlying Class A common stock on April 27, 2010 of \$55.89. The compensation expense related to these RSU awards for the three and nine months ended May 31, 2010 was less than \$1 million.

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**Note 13 - Employee Benefits**

The Company and certain of its subsidiaries have qualified and nonqualified retirement plans covering substantially all employees of these companies. These plans include a defined benefit plan, a supplemental executive retirement benefit plan ( SERBP ), defined contribution plans and multi-employer pension plans. These plans are more fully described in the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended August 31, 2009.

The components of net periodic pension costs for the three and nine months ended May 31, 2010 and 2009, were (in thousands):

|                                    | <b>Defined Benefit Plan</b>                |             |   |             |
|------------------------------------|--|-------------|---|-------------|
|                                    | <b>Three Months Ended May 31,<br/>2010</b> | <b>2009</b> | <b>Nine Months Ended May 31,<br/>2010</b> | <b>2009</b> |
| Interest cost                      | \$ 171                                     | \$ 195      | \$ 513                                    | \$ 585      |
| Expected return on plan assets     | (238)                                      | (243)       | (714)                                     | (729)       |
| Amortization of prior service cost | (24)                                       | 0           | (72)                                      | 0           |
| Recognized actuarial loss          | 131  | 70          | 393                                       | 210         |
| Settlement loss recognized         | 212  | 0           | 625                                       | 0           |
| Net periodic pension cost          | \$ 252                                     | \$ 22       | \$ 745                                    | \$ 66       |

  

|                           | <b>SERBP</b>                               |             |   |             |
|---------------------------|--|-------------|---|-------------|
|                           | <b>Three Months Ended May 31,<br/>2010</b> | <b>2009</b> | <b>Nine Months Ended May 31,<br/>2010</b> | <b>2009</b> |
| Service cost              | \$ 15                                      | \$ 9        | \$ 45                                     | \$ 27       |
| Interest cost             | 33   | 31          | 99  | 93          |
| Recognized actuarial gain | (1)  | (8)         | (3)                                       | (24)        |
| Net periodic pension cost | \$ 47                                      | \$ 32       | \$ 141                                    | \$ 96       |

***Defined Benefit Plans***

Benefits under the Company's defined benefit plan have been frozen since June 30, 2006. In general, additional contributions to the plan are not required and no contributions are expected to be made to the defined benefit plan in the remainder of fiscal 2010; however, changes in the discount rate or actual investment returns that are lower than the long-term expected return on plan assets could result in the need for the Company to make additional contributions. The Company did not make contributions to the defined benefit plan during the three and nine months ended May 31, 2010 or 2009. Benefit payments to SERBP participants were less than \$1 million for all periods presented.

***Multiemployer Pension Plans***

The Company contributes to various multiemployer pension plans in accordance with its collective bargaining agreements. Company contributions to the multiemployer plans were \$1 million and \$2 million, respectively, during the three and nine months ended May 31, 2010, compared to less than \$1 million and \$2 million, respectively, during the same periods in the prior year.

Approximately 60% of the Company's contributions are made to the Western Independent Shops Pension Trust (the WISP Trust) for the benefit of union employees of SMB. In 2004, the IRS extended the period over which the WISP Trust amortizes unfunded liabilities by seven years, conditioned upon maintenance of certain minimum funding levels. Based on the actuarial valuation for the WISP Trust as of October 1, 2009, the funded percentage of the WISP Trust (based on the ratio of the market value of assets to the accumulated benefits liability (present value of accrued benefits)) was 65.4%, which is below the targeted funding ratio specified in the agreement with the IRS. As a result, the WISP Trust may seek relief from the specified funding requirement from the IRS. If the WISP Trust cannot obtain relief, revocation by the IRS of the

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amortization extension retroactively to the 2002 plan year could occur and result in a material liability for the Company's share of the resulting funding deficiency, the extent of which currently cannot be estimated.

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In 2006, the Pension Protection Act (the *Act*) became law and, together with related regulations, established new minimum funding requirements for multiemployer pension plans. The Act mandates that multiemployer pension plans that are below certain funding levels or that have projected funding deficiencies adopt a funding improvement plan or a rehabilitation program to improve the funding levels over a defined period of time. In January 2010, the Company was notified by the plan administrator of the WISP Trust that the plan is in critical status for 2009 because without the benefit of the relief from the IRS discussed above, the WISP Trust's funding standard account is expected to show a funding deficiency on September 30, 2010. As a result, the trustees of the WISP Trust are required to update the WISP Trust's Rehabilitation Plan. Adoption of any updates to the rehabilitation plan is subject to collective bargaining. At this time, the Company is not required to increase its contributions to the WISP Trust.

In December 2008, the Worker, Retiree, and Employer Recovery Act of 2008 (the *Recovery Act*) became law. For plan years beginning October 1, 2008 through September 30, 2009, the Recovery Act allows multiemployer plans to freeze their funding certification based on the funding status of the previous plan year. In addition, the Recovery Act provides multiemployer plans in endangered or critical status in plan years beginning in 2008 or 2009 a three-year extension of the plan's funding improvement or rehabilitation period. The Company has been notified by several of the other multiemployer plans to which it contributes that the underlying plans would have been in critical status had they not frozen their 2008 funding status under the Recovery Act.

The Company also has contingent liabilities for its share of the unfunded liabilities of each plan to which it contributes, including a withdrawal liability of \$28 million for the WISP Trust, which was calculated by the Trust actuary as of September 30, 2009. The withdrawal liabilities would be triggered only if the Company were to withdraw or partially withdraw from the respective plans. Because the Company has no current intention of withdrawing from any of the multiemployer plans in which it participates, it has not recognized a liability for these contingencies.

### ***Defined Contribution Plans***

The Company has several defined contribution plans covering certain employees. For the three and nine months ended May 31, 2010, the Company made contributions to the defined contribution plans of less than \$1 million compared to contributions of less than \$1 million and \$4 million, respectively, for the same periods of the prior year. The Company suspended employer contributions to these plans effective in March 2009 and resumed contributions to certain of these plans in April 2010.

### **Note 14 - Segment Information**

The Company operates in three reporting segments: metal purchasing, processing, recycling, selling and trading (*MRB*), used auto parts (*APB*) and mini-mill steel manufacturing (*SMB*). Additionally, the Company is a noncontrolling partner in joint ventures, which are either in the metals recycling business or are suppliers of unprocessed metal. The Company's reporting segments are based on the nature of the business activities (nature of different products and production processes) from which it earns revenues and incurs expenses, financial information reviewed by the chief operating decision-maker, capital allocation and performance assessment process, organizational structure and financial information presented to the Board of Directors and investors.

The information provided below is obtained from internal information that is provided to the Company's chief operating decision-maker for the purpose of corporate management. The Company uses operating income (loss) to measure segment performance. The Company does not allocate corporate interest income and expense, income taxes, other income and expenses related to corporate activity, or corporate expense for management and administrative services that benefit all three segments. Because of this unallocated expense, the operating income (loss) of each segment does not reflect the operating income (loss) the segment would have as a stand-alone business.

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## SCHNITZER STEEL INDUSTRIES, INC.

The following is a summary of the Company's total assets (in thousands):

|                              | May 31, 2010 | August 31, 2009 |
|------------------------------|--------------|-----------------|
| Metals Recycling Business    | \$ 1,382,190 | \$ 1,266,222    |
| Auto Parts Business          | 245,921      | 272,983         |
| Steel Manufacturing Business | 324,158      | 331,811         |
| Total segment assets         | 1,952,269    | 1,871,016       |
| Corporate and eliminations   | (602,111)    | (602,783)       |
| Total assets                 | \$ 1,350,158 | \$ 1,268,233    |

The table below illustrates the Company's operating results from continuing operations by segment for the three and nine months ended May 31, 2010 and 2009, respectively (in thousands):

|                                       | Three Months Ended May 31, |            | Nine Months Ended May 31, |              |
|---------------------------------------|----------------------------|------------|---------------------------|--------------|
|                                       | 2010                       | 2009       | 2010                      | 2009         |
| Revenues:                             |                            |            |                           |              |
| Metals Recycling Business             | \$ 618,136                 | \$ 317,524 | \$ 1,423,958              | \$ 1,055,539 |
| Auto Parts Business                   | 67,580                     | 36,050     | 177,643                   | 108,107      |
| Steel Manufacturing Business          | 86,407                     | 46,822     | 210,631                   | 197,378      |
| Segment revenue                       | 772,123                    | 400,396    | 1,812,232                 | 1,361,024    |
| Intersegment eliminations             | (68,584)                   | (18,367)   | (150,082)                 | (100,352)    |
| Total revenues                        | \$ 703,539                 | \$ 382,029 | \$ 1,662,150              | \$ 1,260,672 |
| Depreciation and amortization:        |                            |            |                           |              |
| Metals Recycling Business             | \$ 9,614                   | \$ 9,501   | \$ 28,312                 | \$ 27,006    |
| Auto Parts Business                   | 1,916                      | 1,658      | 5,554                     | 5,094        |
| Steel Manufacturing Business          | 3,257                      | 3,018      | 9,725                     | 8,993        |
| Segment depreciation and amortization | 14,787                     | 14,177     | 43,591                    | 41,093       |
| Corporate                             | 1,130                      | 1,024      | 3,186                     | 3,018        |
| Total depreciation and amortization   | \$ 15,917                  | \$ 15,201  | \$ 46,777                 | \$ 44,111    |

Reconciliation of the Company's segment operating income (loss) to income (loss) from continuing operations before income taxes:

|                                 |           |          |           |            |
|---------------------------------|-----------|----------|-----------|------------|
| Metals Recycling Business       | \$ 53,061 | \$ 6,034 | \$ 97,641 | \$ (7,954) |
| Auto Parts Business             | 18,173    | 4,609    | 41,460    | (4,510)    |
| Steel Manufacturing Business    | 3,904     | (4,961)  | (5,785)   | (42,642)   |
| Segment operating income (loss) | 75,138    | 5,682    | 133,316   | (55,106)   |
| Corporate and eliminations      | (11,363)  | (9,924)  | (31,722)  | (11,827)   |

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|                         |        |         |         |          |
|-------------------------|--------|---------|---------|----------|
| Operating income (loss) | 63,775 | (4,242) | 101,594 | (66,933) |
| Other income (expense)  | (302)  | 5,005   | (725)   | 3,962    |

|  |           |        |            |             |
|--|-----------|--------|------------|-------------|
| Income (loss) from continuing operations before income taxes | \$ 63,473 | \$ 763 | \$ 100,869 | \$ (62,971) |
|--|-----------|--------|------------|-------------|

## Note 15 - Income Tax Expense (Benefit)

The effective tax rates for the Company's continuing operations for the three and nine months ended May 31, 2010 were 34.2% and 33.0%, respectively, compared to expense (benefit) of 94.8% and (39.9%), respectively, for the same periods of fiscal 2009. The effective rate for the three months ended May 31, 2009 reflected the impact of near break-even income from continuing operations before income taxes for the quarter. The effective rate for the nine months ended May 31, 2010 was less than the statutory rate because in the first quarter of fiscal 2010 the Worker, Homeownership, and Business Act of 2009 extended the carry back period for corporate net operating losses ( NOLs ) from two years to five years, thereby restoring the tax benefit of the full Internal Revenue Code Section 199 manufacturing deduction originally claimed by the Company in fiscal 2007. This caused a 1.2% reduction in the fiscal 2010 effective rate. The remaining differences between the effective rate and the Federal statutory rate were attributable to: the manufacturing deduction from current year operations, state taxes, the lower foreign tax rate on permanently reinvested foreign earnings, noncontrolling interests and nondeductible officers' compensation.

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SCHNITZER STEEL INDUSTRIES, INC.

The Company files federal and state income tax returns in the United States and foreign tax returns in Puerto Rico and Canada. The federal statute of limitations has expired for fiscal 2003 and prior years, and the Company is no longer subject to state and foreign tax examinations for those years. Federal and state tax authorities are currently examining the Company's income tax returns for fiscal years 2004 to 2008.

Deferred taxes included the benefits from a federal NOL carry forward of \$1 million that will expire if not used by 2012 and state tax credits that will expire if not used between 2010 and 2020. A valuation allowance of \$1 million was recorded as of May 31, 2010 for the federal capital loss carry forward and the state tax credits that are expected to expire unused in the future. Management believes it is more likely than not that the Company will generate sufficient taxable income prior to the expiration of the remaining deferred tax assets to ensure their realization.

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SCHNITZER STEEL INDUSTRIES, INC.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This section includes a discussion of our operations for the third quarter of fiscal 2010 and 2009. The following discussion and analysis provides information we believe is relevant to an assessment and understanding of our results of operations and financial condition. The discussion should be read in conjunction with our 2009 Form 10-K and the Unaudited Condensed Consolidated Financial Statements and the related notes thereto included elsewhere in this Form 10-Q.

**Forward-looking Statements**

Statements and information included in this Quarterly Report on Form 10-Q by the Company that are not purely historical are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements in this Quarterly Report on Form 10-Q include statements regarding the Company's expectations, intentions, beliefs and strategies regarding the future, including statements regarding trends, cyclicity and changes in the markets the Company sells into, strategic direction, changes to manufacturing processes, the cost of compliance with environmental and other laws, expected tax rates and deductions, the realization of deferred tax assets, planned capital expenditures, liquidity positions, ability to generate cash from continuing operations, the potential impact of adopting new accounting pronouncements, expected results including pricing, sales volumes, profitability, obligations under the Company's retirement plans, savings or additional costs from business realignment and cost containment programs and the adequacy of accruals.

When used in this report, the words "believes," "expects," "anticipates," "intends," "assumes," "estimates," "evaluates," "may," "could," "or" and "might" and similar expressions are intended to identify forward-looking statements.

The Company may make other forward-looking statements from time to time, including in press releases and public conference calls. All forward-looking statements made by the Company are based on information available to the Company at the time the statements are made, and the Company assumes no obligation to update any forward-looking statements, except as may be required by law. Actual results are subject to a number of risks and uncertainties that could cause actual results to differ materially from those included in, or implied by, such forward-looking statements. Some of these risks and uncertainties are discussed in Item 1A. Risk Factors of Part I in the Company's most recent Annual Report on Form 10-K. Other examples include volatile supply and demand conditions affecting prices and volumes in the markets for both the Company's products and raw materials it purchases; world economic conditions; world political conditions; unsettled credit markets; the Company's ability to match output with demand; changes in federal and state income tax laws; government regulations and environmental matters; the impact of pending or new laws and regulations regarding imports and exports into the United States and other countries; foreign currency fluctuations; competition; seasonality, including weather; energy supplies; freight rates and availability of transportation; loss of key personnel; the inability to obtain sufficient quantities of scrap metal to support current orders; purchase price estimates made during acquisitions; business integration issues relating to acquisitions of businesses; creditworthiness of and availability of credit to suppliers and customers; new accounting pronouncements; availability of capital resources; business disruptions resulting from installation or replacement of major capital assets; and the adverse impact of climate change, including as a result of treaties, legislation or regulations.

All references to "we," "our," "us," "SSI," and "the Company" refer to Schnitzer Steel Industries, Inc.



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SCHNITZER STEEL INDUSTRIES, INC.

**General**

Founded in 1906, Schnitzer Steel Industries, Inc., an Oregon corporation, is currently one of the nation's largest recyclers of ferrous and nonferrous scrap metal, a leading recycler of used and salvaged vehicles and a manufacturer of finished steel products.

We operate in three reporting segments: the Metals Recycling Business ( MRB ), the Auto Parts Business ( APB ) and the Steel Manufacturing Business ( SMB ), which collectively provide an end of life cycle solution for a variety of products through our integrated businesses. Our reporting segments are based on the nature of the business activities (nature of different products and production processes) from which we earn revenues and incur expenses, financial information reviewed by the chief operating decision-maker, capital allocation and performance assessment process, organizational structure and financial information presented to the Board of Directors and investors. The financial results for our reporting segments are consistent with the method and basis in which we internally present and dissect financial information for making operating decisions. We use operating income (loss) to measure our segment performance. Corporate expense consists primarily of unallocated expense for management and administrative services that benefit all three business segments. As a result of this unallocated expense, the operating income (loss) of each segment does not reflect the operating income (loss) the segment would have as a stand-alone business. For further information regarding the Company's segments refer to Note 14 Segment Information, in the notes to the unaudited condensed consolidated financial statements, in Part I, Item 1 of this report.

Our results of operations from continuing operations depend in large part on demand and prices for recycled metal in global and domestic markets and steel products in the Western U.S. Our deep water port facilities on both the East and West coasts of the U.S. (in Everett, Massachusetts; Oakland, California; Portland, Oregon and Tacoma, Washington) and access to port facilities in Rhode Island, Hawaii and Puerto Rico allow the Company to meet the demand for recycled metal by steel manufacturers located in Europe, Asia, Central America and Africa. Our processing facilities in the Southeastern U.S. also provide access to the automobile and steel manufacturing industries in that region. Periodically, fluctuating or volatile supply and demand conditions affect market prices for and volumes of recycled ferrous and nonferrous metal in global markets and for steel products in the Western U.S. and can have a significant impact on the results of operations for all three operating segments, as can freight rates and the availability of transportation.

**Executive Overview of Quarterly Results**

Our financial results for the third quarter of fiscal 2010 benefited from continued broad-based demand for scrap and recycled metal products, improvements in commodity markets, increased availability of raw materials and strong operational performance. Financial performance improved in all three of our businesses.

Despite the improvements in demand, which drove increased average net selling prices, we continue to face challenging market conditions, including reduced forward selling prices towards the end of the third quarter. Nevertheless, we believe that our low leveraged balance sheet will enable us to fund investment opportunities in capital expenditures and acquisitions as well as provide working capital which will enable us to support anticipated stronger demand and higher sales volumes.

The following items summarize our financial results for the third quarter of fiscal 2010:

Revenues of \$704 million, compared to revenues of \$382 million in the third quarter of fiscal 2009;

Net income attributable to SSI of \$40 million, or \$1.43 per share (diluted), compared to net loss attributable to SSI of (\$2) million, or (\$0.05) per share (diluted) in the third quarter of fiscal 2009.

For the third quarter of fiscal 2010, MRB generated revenues of \$618 million, a \$301 million increase from the same period in fiscal 2009. This included a \$228 million, or 85%, increase in ferrous revenues and a \$72 million, or 148%, increase in nonferrous revenues. The increase in ferrous revenues was primarily driven by a 70% increase in the average net selling price and a 13% increase in sales volumes, compared to the same period in the prior year. The increase in nonferrous revenues was primarily driven by an 84% increase in the average net selling price and a 38% increase in sales volumes, compared to the same period in the prior year. MRB had



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SCHNITZER STEEL INDUSTRIES, INC.

operating income of \$53 million for the third quarter of fiscal 2010, compared to \$6 million for the same period in fiscal 2009. The improvement in operating income was primarily due to increased world-wide demand for scrap and recycled metal, which led to higher average net selling prices and sales volumes, improvements in the availability of raw materials, and operating and production efficiencies that resulted in improved operating margins.

For the third quarter of fiscal 2010, APB generated revenues of \$68 million, a \$32 million increase from the same period in fiscal 2009. In addition, APB achieved operating income (which does not include operating results from discontinued operations) of \$18 million for the third quarter of fiscal 2010, compared to operating income of \$5 million for the same period in fiscal 2009. The increases in revenue and operating income were attributable to improvements in commodity prices, an increase from 39 to 45 self-service store locations, higher sales volumes and improved production operating efficiencies.

For the third quarter of fiscal 2010, SMB generated revenues of \$86 million, a \$40 million increase compared to the same period in fiscal 2009. The increase in revenues over the prior year period reflected a 54% increase in finished steel product volumes sold and a 21% increase in average finished steel product selling prices. The increase in sales tons reflected improved, but still weak, West Coast demand for finished steel products. SMB had operating income of \$4 million for the third quarter of fiscal 2010, compared to an operating loss of (\$5) million for the same period in fiscal 2009. The third quarter 2009 operating loss included \$3 million of abnormal production costs that could not be capitalized into inventory.

***Business Combinations***

During the first nine months of fiscal 2010, we spent \$41 million to complete the acquisition of six self-service used auto parts stores which operate under our Pick-n-Pull brand and a metals recycler. These acquisitions are as follows:

In October 2009, we completed the acquisition of four self-service used auto parts stores located near our MRB export facility in Portland, Oregon. This acquisition represented our first used auto parts operations in the Pacific Northwest.

In January 2010, we completed the acquisition of two self-service used auto parts stores, which increased to four the number of used auto parts facilities that we operate in the Dallas-Fort Worth Metroplex.

In April 2010, the Company completed the acquisition of a metals recycler in Montana to provide an additional source of scrap metal for the Company's Tacoma, Washington export facility.

In October 2009, we completed the sale to LKQ of our full-service used auto parts operation, which had operated as part of the APB reporting segment. The full-service used auto parts operation is not included in APB's results of operations in fiscal 2009 or fiscal 2010 because the results of this discontinued operation have been reclassified for all periods presented.

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## SCHNITZER STEEL INDUSTRIES, INC.

**Results of Operations**

| (\$ in thousands)                                   | Three Months Ended May 31, |            |             | Nine Months Ended May 31, |              |             |
|---|----------------------------|------------|-------------|---------------------------|--------------|-------------|
|   | 2010                       | 2009       | %<br>Change | 2010                      | 2009         | %<br>Change |
| <b>Revenues:</b>                                    |                            |            |             |                           |              |             |
| Metals Recycling Business                           | \$ 618,136                 | \$ 317,524 | 95%         | \$ 1,423,958              | \$ 1,055,539 | 35%         |
| Auto Parts Business                                 | 67,580                     | 36,050     | 87%         | 177,643                   | 108,107      | 64%         |
| Steel Manufacturing Business                        | 86,407                     | 46,822     | 85%         | 210,631                   | 197,378      | 7%          |
| Intercompany revenue eliminations                   | (68,584)                   | (18,367)   | 273%        | (150,082)                 | (100,352)    | 50%         |
| Total revenues                                      | 703,539                    | 382,029    | 84%         | 1,662,150                 | 1,260,672    | 32%         |
| <b>Cost of goods sold:</b>                          |                            |            |             |                           |              |             |
| Metals Recycling Business                           | 547,253                    | 293,705    | 86%         | 1,277,855                 | 1,010,827    | 26%         |
| Auto Parts Business                                 | 38,103                     | 22,610     | 69%         | 104,665                   | 85,360       | 23%         |
| Steel Manufacturing Business                        | 80,420                     | 50,442     | 59%         | 210,945                   | 235,460      | (10%)       |
| Intercompany cost of goods sold eliminations        | (67,055)                   | (19,323)   | 247%        | (147,224)                 | (114,086)    | 29%         |
| Total cost of goods sold                            | 598,721                    | 347,434    | 72%         | 1,446,241                 | 1,217,561    | 19%         |
| <b>Selling, general and administrative expense:</b> |                            |            |             |                           |              |             |
| Metals Recycling Business                           | 19,360                     | 17,703     | 9%          | 51,093                    | 60,405       | (15%)       |
| Auto Parts Business                                 | 11,304                     | 8,831      | 28%         | 31,518                    | 27,257       | 16%         |
| Steel Manufacturing Business                        | 2,083                      | 1,341      | 55%         | 5,471                     | 4,560        | 20%         |
| Corporate   | 10,032                     | 10,846     | (8%)        | 28,804                    | 26,098       | 10%         |
| Total SG&A expense                                  | 42,779                     | 38,721     | 10%         | 116,886                   | 118,320      | (1%)        |
| <b>Environmental matters:</b>                       |                            |            |             |                           |              |             |
| Metals Recycling Business                           | 141                        | 0          | NA          | (241)                     | (6,080)      | (96%)       |
| Total environmental matters                         | 141                        | 0          | NA          | (241)                     | (6,080)      | (96%)       |
| <b>(Income) loss from joint ventures:</b>           |                            |            |             |                           |              |             |
| Metals Recycling Business                           | (1,679)                    | 82         | NM          | (2,390)                   | (1,659)      | 44%         |
| Change in intercompany (profit) loss elimination    | (198)                      | 34         | NM          | 60                        | (537)        | NM          |
| Total joint venture (income) loss                   | (1,877)                    | 116        | NM          | (2,330)                   | (2,196)      | 6%          |
| <b>Operating income (loss):</b>                     |                            |            |             |                           |              |             |
| Metals Recycling Business                           | 53,061                     | 6,034      | 779%        | 97,641                    | (7,954)      | NM          |
| Auto Parts Business                                 | 18,173                     | 4,609      | 294%        | 41,460                    | (4,510)      | NM          |
| Steel Manufacturing Business                        | 3,904                      | (4,961)    | NM          | (5,785)                   | (42,642)     | (86%)       |
| Corporate expense                                   | (10,547)                   | (10,593)   | (0%)        | (29,325)                  | (25,845)     | 13%         |
| Change in intercompany profit (loss) elimination    | (816)                      | 669        | NM          | (2,397)                   | 14,018       | NM          |
| Total operating income (loss)                       | \$ 63,775                  | \$ (4,242) | NM          | \$ 101,594                | \$ (66,933)  | NM          |

NA = Not Applicable

NM = Not Meaningful

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Results of Operation exclude results from discontinued operations

### ***Revenues***

Consolidated revenues for the third quarter of fiscal 2010 increased \$322 million, or 84%, and increased \$401 million, or 32%, for the first nine months of fiscal 2010 compared to the same periods in fiscal 2009, with improvements in all business segments. These increases were primarily driven by increased world-wide demand for scrap and recycled metal, which led to higher average net selling prices and sales volumes, and, to a lesser extent, by West Coast demand for finished steel products.

### ***Operating Income (Loss)***

Consolidated operating income (loss) increased \$68 million for the third quarter of fiscal 2010 and increased \$169 million for the first nine months of fiscal 2010 compared to operating losses in the same periods in fiscal 2009. The \$68 million improvement in third quarter operating income was primarily due to higher average net selling prices which outpaced our raw material purchase and production costs and higher sales volumes. The \$169 million improvement in operating income in the first nine months of fiscal 2010 compared to the prior year was primarily due to higher average net selling prices and higher sales volumes, increased availability of

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SCHNITZER STEEL INDUSTRIES, INC.

raw materials and the recognition in the first nine months of fiscal 2009 of \$52 million in non-cash NRV inventory write-downs and \$19 million of production costs that could not be capitalized in inventory.

Included in operating income was an increase in SG&A expenses of \$4 million for the three months ended May 31, 2010 compared to the same period in the prior year, primarily due to a \$7 million increase in accrued compensation for the three months ended May 31, 2010, resulting from an increase in incentive compensation, including share-based compensation, due to improvements in financial performance. This increase was partially offset by \$3 million in benefits recognized from legal settlements and environmental cost reimbursements.

SG&A expenses decreased by \$1 million for the nine months ended May 31, 2010, compared to the same period in the prior year, primarily due to \$9 million in current year benefits recognized from legal settlements, environmental cost reimbursements and reduced professional service fees, \$8 million in higher bad debt expense recognized in the prior year resulting from bankruptcies due to adverse financial conditions experienced by certain of our customers, and the recognition of a \$4 million reduction in expense for the settlement of a dispute with a customer. The decrease was partially offset by a \$17 million increase in accrued compensation for the nine months ended May 31, 2010, resulting from an increase in incentive compensation, including share-based compensation, due to improvements in financial performance.

***Income Tax Expense (Benefit)***

The effective tax rates for our continuing operations for the three and nine month periods ended May 31, 2010 were 34.2% and 33.0%, respectively, compared to expense (benefit) of 94.8% and (39.9%), respectively, for the same periods of fiscal 2009. The effective rate for the three months ended May 31, 2009 reflected the impact of near break-even income from continuing operations before income taxes for the quarter. The effective rate for the nine months ended May 31, 2010 was less than the statutory rate because in the first quarter of fiscal 2010 the Worker, Homeownership, and Business Act of 2009 extended the carry back period for corporate net operating losses ( NOLs ) from two years to five years, thereby restoring the tax benefit of the full Internal Revenue Code Section 199 manufacturing deduction we originally claimed in fiscal 2007. This caused a 1.2% reduction in our fiscal 2010 effective rate. The effective tax rate is expected to be approximately 32% for the remainder of fiscal 2010.

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### SCHNITZER STEEL INDUSTRIES, INC.

#### Financial results by segment

We operate our business across three reporting segments: MRB, APB and SMB. For further information regarding our segments refer to Note 14 - Segment Information, in the notes to the unaudited condensed consolidated financial statements, in Part I, Item 1 of this report.

#### Metals Recycling Business

| (\$ in thousands, except for prices)                                | Three Months Ended May 31, |            |          | Nine Months Ended May 31, |            |          |
|---|----------------------------|------------|----------|---------------------------|------------|----------|
|   | 2010                       | 2009       | % Change | 2010                      | 2009       | % Change |
| Ferrous revenues  | \$ 495,658                 | \$ 267,548 | 85%      | \$ 1,127,662              | \$ 878,061 | 28%      |
| Nonferrous revenues   | 120,527                    | 48,541     | 148%     | 291,130                   | 172,056    | 69%      |
| Other   | 1,951                      | 1,435      | 36%      | 5,166                     | 5,422      | (5%)     |
| Total segment revenues  | 618,136                    | 317,524    | 95%      | 1,423,958                 | 1,055,539  | 35%      |
| Cost of goods sold  | 547,253                    | 293,705    | 86%      | 1,277,855                 | 1,010,827  | 26%      |
| Selling, general and administrative expense                         | 19,360                     | 17,703     | 9%       | 51,093                    | 60,405     | (15%)    |
| Environmental matters   | 141                        | 0          | NA       | (241)                     | (6,080)    | (96%)    |
| (Income) loss from joint ventures                                   | (1,679)                    | 82         | NM       | (2,390)                   | (1,659)    | 44%      |
| Segment operating income (loss)                                     | \$ 53,061                  | \$ 6,034   | 779%     | \$ 97,641                 | \$ (7,954) | NM       |
| Average ferrous recycled metal sales prices (\$/LT): <sup>(1)</sup> |                            |            |          |                           |            |          |
| Domestic  | \$ 368                     | \$ 186     | 98%      | \$ 317                    | \$ 285     | 11%      |
| Export  | \$ 382                     | \$ 228     | 68%      | \$ 325                    | \$ 267     | 22%      |
| Average   | \$ 378                     | \$ 223     | 70%      | \$ 323                    | \$ 271     | 19%      |
| Ferrous sales volume (LT, in thousands):                            |                            |            |          |                           |            |          |
| Steel Manufacturing Business  | 139                        | 55         | 153%     | 342                       | 230        | 49%      |
| Other domestic  | 197                        | 87         | 126%     | 492                       | 316        | 56%      |
| Total domestic  | 336                        | 142        | 137%     | 834                       | 546        | 53%      |
| Export  | 839                        | 895        | (6%)     | 2,272                     | 2,353      | (3%)     |
| Total ferrous sales volume (LT, in thousands)                       | 1,175                      | 1,037      | 13%      | 3,106                     | 2,899      | 7%       |
| Average nonferrous sales price (\$/pound) <sup>(1)</sup>            | \$ 0.94                    | \$ 0.51    | 84%      | \$ 0.83                   | \$ 0.60    | 38%      |
| Nonferrous sales volumes (pounds, in thousands)                     | 124,283                    | 90,226     | 38%      | 339,422                   | 274,407    | 24%      |
| Outbound freight included in cost of goods sold (in thousands)      | \$ 55,806                  | \$ 38,954  | 43%      | \$ 135,539                | \$ 100,338 | 35%      |

<sup>(1)</sup> Price information is shown after excluding the cost of freight incurred to deliver the product to the customer.

LT = Long Ton, which is 2,240 pounds

NA = Not Applicable

NM = Not Meaningful

#### Revenues

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MRB revenues increased \$301 million, or 95%, during the quarter ended May 31, 2010, and increased \$368 million, or 35%, during the nine months ended May 31, 2010, compared to the same periods in the prior year.

Ferrous revenues increased \$228 million, or 85%, during the quarter ended May 31, 2010, and increased \$250 million, or 28%, during the nine months ended May 31, 2010, compared to the same periods in the prior year. The average net selling price increased by \$155 per long ton, or 70%, during the third quarter ended May 31, 2010, compared to the same period in the prior year and increased by \$52 per long ton, or 19%, during the first nine months of fiscal 2010, compared to the same period in the prior year. These increases were primarily driven by strong demand in Asian and domestic markets, which provided support to both domestic and export selling prices. Ferrous sales volumes increased 138,000 tons, or 13%, in the third quarter of fiscal 2010 and 207,000 tons, or 7%, for the first nine months of fiscal 2010. The increase in ferrous sales volumes was primarily driven by world-wide demand for scrap and recycled metal, which included sales to SMB, and increased availability of raw materials.

Nonferrous revenues increased \$72 million, or 148%, during the quarter ended May 31, 2010, and increased \$119 million, or 69%, during the nine months ended May 31, 2010, compared to the same periods in the prior year. Nonferrous average net selling prices increased \$0.43 per pound, or 84%, during the quarter ended May 31, 2010, and increased \$0.23 per pound, or 38%, during the nine months ended May 31, 2010, compared to the same periods in the prior year. Nonferrous volumes increased by 34 million pounds, or 38%, in the third quarter of fiscal 2010 and 65 million pounds, or 24%, for the first nine months of fiscal 2010.



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## SCHNITZER STEEL INDUSTRIES, INC.

**Segment Operating Income**

Operating income for MRB increased \$47 million during the quarter ended May 31, 2010, and increased \$106 million during the nine months ended May 31, 2010, compared to the same periods in the prior year. These increases reflected improved world-wide demand for scrap and recycled metal, which led to higher average net selling prices that outpaced the increase in our raw material purchase and production costs, increased sales volumes, improvements in the available supply of raw materials and continued benefits from improved production operating efficiencies that together resulted in improved margins. Additionally, operating income for the first nine months ended May 31, 2010 increased compared to the prior year due to the recognition of a \$29 million non-cash NRV inventory write-down and \$4 million of production costs that could not be capitalized in inventory in the first nine months of fiscal 2009.

Included in operating income was an increase in SG&A expenses of \$2 million for the three months ended May 31, 2010, compared to the same period in the prior year, primarily due to a \$3 million increase in accrued compensation for the three months ended May 31, 2010, resulting from an increase in incentive compensation, including share-based compensation, due to improvements in financial performance. This increase was partially offset by \$1 million in benefits recognized during the quarter from legal settlements and environmental cost reimbursements.

SG&A expenses decreased by \$9 million for the nine months ended May 31, 2010 compared to the same period in the prior year, primarily due to \$8 million in bad debt expense in the prior year, \$4 million in current year benefits from legal settlements and environmental cost reimbursements and the recognition of a \$4 million reduction in expense for the settlement of a dispute with a customer. This decrease was partially offset by a \$5 million increase in accrued compensation for the nine months ended May 31, 2010, resulting from an increase in incentive compensation, including share-based compensation, due to improvements in financial performance.

**Auto Parts Business**

| (\$ in thousands)                           | Three Months Ended May 31, |           |             | Nine Months Ended May 31, |            |             |
|---|----------------------------|-----------|-------------|---------------------------|------------|-------------|
|   | 2010                       | 2009      | %<br>Change | 2010                      | 2009       | %<br>Change |
| Revenues                                    | \$ 67,580                  | \$ 36,050 | 87%         | \$ 177,643                | \$ 108,107 | 64%         |
| Cost of goods sold                          | 38,103                     | 22,610    | 69%         | 104,665                   | 85,360     | 23%         |
| Selling, general and administrative expense | 11,304                     | 8,831     | 28%         | 31,518                    | 27,257     | 16%         |
| Segment operating income (loss)             | \$ 18,173                  | \$ 4,609  | 294%        | \$ 41,460                 | \$ (4,510) | NM          |
| Number of stores at period end              | 45                         | 39        | 15%         | 45                        | 39         | 15%         |

NM = Not Meaningful

**Revenues**

APB revenues increased \$32 million, or 87%, during the quarter ended May 31, 2010, and increased \$70 million, or 64%, during the nine months ended May 31, 2010, compared to the same periods in the prior year. In the third quarter, these improvements included a \$15 million increase in scrap vehicle revenue, an \$11 million increase in core revenue, and a \$4 million increase in parts revenue, compared to the same period in the prior year. The improvements for the first nine months of fiscal 2010 were driven by a \$30 million increase in scrap vehicle revenue, a \$24 million increase in core revenue and a \$12 million increase in parts revenue compared to the same period in the prior year. The increase in revenues was driven by improvements in commodity prices, an increase from 39 to 45 self-service store locations, increased sales of used auto parts attributable to benefits recognized from purchasing higher quality vehicles, including additional vehicles purchased pursuant to the Cash-For-Clunkers government stimulus program, and improved production operating efficiencies.

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## SCHNITZER STEEL INDUSTRIES, INC.

**Segment Operating Income**

Operating income for APB increased \$14 million during the quarter ended May 31, 2010, and increased \$46 million during the nine months ended May 31, 2010, compared to the same periods in the prior year. The improvement in operating income reflected the impact of higher sales prices and volumes for scrapped vehicles, cores and parts, which resulted primarily from increases in commodity prices, an increase from 39 to 45 self-service store locations, and improved operating efficiencies.

Included in operating income was an increase in SG&A expense of \$2 million and \$4 million for the three and nine months ended May 31, 2010, respectively, compared to the same periods in the prior year. The increase was primarily attributable to increases in accrued compensation of \$1 million and \$3 million for the three and nine months ended May 31, 2010, respectively, primarily resulting from an increase in incentive compensation, including share-based compensation, due to improvements in operating results over the same periods in the prior year. APB's results of operations do not include operating results from discontinued operations. Refer to Executive Overview of Quarterly Results - Business Combinations above.

**Steel Manufacturing Business**

| (\$ in thousands, except price)                            | Three Months Ended May 31, |            |             | Nine Months Ended May 31, |             |        |
|--|----------------------------|------------|-------------|---------------------------|-------------|--------|
|  | 2010                       | 2009       | %<br>Change | 2010                      | 2009        | change |
| Revenues <sup>(2)</sup>                                    | \$ 86,407                  | \$ 46,822  | 85%         | \$ 210,631                | \$ 197,378  | 7%     |
| Cost of goods sold   | 80,420                     | 50,442     | 59%         | 210,945                   | 235,460     | (10%)  |
| Selling, general and administrative expense                | 2,083                      | 1,341      | 55%         | 5,471                     | 4,560       | 20%    |
| Segment operating income (loss)                            | \$ 3,904                   | \$ (4,961) | NM          | \$ (5,785)                | \$ (42,642) | (86%)  |
| Finished goods average sales price (\$/ton) <sup>(1)</sup> | \$ 635                     | \$ 524     | 21%         | \$ 576                    | \$ 664      | (13%)  |
| Finished steel products sold (tons, in thousands)          | 131                        | 85         | 54%         | 328                       | 266         | 23%    |

<sup>(1)</sup> Price information is shown after netting the cost of freight incurred to deliver the product to the customer.

<sup>(2)</sup> Revenues include sales of semi-finished goods (billets) and finished steel products.

NM = Not Meaningful

**Revenues**

SMB revenues increased \$40 million, or 85%, during the quarter ended May 31, 2010, and increased \$13 million, or 7%, during the nine months ended May 31, 2010, compared to the same periods in the prior year. The increase in revenues for the third quarter reflected a 54% increase in tons of finished steel products sold and a 21% increase in average finished steel product selling prices. The increase in revenues during the nine months ended May 31, 2010 reflected a 23% increase in tons of finished steel products sold. The increase in sales volume in both the three and nine month periods ended May 31, 2010 and the increase in third quarter average selling prices reflected improved, but still weak, West Coast demand for finished steel products.

**Segment Operating Income (Loss)**

Operating income for SMB increased \$9 million during the quarter ended May 31, 2010, and the operating loss decreased \$37 million during the nine months ended May 31, 2010, compared to operating losses in the same periods in the prior year, primarily due to increased finished steel products sold in the three and nine months ended May 31, 2010, and the recognition of a \$32 million non-cash NRV inventory write-down in the first quarter of fiscal 2009 and \$3 million and \$15 million of production costs that could not be capitalized in inventory in the third quarter and

first nine months of fiscal 2009, respectively.

### **Liquidity and Capital Resources**

We rely on cash provided by operating activities as a primary source of liquidity, supplemented by current cash resources and existing credit facilities.

#### ***Sources and Uses of Cash***

We had cash balances of \$32 million and \$41 million at May 31, 2010 and August 31, 2009, respectively. Cash balances are intended to be used primarily for working capital and capital expenditures.

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SCHNITZER STEEL INDUSTRIES, INC.

Net cash provided by operating activities for the nine months ended May 31, 2010 was \$40 million, compared to net cash provided by operating activities of \$241 million in the same period of the prior year. Sources of cash included an income tax refund of \$41 million that was received in the second quarter of fiscal 2010, an increase of \$15 million in accounts payable due to timing of payments and an increase in accrued income taxes of \$13 million due to improved financial results. Uses of cash included a \$133 million increase in inventory (excluding \$35 million of inventory sold as a part of the divestiture of the full service auto parts operations) due to higher purchase costs and higher volumes of material on hand at period end and an increase in accounts receivable of \$24 million due to timing of collections.

Net cash used in investing activities for the nine months ended May 31, 2010 was \$35 million, compared to \$143 million in the same period of the prior year. Net cash used in investing activities included \$41 million paid for completed acquisitions and \$35 million in capital expenditures to upgrade the Company's equipment and infrastructure, partially offset by \$41 million in proceeds from the sale of the full-service auto parts business and other assets.

Net cash used in financing activities for the nine months ended May 31, 2010 was \$15 million, compared to net cash used in financing activities of \$65 million in the same period of the prior year. Cash used in the period included an \$11 million reduction in long-term debt.

***Credit Facilities***

Our short-term borrowings consist primarily of a one year, unsecured, uncommitted \$25 million credit line with Wells Fargo Bank, N.A that expires March 1, 2011. Interest rates on outstanding indebtedness under the unsecured line of credit are set by the bank at the time of borrowing. We had no borrowings outstanding under this credit line at May 31, 2010 and August 31, 2009.

We maintain a \$450 million revolving credit facility that matures in July 2012, pursuant to an unsecured committed bank credit agreement with Bank of America, N.A., as administrative agent, and the other lenders party thereto. Interest rates on outstanding indebtedness under the agreement are based, at our option, on either the London Interbank Offered Rate ( LIBOR ) plus a spread of between 0.50% and 1.00%, with the amount of the spread based on a pricing grid tied to our leverage ratio, or the greater of the prime rate or the federal funds rate plus 0.50%. In addition, annual commitment fees are payable on the unused portion of the credit facility at rates between 0.10% and 0.25% based on a pricing grid tied to our leverage ratio. As of May 31, 2010 and August 31, 2009, we had borrowings outstanding under the credit facility of \$90 million and \$100 million, respectively. The weighted average interest rate on amounts outstanding under this facility was 0.81% at May 31, 2010.

The two bank credit agreements contain various representations and warranties, events of default and financial and other covenants, including covenants regarding maintenance of a minimum fixed charge coverage ratio and a maximum leverage ratio. As of May 31, 2010, we were in compliance with all such covenants.

In addition, as of May 31, 2010 and August 31, 2009, we had \$8 million of long-term indebtedness in the form of bonds maturing in January 2021.

***Acquisitions***

Acquisitions during the first nine months of fiscal 2010 totaled \$41 million, compared to \$96 million, which included deferred amounts payable of \$3 million, in acquisitions for the same period in the prior year. During the first nine months of fiscal 2010, we continued to expand our presence in regions in which we operate and in new locations through the acquisition of value-creating businesses.

***Capital Expenditures***

Capital expenditures during the first nine months of fiscal 2010 were \$35 million, compared to \$51 million for the same period last year. During the third quarter of fiscal 2010, we continued our investment in general improvements at a number of our metals recycling facilities, including investments in technology to improve the recovery of nonferrous materials from the shredding process

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### **SCHNITZER STEEL INDUSTRIES, INC.**

and investments to further improve efficiency and increase capacity, increase worker safety and enhance environmental systems. We plan to invest \$25 million to \$40 million in capital improvement projects for the remainder of the fiscal year, of which \$7 million is for environmental projects, including investments in storm water systems and in equipment to ensure ongoing compliance with air quality and other environmental regulations.

#### ***Share Repurchase Program***

Pursuant to a share repurchase program authorized by our Board, we may repurchase up to 9.0 million shares of our Class A common stock when management deems such repurchases to be appropriate. Prior to fiscal 2010, we had repurchased approximately 5.1 million shares under the program. No share repurchases were made during the nine months ended May 31, 2010, thus leaving approximately 3.9 million shares available for repurchase under existing Board authorizations.

#### ***Future Liquidity and Commitments***

We make contributions to a defined benefit pension plan, several defined contribution pension plans and several multiemployer pension plans. Contributions vary depending on the plan and are based on plan provisions, actuarial valuations and negotiated labor agreements. Recently, most defined benefit plans have experienced deterioration in their funded status due to the general decline in investment values. We expect to make contributions to our various defined benefit, defined contribution and multiemployer plans of approximately \$2 million for the remainder of fiscal 2010. However, as a result of the deterioration in the funded status of the defined benefit pension plan we may be required or elect to make additional contributions in fiscal 2010. See Note 13 Employee Benefits in the Notes to the Condensed Consolidated Financial Statements.

Accrued environmental liabilities as of May 31, 2010 were \$42 million of which we expect to pay \$3 million over the next 12 months.

We believe our current cash resources, internally generated funds, existing credit facilities and access to the capital markets will provide adequate financing for capital expenditures, acquisitions, working capital, stock repurchases, debt service requirements, post-retirement obligations and future environmental obligations for the next 12 months. However, volatile market conditions may result in the Company further utilizing its available credit lines and curtailing capital and operating expenditures, delaying or restricting acquisitions and share repurchases and reassessing working capital requirements. Should we determine, at any time, that we require additional sources of short-term liquidity, we will evaluate available alternatives and take appropriate steps to obtain sufficient additional funds. There can be no assurance that any such supplemental funding, if sought, could be obtained, or if obtained, would be adequate or on terms acceptable to the Company. However, we believe that our balance sheet at May 31, 2010 and the availability under our existing credit facilities should provide additional sources of liquidity if required.

#### ***Off-Balance Sheet Arrangements***

With the exception of operating leases, we are not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, results of operations or cash flows. We enter into operating leases for both new equipment and property. There have been no material changes to any off-balance sheet arrangements as discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations in our most recent Annual Report on Form 10-K.

#### ***Contractual Obligations***

Long-term bank debt as reported in the contractual obligations table in our Annual Report on Form 10-K for the fiscal year ended August 31, 2009 has decreased \$10 million to \$90 million as of May 31, 2010 due to decreased net borrowings under our credit agreements as described above under Liquidity and Capital Resources.

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### **SCHNITZER STEEL INDUSTRIES, INC.**

#### **Critical Accounting Policies and Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on the Company's unaudited condensed consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America ( "U.S. GAAP" ). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably likely to occur could materially impact the financial statements.

#### **Goodwill**

We evaluate the recoverability of goodwill on an annual basis during the second quarter of each fiscal year and upon the occurrence of certain triggering events or substantive changes in circumstances indicating that the fair value of goodwill may be impaired. We assess the existence of any indicators that imply a potential impairment on a monthly basis.

In the second quarter of fiscal 2010, we performed our annual testing for impairment of goodwill. As part of our assessment of the recovery of goodwill, we conducted a valuation analysis using a market-based income approach with applied discount rates ranging from 8.7% to 11.0% for our reporting segments. The projections used in the income approach took into consideration current and projected future business cycles and did not project cash flows based on the historically high prices and volumes as experienced in fiscal 2008. Based on the results of the first step of our annual assessment of the recoverability of goodwill, the fair values of the reporting segments substantially exceeded their carrying values, indicating that there was no goodwill impairment.

There were no triggering events during the third quarter of fiscal 2010 requiring a goodwill impairment test. We will continue to monitor our goodwill and indefinite-lived intangible and long-lived assets for possible future impairment.

#### **Business Combinations**

On September 1, 2009 we adopted the revised accounting standard for business combinations, which requires us to recognize the assets acquired, the liabilities assumed, and any noncontrolling interests in the acquiree at the acquisition date, measured at their fair values as of that date, generally using a market-based income approach. Measuring assets and liabilities at fair value requires us to determine the price that would be paid by a third party market participant based on the highest and best use of the assets or interests acquired. In addition, following the adoption of this standard, acquisition costs are expensed as incurred.

#### **Recent Accounting Pronouncements**

In December 2008, the Financial Accounting Standards Board issued guidance regarding an employer's disclosures about the plan assets of a defined benefit pension or postretirement plan and will require additional disclosure regarding investment policies and strategies, fair value of each major asset category based on risks of the assets, inputs and valuations techniques used to estimate fair value, fair value measurement hierarchy levels under pension accounting for each asset category and significant concentration of risk information. This standard will be effective for us for the fiscal year ending August 31, 2010 and will be applied prospectively. This guidance will enhance and provide more visibility over our footnote disclosures surrounding the plan assets of our defined benefit pension plan.

In January 2010, an accounting standards update was issued to improve disclosure requirements related to fair value measurement. This update requires additional disclosures relating to significant transfers in and out of Levels 1 and 2 fair value measurements,

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SCHNITZER STEEL INDUSTRIES, INC.

along with the reason for the transfer and separate presentation of purchases, sales, issuances and settlements in the reconciliation of Level 3 fair value measurements. The update was effective for us in the third quarter of the fiscal year ending August 31, 2010, except for disclosures relating to Level 3 activity, which will be effective for the fiscal year ending August 31, 2012 and will be applied prospectively. See Note 11 - Derivative Financial Instruments and Fair Value Measurements.

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SCHNITZER STEEL INDUSTRIES, INC.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Commodity Price Risk**

The information required hereunder is not materially different from the information set forth in Item 7a. Quantitative and Qualitative Disclosures about Market Risk included in our Annual Report on Form 10-K for the year ended August 31, 2009, filed with the SEC and is, therefore, not presented herein.

Additionally, see Note 11 - Derivative Financial Instruments and Fair Value Measurements.

**Credit Risk**

As of May 31, 2010, 32% of our trade accounts receivable balance was covered by letters of credit, compared to 49% as of August 31, 2009. Of the remaining balance as of May 31, 2010 and August 31, 2009, 90% and 85%, respectively, was less than 60 days past due.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

During the quarterly period covered by this report our management, with the participation of the Chief Executive Officer and Chief Financial Officer, completed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the quarterly period covered by this report, disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



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SCHNITZER STEEL INDUSTRIES, INC.

PART II

**ITEM 1. LEGAL PROCEEDINGS**

See Note 7 Environmental Liabilities and Other Contingencies in the notes to the unaudited condensed consolidated financial statements, incorporated by reference herein.

**ITEM 1A. RISK FACTORS**

There have been no material changes to our risk factors reported or new factors identified since the filing of our 2009 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on October 27, 2009.

**ITEM 6. EXHIBITS**

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 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.
- 32.2 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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SCHNITZER STEEL INDUSTRIES, INC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SCHNITZER STEEL INDUSTRIES, INC.  
(Registrant)

Date: June 30, 2010

By: /s/ Tamara L. Lundgren  
Tamara L. Lundgren  
President and Chief Executive Officer

Date: June 30, 2010

By: /s/ Richard D. Peach  
Richard D. Peach  
Sr. Vice President and Chief Financial Officer