SCHNITZER STEEL INDUSTRIES INC
Form 10-Q
January 07, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

of the Securities Exchange Act of 1934

For the Quarterly Period Ended November 30, 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)**	**93-0341923** **(I.R.S. Employer** **Identification No.)**
3200 NW Yeon Ave. **Portland, OR** **(Address of principal executive offices)**	**97210** **(Zip Code)**

(503) 224-9900

(Registrant s telephone number, including area code)

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 x 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 x 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 x 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 x

The Registrant had 24,096,863 shares of Class A common stock, par value of $1.00 per share, and 3,378,745 shares of Class B common stock, par value of $1.00 per share, outstanding as of December 30, 2010.

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

SCHNITZER STEEL INDUSTRIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share amounts)

	November 30, 2010	August 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 57,035	$ 30,342
Accounts receivable, net of allowance for doubtful accounts of $6,229 and $6,209	161,044	126,156
Inventories, net	275,989	268,103
Deferred income taxes	8,969	9,037
Refundable income taxes	8,059	14,610
Prepaid expenses and other current assets	11,698	12,546
Total current assets	522,794	460,794
Property, plant and equipment	890,112	871,901
Less accumulated depreciation	424,282	411,091
Property, plant and equipment, net	465,830	460,810
Other assets:		
Investments in joint venture partnerships	16,642	13,706
Goodwill	383,416	380,332
Intangibles, net	19,817	20,444
Other assets	7,643	7,332
Total assets	$ 1,416,142	$ 1,343,418
Liabilities and Equity		
Current liabilities:		
Long-term debt and capital lease obligations, current	$ 527	$ 1,189
Accounts payable	76,866	91,879
Accrued payroll and related liabilities	20,236	34,162
Environmental liabilities	2,560	2,588
Accrued income taxes	930	1,816
Other accrued liabilities	26,399	28,479
Total current liabilities	127,518	160,113
Deferred income taxes	61,472	58,630
Long-term debt and capital lease obligations, net of current maturities	179,143	99,240
Environmental liabilities, net of current portion	37,349	37,286
Other long-term liabilities	11,018	8,517
Total liabilities	416,500	363,786
Commitments and contingencies (Note 7)		

Schnitzer Steel Industries, Inc. (SSI) shareholders equity:		
Preferred stock 20,000 shares $1.00 par value authorized, none issued	0	0
Class A common stock 75,000 shares $1.00 par value authorized, 23,721 and 22,700 shares issued and outstanding	23,721	22,700
Class B common stock 25,000 shares $1.00 par value authorized, 3,754 and 4,721 shares issued and outstanding	3,754	4,721
Additional paid-in capital	3,089	1,815
Retained earnings	965,969	948,642
Accumulated other comprehensive loss	(1,689)	(2,552)
Total SSI shareholders equity	994,844	975,326
Noncontrolling interests	4,798	4,306
Total equity	999,642	979,632
Total liabilities and equity	$ 1,416,142	$ 1,343,418

The accompanying notes to the unaudited condensed consolidated financial statements

are an integral part of these statements.

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share amounts)

	Three Months Ended November 30, 2010	2009
Revenues	$ 675,104	$ 394,282
Operating expense:		
Cost of goods sold	602,546	350,938
Selling, general and administrative	45,075	34,446
Environmental matters	(200)	150
Income from joint ventures	(757)	(534)
Operating income	28,440	9,282
Other income (expense):		
Interest income	55	118
Interest expense	(598)	(618)
Other income, net	161	301
Total other expense	(382)	(199)
Income from continuing operations before income taxes	28,058	9,083
Income tax expense	(9,164)	(1,864)
Income from continuing operations	18,894	7,219
Income (loss) from discontinued operations, net of tax	23	(14,974)
Net income (loss)	18,917	(7,755)
Net income attributable to noncontrolling interests	(1,123)	(814)
Net income (loss) attributable to SSI	$ 17,794	$ (8,569)
Basic:		
Income per share from continuing operations attributable to SSI	$ 0.65	$ 0.23
Income (loss) per share from discontinued operations attributable to SSI	0.00	(0.54)
Net income (loss) per share attributable to SSI	$ 0.65	$ (0.31)
Diluted:		
Income per share from continuing operations attributable to SSI	$ 0.64	$ 0.23
Income (loss) per share from discontinued operations attributable to SSI	0.00	(0.53)
Net income (loss) per share attributable to SSI	$ 0.64	$ (0.30)

Weighted average number of common shares:		
Basic	27,563	27,803
Diluted	27,871	28,130
Dividends declared per common share	$ 0.017	$ 0.017

The accompanying notes to the unaudited condensed consolidated financial statements

are an integral part of these statements.

4

SCHNITZER STEEL INDUSTRIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Three Months Ended November 30, 2010	2009
Cash flows from operating activities:		
Net income (loss)	$ 18,917	$ (7,755)
Adjustments to reconcile net income (loss) to cash used in operating activities:		
Depreciation and amortization	16,321	15,327
Inventory write-down	0	368
Deferred income taxes	2,464	1,009
Undistributed equity in earnings of joint ventures	(962)	(483)
Share-based compensation expense	3,568	2,731
Excess tax (benefit) deficiency from share-based payment arrangements	383	(16)
(Gain) loss on disposal of a business and other assets	(61)	17,103
Environmental matters	(200)	150
Net gain on derivatives	(759)	(1,586)
Changes in assets and liabilities:		
Accounts receivable	(34,740)	(9,138)
Inventories	(6,456)	(90,734)
Refundable income taxes	53	(1,946)
Prepaid expenses and other current assets	740	1,844
Intangibles and other long-term assets	(556)	(2)
Accounts payable	(7,387)	(11,259)
Accrued payroll and related liabilities	(13,942)	(6,616)
Other accrued liabilities	(1,291)	883
Accrued income taxes	5,173	401
Environmental liabilities	(65)	(303)
Other long-term liabilities	3	7
Distributed equity in earnings of joint ventures	1,175	0
Net cash used in operating activities	(17,622)	(90,015)
Cash flows from investing activities:		
Capital expenditures	(25,168)	(8,249)
Acquisitions, net of cash acquired	(6,956)	(18,126)
Joint venture (payments) receipts, net	(619)	177
Proceeds from sale of business and other assets	251	41,083
Net cash provided by (used in) investing activities	(32,492)	14,885
Cash flows from financing activities:		
Proceeds from line of credit	147,500	112,500
Repayment of line of credit	(147,500)	(89,000)
Borrowings from long-term debt	168,000	190,500
Repayment of long-term debt	(88,144)	(157,273)
Restricted stock withheld for taxes	(1,873)	(2,361)
Excess tax benefit (deficiency) from share-based payment arrangements	(383)	16
Stock options exercised	16	443
Distributions to noncontrolling interests	(631)	(409)

Dividends paid	(466)	(472)
Net cash provided by financing activities	76,519	53,944
Effect of exchange rate changes on cash	288	141
Net increase (decrease) in cash and cash equivalents	26,693	(21,045)
Cash and cash equivalents as of beginning of period	30,342	41,026
Cash and cash equivalents as of end of period	$ 57,035	$ 19,981

The accompanying notes to the unaudited condensed consolidated financial statements

are an integral part of these statements.

5

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 (US 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 US GAAP. 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 year ended August 31, 2010. The results for the three months ended November 30, 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 $22 million as of November 30, 2010 and $25 million as of August 31, 2010.

Goodwill and Other Intangible Assets, net

Goodwill represents the excess of the purchase price over the estimated fair value of the net tangible and intangible assets of the acquired entities. The Company evaluates goodwill and intangibles with an indefinite life annually during the second fiscal quarter and upon the occurrence of certain triggering events or substantive changes in circumstances that indicate that the fair value of goodwill or indefinite lived intangible assets may be impaired. Impairment of goodwill is tested at the reporting unit level. The Company s reporting units, for which goodwill has been allocated, are equivalent to the Company s reporting segments, as all of the components of the respective segments have similar economic characteristics.

In addition, the Company tests indefinite-lived intangibles for impairment by either comparing the carrying value of the intangible to the projected discounted cash flows from the intangible or using the relief from royalties method. If the carrying value exceeds the projected discounted cash flows attributed to the intangible asset, the carrying value is no longer considered recoverable and the Company will record an impairment. See Note 5 Goodwill and Other Intangible Assets, net for further detail.

Note 2 - Inventories, net

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

	November 30, 2010	August 31, 2010
Processed and unprocessed scrap metal	$ 192,475	$ 189,618
Semi-finished steel products (billets)	10,216	5,593
Finished goods	42,576	43,352
Supplies, net	30,722	29,540
Inventories, net	$ 275,989	$ 268,103

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - Business Combinations

During the three months ended November 30, 2010, the Company spent $6 million to acquire a metals recycler and a used auto parts facility. These acquisitions were as follows:

In September 2010, the Company acquired a metals recycler in Maui, Hawaii to provide an additional source of scrap metal for the Metals Recycling Business (MRB) Hawaiian export facility.

In November 2010, the Company acquired a used auto parts facility located near MRB s export facility in Oakland, California.

For each acquisition the purchase price was allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their respective estimated fair values on the date of acquisition. The excess of the aggregate purchase prices over the fair value of the identifiable net assets acquired of $2 million for the three months ended November 30, 2010 was recorded as goodwill, most of which is expected to be deductible for tax purposes.

The Company paid a premium (i.e., goodwill) over the fair value of the net tangible and identified intangible assets acquired in the transactions described above for a number of reasons, including but not limited to the following:

The acquired businesses enhance the Company s regional market position; and

The Company anticipates cost savings, efficiencies and synergies.

These acquisitions were not material, individually or in the aggregate, to the Company s financial position or results of operations. Pro forma operating results for these acquisitions are not presented, since the aggregate results would not be materially different than reported results.

Note 4 - 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 November 30, 2010**	**2009**
Revenues	$ 0	$ 9,991
Loss from discontinued operations before income taxes	$ 0	$ (292)
Income (loss) on sale of full-service operations, including adjustments	23	(17,022)
Income tax benefit	0	2,340

Income (loss) from discontinued operations, net of tax	$ 23	$ (14,974)

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Goodwill and Other Intangible Assets, net

The gross changes in the carrying amount of goodwill by reporting segment for the three months ended November 30, 2010 were as follows (in thousands):

	Metals Recycling Business	Auto Parts Business	Total
Balance as of August 31, 2010	$ 230,198	$ 150,134	$ 380,332
Acquisitions	2,436	0	2,436
Foreign currency translation adjustment	0	648	648
Balance as of November 30, 2010	$ 232,634	$ 150,782	$ 383,416

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

		November 30, 2010		August 31, 2010	
	Life In Years	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Identifiable intangibles:					
Tradename	Indefinite	$ 750	$ 0	$ 750	$ 0
Tradename	1 - 6	507	(371)	583	(423)
Marketing agreement	5	563	(187)	563	(159)
Employment agreements	2	1,117	(1,024)	1,117	(884)
Covenants not to compete	3 - 20	25,020	(11,418)	27,797	(13,329)
Leasehold interests	2 - 25	1,260	(89)	862	(266)
Lease termination fee	15	0	0	200	(200)
Permits and licenses	3 - 9	780	(81)	780	(54)
Supply contracts	Indefinite	361	0	361	0
Supply contracts	2 - 6	4,689	(2,270)	4,571	(2,035)
Real property options	Indefinite	210	0	210	0
Total		$ 35,257	$ (15,440)	$ 37,794	$ (17,350)

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. The total intangible asset amortization expense for the three months ended November 30, 2010 and 2009 was $1 million.

Note 6 - Short-Term Borrowings, Long-Term Debt and Capital Lease Obligations

The Company has an unsecured, uncommitted $25 million credit line with Wells Fargo Bank, N.A that expires on March 1, 2011. Interest rates are set by the bank at the time of borrowing. The Company had no borrowings outstanding under this facility as of November 30, 2010 or August 31, 2010.

The Company also 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 amended agreement are based, at the Company s option, on either the London Interbank Offered Rate 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. The Company had borrowings outstanding under the credit facility of $170 million as of November 30, 2010 and $90 million as of August 31, 2010. The Company paid commitment fees of less than $1 million for the three

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

months ended November 30, 2010 and 2009. The weighted average interest rate on amounts outstanding under this facility was 0.75% as of November 30, 2010 and 0.79% as of August 31, 2010. The carrying value of this debt approximates fair value as it primarily consists of variable interest rate notes. See Note 14 Subsequent Events.

These 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 November 30, 2010 and August 31, 2010, the Company was in compliance with all such covenants.

The Company had capital lease obligations for the use of equipment of $2 million as of November 30, 2010 and August 31, 2010 that expire at various dates through September 2015. Additionally, as of November 30, 2010 and August 31, 2010, the Company had $8 million of long-term bonded indebtedness that matures in January 2021.

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.

Changes in the Company s environmental liabilities for the three months ended November 30, 2010 were as follows (in thousands):

Reporting Segment	Balance as of August 31, 2010	Reserves Established (Released), Net	Payments	Balance as of November 30, 2010	Short-Term	Long-Term
Metals Recycling Business	$ 25,374	$ (100)	$ (65)	$ 25,209	$ 2,006	$ 23,203
Auto Parts Business	14,500	200	0	14,700	554	14,146
Total	$ 39,874	$ 100	$ (65)	$ 39,909	$ 2,560	$ 37,349

Metals Recycling Business

As of November 30, 2010, MRB had environmental reserves of $25 million for the potential remediation of locations where it has conducted business and has environmental liabilities from historical or recent activities.

Portland Harbor

The Company has been notified by the United States Environmental Protection Agency (EPA) under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) that it is one of the potentially responsible parties (PRPs) that own or operate or formerly owned or operated sites adjacent to the Portland Harbor Superfund site (the Site). The precise nature and extent of any cleanup of the Site, the parties to be involved, the process to be followed for any cleanup and the allocation of the costs for any cleanup among responsible parties have not yet been determined, but the process of identifying additional PRPs and beginning allocation of costs is underway. It is unclear to what extent the Company will be liable for environmental costs or natural resource damage claims or third party contribution or damage claims with respect to the Site. While the Company participated in certain preliminary Site 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 (RI/FS).

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 RI/FS. The Company has also joined with more than 80 other PRPs, including the LWG, in a voluntary process to establish an allocation of costs at the Site. These parties have selected an allocation team and have entered into an allocation process design agreement. The LWG has also commenced federal court litigation, which has been stayed, seeking to bring additional parties into the allocation process.

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 Phase I agreement and paid a portion of those costs. The Company did not participate in funding the second phase of the natural resource damage assessment.

The cost of the investigations and any remediation associated with the Site will not be reasonably estimable until 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 by the EPA. However, given the size of the Site and the nature of the conditions identified to date, the total cost of the investigations and remediation is likely to be substantial. In addition, because there has not been a determination of the total cost of the investigations, the remediation that will be required, the amount of natural resource damages or how the costs of the ongoing investigations and any remedy and natural resource damages will be allocated among the PRPs, it is not possible to estimate the costs which the Company might incur in connection with the Site, although such costs could be material to the Company s financial position or results of operations. The Company has insurance policies that it believes will provide reimbursement for costs it incurs for defense and remediation in connection with the Site, although there is no assurance that those policies will cover all of the costs which the Company may incur. 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 November 30, 2010 and August 31, 2010, the Company s reserve for third party investigation costs of the Site was $1 million.

The Oregon Department of Environmental Quality is separately providing oversight of voluntary investigations by the Company involving the Company s sites adjacent to the Portland Harbor which are focused on controlling any current uplands releases of contaminants into the Willamette River. No reserves have been established in connection with these investigations because the extent of contamination (if any) and the Company s responsibility for the contamination (if any) has not yet been determined.

Other Metals Recycling Business Sites

As of November 30, 2010, the Company had environmental reserves related to various MRB sites of $24 million. The reserves, which range in amounts from less than $1 million to $2 million per site, relate to the potential future remediation of soil contamination, groundwater contamination and storm water runoff issues. No material environmental compliance enforcement proceedings are currently pending related to these sites.

Auto Parts Business

As of November 30, 2010, the Company had environmental reserves related to various APB sites of $15 million. The reserves, which range in amounts from less than $1 million to $2 million per site, relate to the potential future remediation of soil contamination, groundwater contamination and storm water runoff issues. No material 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 1998 and has since been renewed through 2012. The permit is based upon an annual production capacity of 950 thousand tons.

SMB had no environmental reserves as of November 30, 2010.

Other than the Portland Harbor Superfund site, which is discussed above, management currently believes that adequate provision has been made in the financial statements for the potential impact of these issues and that the outcomes will not have a material adverse effect on the condensed consolidated financial statements of the Company as a whole. Historically, the amounts the Company has ultimately paid for such remediation activities have not been material.

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 8 - Changes in Equity and Comprehensive Income (Loss)

The following is a summary of the changes in equity and comprehensive income (loss) for the three months ended November 30 (in thousands):

	2010			2009		
	SSI shareholders equity	Noncontrolling interests	Total equity	SSI shareholders equity	Noncontrolling interests	Total equity
Balance as of August 31	$ 975,326	$ 4,306	$ 979,632	$ 919,367	$ 3,383	$ 922,750
Net income (loss)	17,794	1,123	18,917	(8,569)	814	(7,755)
Components of other comprehensive income (loss), net of tax:						
Foreign currency translation adjustment	660	0	660	572	0	572
Pension obligations, net	86	0	86	0	0	0
Change in net unrealized gain on cash flow hedges	117	0	117	175	0	175
Comprehensive income (loss)	18,657	1,123	19,780	(7,822)	814	(7,008)
Distributions to noncontrolling interests	0	(631)	(631)	0	(409)	(409)
Restricted stock withheld for taxes	(1,873)	0	(1,873)	(2,361)	0	(2,361)
Stock options exercised	16	0	16	443	0	443
Share-based compensation expense	3,568	0	3,568	2,731	0	2,731
Cash dividends	(467)	0	(467)	(472)	0	(472)
Excess tax benefits from share-based payment arrangements	(383)	0	(383)	16	0	16
Balance as of November 30	$ 994,844	$ 4,798	$ 999,642	$ 911,902	$ 3,788	$ 915,690

Note 9 - Employee Benefits

Multiemployer Pension Plans

Approximately 60% of the Company s multiemployer pension plan contributions are made to the Western Independent Shops Pension Trust (the WISP Trust) for the benefit of union employees of SMB. In 2004, the Internal Revenue Service (IRS) approved a seven-year extension of the period over which the WISP Trust may amortize unfunded liabilities, conditioned upon maintenance of certain minimum funding levels. Based on the actuarial valuation for the WISP Trust as of October 1, 2009 (the latest available actuarial information), 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 has submitted a request for waiver to the IRS for relief from the specified funding requirements. If the WISP Trust cannot obtain relief, revocation by the IRS of the 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.

Note 10 - Income Taxes

The effective tax rates for the Company s continuing operations for the three months ended November 30, 2010 and 2009 were 32.7%, and 20.5%, respectively.

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

A reconciliation of the difference between the federal statutory rate and the Company s effective rate for the three months ended November 30 is as follows:

	2010	2009
Federal statutory rate	35.0%	35.0%
State taxes, net of credits	1.0	1.5
Foreign income taxed at different rates	(1.1)	(1.3)
Section 199 deduction	(1.4)	(1.1)
Reinstate previous Section 199 deduction	0.0	(12.8)
Non-deductible officers compensation	0.3	1.9
Noncontrolling interests	(1.4)	(3.1)
Other	0.3	0.4
Effective tax rate	32.7%	20.5%

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, Canadian and several state tax authorities are currently examining the Company s income tax returns for fiscal years 2004 to 2008.

The Company currently pays a 7% tax rate on earnings in Puerto Rico. The Company is aware that regulatory agencies there are reevaluating the Company s entitlement to a manufacturing tax exemption. While the Company currently believes it will continue to be entitled to the 7% tax rate under existing exemptions, a change in the Company s tax exemption status could cause an increase in the tax rate on Puerto Rico earnings and in the overall effective tax rate on consolidated earnings. Based upon known facts the possible impact of a change in rates cannot currently be reasonably estimated.

Deferred taxes included the benefits from state net operating loss carry forwards of $1 million and state tax credits of $2 million that will expire if not used between 2011 and 2029. As of November 30, 2010, the Company had a valuation allowance of $1 million for a federal capital loss carry forward and for 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.

Note 11 - Net Income (Loss) Per Share

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 (loss) 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 shares, DSU and RSU awards using the treasury stock method. Common stock equivalent shares that were considered antidilutive and were excluded from the calculation of diluted earnings per share were 50,599 and 179,578 for the three months ended November 30, 2010 and 2009, respectively.

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table sets forth the information used to compute basic and diluted net income (loss) per share attributable to SSI for the three months ended November 30 (in thousands):

	2010	2009
Income from continuing operations	$ 18,894	$ 7,219
Net income attributable to noncontrolling interests	(1,123)	(814)
Income from continuing operations attributable to SSI	17,771	6,405
Income (loss) from discontinued operations, net of tax	23	(14,974)
Net income (loss) attributable to SSI	$ 17,794	$ (8,569)
Computation of shares:		
Weighted average common shares outstanding, basic	27,563	27,803
Incremental common shares attributable to dilutive stock options, performance share awards, DSUs and RSUs	308	327
Weighted average common shares outstanding, diluted	27,871	28,130

Note 12 - Related Party Transactions

The Company purchases recycled metal from its joint venture operations at prices that approximate fair market value. These purchases totaled $10 million and $4 million for the three months ended November 30, 2010 and 2009, respectively. Payments from these joint ventures were $1 million and less than $1 million for the three months ended November 30, 2010 and 2009, respectively. The Company owed $3 million to joint ventures as of November 30, 2010 compared to $1 million as of August 31, 2010.

In November 2010, the Company and a joint venture partner entered into a series of agreements to facilitate the expansion of their joint venture operations in order to increase the flow of scrap into MRB yards. In order to fund this growth, the Company and its joint venture partner each contributed an additional $2 million in equity to the joint venture.

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 less than $1 million for the three months ended November 30, 2010 and 2009, respectively. 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. The partnership also leases property owned by Mr. Klauer, through a company of which he is the sole shareholder. 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 for this parcel was less than $1 million for the three months ended November 30, 2010 and 2009.

Certain members of the Schnitzer family own significant interests in the Company. All transactions with the Schnitzer family (including Schnitzer family companies) require the approval of the Company s Audit Committee, and the Company is in compliance with this policy. Members of the Schnitzer family 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 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 metal operations property. As these costs have increased substantially in the last

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 recognized less than $1 million and $2 million in reimbursement of environmental expenses in the three months ended November 30, 2010 and 2009, respectively, for SIC s share of costs. Amounts receivable from SIC under this agreement were $1 million as of November 30, 2010 and August 31, 2010.

Note 13 - Segment Information

The Company operates in three reporting segments: metal purchasing, processing, recycling and selling (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 reporting segment does not reflect the operating income (loss) the reporting segment would have as a stand-alone business. All amounts presented exclude the results of operations of the Company s discontinued full-service used auto parts operation.

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The table below illustrates the Company s operating results from continuing operations by reporting segment for the three months ended November 30 (in thousands):

	2010	2009
Revenues:		
Metals Recycling Business:		
External customer revenues	$ 559,999	$ 280,841
Intersegment revenues	31,709	35,631
Total Metals Recycling Business revenues	591,708	316,472
Auto Parts Business:		
External customer revenues	51,471	44,761
Intersegment revenues	15,210	10,500
Total Auto Parts Business revenues	66,681	55,261
Steel Manufacturing Business:		
External customer revenues	63,634	68,680
Total revenues:		
External customer revenues	675,104	394,282
Intersegment revenues	46,919	46,131
Total revenues	$ 722,023	$ 440,413

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

Metals Recycling Business	$ 25,533	$ 15,909
Auto Parts Business	14,039	10,417
Steel Manufacturing Business	(2,035)	(7,565)
Segment operating income	37,537	18,761
Corporate and eliminations	(9,097)	(9,479)
Operating income	28,440	9,282
Interest income	55	118
Interest expense	(598)	(618)
Other income	161	301
Income from continuing operations before income taxes	$ 28,058	$ 9,083

Note 14 - Subsequent Events

Subsequent to November 30, 2010, the Company spent $82 million to acquire two metals recyclers and a self-service used auto parts store. These acquisitions were as follows:

In December 2010, the Company acquired a metals recycler with two yards in Macon, Georgia. This acquisition expanded the Company s presence in the Southeastern US.

In December 2010, the Company acquired a self-service used auto parts store in Waco, Texas. This acquisition expanded APB s presence in Texas.

In December 2010, the Company acquired a metals recycler with six yards on Vancouver Island, British Columbia, Canada that previously supplied ferrous scrap to the Company s Tacoma facility. This acquisition marked MRB s initial expansion into Canada.

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

These acquisitions were not material, individually or in the aggregate, to the Company s financial position or results of operations. Pro forma operating results for these acquisitions are not presented, since the aggregate results would not be materially different than reported results.

Table of Contents

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 first quarter of fiscal 2011 and 2010. The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of our results of operations and financial condition. The discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended August 31, 2010 and the unaudited condensed consolidated financial statements and the related notes thereto included in Part I, Item 1 of this report.

Forward-Looking Statements

Statements and information included in this Quarterly Report on Form 10-Q by Schnitzer Steel Industries, Inc. (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. Except as noted herein or as the context may otherwise require, all references to we, our, us and SSI refer to the Company and its consolidated subsidiaries.

Forward-looking statements in this Quarterly Report on Form 10-Q include statements regarding our expectations, intentions, beliefs and strategies regarding the future, including statements regarding trends, cyclicality and changes in the markets we sell 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 and profitability; obligations under our 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, op future, forward, potential, probable and similar expressions are intended to identify forward-looking statements.

We may make other forward-looking statements from time to time, including in press releases and public conference calls. All forward-looking statements we make are based on information available to us at the time the statements are made, and we assume no obligation to update any forward-looking statements, except as may be required by law. Our business is 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 our Annual Report on Form 10-K for the year ended August 31, 2010. Other examples include volatile supply and demand conditions affecting prices and volumes in the markets for both our products and raw materials we purchase; world economic conditions; world political conditions; our ability to match raw material intake and finished product output with demand; changes in income tax laws; government regulations and environmental matters; the impact of pending or new laws and regulations regarding imports into and exports from the United States (US) 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.

SCHNITZER STEEL INDUSTRIES, INC.

General

Founded in 1906, Schnitzer Steel Industries, Inc., an Oregon corporation, is 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 metal products through our integrated businesses. 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 reporting segments. As a result of this unallocated expense, the operating income (loss) of each reporting segment does not reflect the operating income (loss) the reporting segment would have as a stand-alone business. For further information regarding our reporting segments, see Note 13 Segment Information in the notes to the unaudited condensed consolidated financial statements in Part I, Item 1 of this report.

Our results of operations depend in large part on demand and prices for recycled metal in foreign and domestic markets and steel products in the Western US. Our deep water port facilities on both the East and West coasts of the US (in Everett, Massachusetts; Oakland, California; Portland, Oregon; Tacoma, Washington; and Providence, Rhode Island, all of which are owned except for the Providence, Rhode Island facility, which is operated under a long-term lease) and access to public deep water port facilities (in Kapolei, Hawaii and Salinas, Puerto Rico) allow us to meet the demand for recycled metal by steel manufacturers located in Europe, Asia, Central America and Africa. Our processing facilities in the Southeastern US also provide access to the automobile and steel manufacturing industries in that region.

Executive Overview of Financial Results

In the first quarter of fiscal 2011, we delivered strong financial and operating performance, continuing an overall upward trend in year-over-year performance. Our improved performance was due to higher demand in foreign markets, improved operating efficiencies, enhanced supply networks and continued benefits from technology investments. We achieved these results despite a sluggish domestic economy which constricted the flow of scrap metal from consumer, manufacturing, construction and demolition activities. Better economic conditions in overseas markets, particularly in Asia, generated higher demand for exports of ferrous and nonferrous recycled materials and led to enhanced performance for our Metals Recycling Business due to our geographic concentration on the east and west coasts and seven deep water ports. Our Auto Parts Business generated healthy demand from retail parts sales as consumers look to maintain vehicles longer and generated robust operating income growth from the entire value chain of autobody dismantling. Our Steel Manufacturing Business capitalized on increased average selling prices to narrow its operating loss from the first quarter of fiscal 2010. The outcome was solid earnings generation during the first quarter of 2011 while maintaining a conservative capital structure that supports our strategy for growth.

The following items summarize our consolidated financial results for the first quarter of fiscal 2011:

- Revenues of $675 million, compared to $394 million in the first quarter of fiscal 2010;

- Operating income of $28 million, compared to $9 million in the first quarter of fiscal 2010;

- Income from continuing operations attributable to SSI of $18 million, or $0.64 per share (diluted), compared to $6 million, or $0.23 per share (diluted), in the first quarter of fiscal 2010;

- Net income attributable to SSI of $18 million, or $0.64 per share (diluted), compared to net loss attributable to SSI of ($9) million, or ($0.30) per share (diluted), in the first quarter of fiscal 2010;

Net cash used in operating activities of $18 million, compared to $90 million in the first quarter of fiscal 2010;

Cash and cash equivalents of $57 million, compared to $30 million as of August 31, 2010; and

Debt, net of cash, of $123 million, compared to $70 million as of August 31, 2010 (see the reconciliation of Debt, net of cash in Non-GAAP Financial Measures at the end of Item 2).

SCHNITZER STEEL INDUSTRIES, INC.

In the first quarter of fiscal 2011, our MRB segment generated revenues of $592 million, a $275 million increase from the first quarter of fiscal 2010, which included a $249 million, or 107%, increase in ferrous revenues, reflecting record quarterly volumes of processed ferrous tons sold, and a $25 million, or 31%, increase in nonferrous revenues. MRB had operating income of $26 million compared to $16 million for the first quarter of fiscal 2010.

In the first quarter of fiscal 2011, our APB segment generated revenues of $67 million, an $11 million increase from the first quarter of fiscal 2010. The increase in revenues was driven by a $7 million increase in scrap vehicle revenue and a $4 million increase in core revenue. APB had record first quarter operating income of $14 million compared to $10 million for the first quarter of fiscal 2010.

In the first quarter of fiscal 2011, our SMB segment generated revenues of $64 million, a $5 million decrease from the first quarter of fiscal 2010. The decrease in revenues reflected a decrease in sales of semi-finished products (billets). SMB had an operating loss of ($2) million compared to ($8) million for the first quarter of fiscal 2010.

Business Combinations

As part of our continued focus on growth, we spent $6 million on value-creating acquisitions during the first quarter of fiscal 2011. These acquisitions included a metals recycler in Maui, Hawaii, which provides an additional source of scrap metal for MRB s Hawaiian export facility and a used auto parts facility located near MRB s export facility in Oakland, California.

Table of Contents

SCHNITZER STEEL INDUSTRIES, INC.

Results of Operations

($ in thousands)	Three Months Ended November 30, 2010	2009	% Change
Revenues:			
Metals Recycling Business	$ 591,708	$ 316,472	87%
Auto Parts Business	66,681	55,261	21%
Steel Manufacturing Business	63,634	68,680	(7%)
Intercompany revenue eliminations (1)	(46,919)	(46,131)	2%
Total revenues	675,104	394,282	71%
Cost of goods sold:			
Metals Recycling Business	545,688	286,854	90%
Auto Parts Business	41,229	34,192	21%
Steel Manufacturing Business	64,218	74,841	(14%)
Intercompany cost of goods sold eliminations (1)	(48,589)	(44,949)	8%
Total cost of goods sold	602,546	350,938	72%
Selling, general and administrative (SG&A) expense:			
Metals Recycling Business	21,648	14,041	54%
Auto Parts Business	11,413	10,652	7%
Steel Manufacturing Business	1,451	1,404	3%
Corporate (2)	10,563	8,349	27%
Total SG&A expense	45,075	34,446	31%
Environmental matters:			
Metals Recycling Business	(200)	150	NM
Total environmental matters	(200)	150	NM
Income from joint ventures:			
Metals Recycling Business	(961)	(482)	99%
Change in intercompany (profit) loss elimination (3)	204	(52)	NM
Total joint venture income	(757)		