

SCHNITZER STEEL INDUSTRIES INC
Form 10-Q
April 05, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the Quarterly Period Ended February 29, 2012

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 93-0341923
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

3200 NW Yeon Ave. 97210
Portland, OR (Zip Code)
(Address of principal executive offices)
(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 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 25,233,810 shares of Class A common stock, par value of \$1.00 per share, and 2,058,972 shares of Class B common stock, par value of \$1.00 per share, outstanding as of March 30, 2012.

SCHNITZER STEEL INDUSTRIES, INC.
INDEX

	PAGE
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of February 29, 2012 and August 31, 2011</u>	<u>3</u>
<u>Condensed Consolidated Statements of Income for the Three and Six Months Ended February 29, 2012 and February 28, 2011</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended February 29, 2012 and February 28, 2011</u>	<u>5</u>
<u>Notes to the Unaudited Condensed Consolidated Financial Statements</u>	<u>6</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>17</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>28</u>
<u>Item 4. Controls and Procedures</u>	<u>28</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>29</u>
<u>Item 1A. Risk Factors</u>	<u>29</u>
<u>Item 6. Exhibits</u>	<u>30</u>
<u>SIGNATURES</u>	<u>31</u>

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)
SCHNITZER STEEL INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except per share amounts)

	February 29, 2012	August 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$51,720	\$49,462
Accounts receivable, net of allowance for doubtful accounts of \$6,603 and \$6,148	210,083	229,975
Inventories, net	324,818	335,120
Deferred income taxes	11,274	11,784
Refundable income taxes	13,581	3,541
Prepaid expenses and other current assets	31,004	24,117
Total current assets	642,480	653,999
Property, plant and equipment, net of accumulated depreciation of \$503,416 and \$471,305	552,851	555,284
Investments in joint venture partnerships	17,654	17,208
Goodwill	628,079	627,805
Intangibles, net of accumulated amortization of \$16,409 and \$20,846	18,029	20,906
Other assets	14,694	14,967
Total assets	\$1,873,787	\$1,890,169
Liabilities and Equity		
Current liabilities:		
Short-term borrowings	\$668	\$643
Accounts payable	115,415	141,011
Accrued payroll and related liabilities	22,040	36,475
Environmental liabilities	3,060	2,983
Accrued income taxes	3,836	13,833
Other accrued liabilities	41,521	38,368
Total current liabilities	186,540	233,313
Deferred income taxes	88,926	85,378
Long-term debt, net of current maturities	412,891	403,287
Environmental liabilities, net of current portion	37,569	37,872
Other long-term liabilities	9,562	10,030
Total liabilities	735,488	769,880
Commitments and contingencies (Note 7)		
Redeemable noncontrolling interest	21,176	19,053
Schnitzer Steel Industries, Inc. ("SSI") shareholders' equity:		
Preferred stock – 20,000 shares \$1.00 par value authorized, none issued	—	—
Class A common stock – 75,000 shares \$1.00 par value authorized, 24,873 and 24,241 shares issued and outstanding	24,873	24,241
Class B common stock – 25,000 shares \$1.00 par value authorized, 2,417 and 3,060 shares issued and outstanding	2,417	3,060
Additional paid-in capital	5,099	762
Retained earnings	1,079,528	1,065,109

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Accumulated other comprehensive income (loss)	(610) 1,540
Total SSI shareholders' equity	1,111,307	1,094,712
Noncontrolling interests	5,816	6,524
Total equity	1,117,123	1,101,236
Total liabilities and equity	\$1,873,787	\$1,890,169

The accompanying Notes to the Unaudited Condensed Consolidated Financial Statements are an integral part of these statements.

3

SCHNITZER STEEL INDUSTRIES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (Unaudited, in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	2/29/2012	2/28/2011	2/29/2012	2/28/2011
Revenues	\$886,612	\$721,842	\$1,698,787	\$1,396,946
Operating expense:				
Cost of goods sold	817,087	632,856	1,559,303	1,235,402
Selling, general and administrative	52,370	44,033	108,362	88,908
Income from joint ventures	(832)	(984)	(1,833)	(1,741)
Operating income	17,987	45,937	32,955	74,377
Other income (expense):				
Interest income	72	234	234	289
Interest expense	(3,472)	(1,157)	(6,743)	(1,755)
Other income (expense), net	545	2,854	(11)	3,015
Total other income (expense)	(2,855)	1,931	(6,520)	1,549
Income from continuing operations before income taxes	15,132	47,868	26,435	75,926
Income tax expense	(4,767)	(15,745)	(8,328)	(24,909)
Income from continuing operations	10,365	32,123	18,107	51,017
Income from discontinued operations, net of tax	—	11	—	34
Net income	10,365	32,134	18,107	51,051
Net income attributable to noncontrolling interests	(735)	(1,309)	(1,462)	(2,432)
Net income attributable to SSI	\$9,630	\$30,825	\$16,645	\$48,619
Basic:				
Income per share from continuing operations attributable to SSI	\$0.35	\$1.12	\$0.61	\$1.76
Income per share from discontinued operations	—	—	—	—
Net income per share attributable to SSI	\$0.35	\$1.12	\$0.61	\$1.76
Diluted:				
Income per share from continuing operations attributable to SSI	\$0.35	\$1.10	\$0.60	\$1.74
Income per share from discontinued operations	—	—	—	—
Net income per share attributable to SSI	\$0.35	\$1.10	\$0.60	\$1.74
Weighted average number of common shares:				
Basic	27,509	27,627	27,480	27,595
Diluted	27,781	27,944	27,734	27,918
Dividends declared per common share	\$0.017	\$0.017	\$0.034	\$0.034

The accompanying Notes to the Unaudited Condensed Consolidated Financial Statements are an integral part of these statements.

SCHNITZER STEEL INDUSTRIES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited, in thousands)

	Six Months Ended	
	2/29/2012	2/28/2011
Cash flows from operating activities:		
Net income	\$ 18,107	\$ 51,051
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	40,991	34,476
Deferred income taxes	4,109	2,136
Undistributed equity in earnings of joint ventures	(1,833	) (1,931
Share-based compensation expense	5,895	6,692
Excess tax benefit from share-based payment arrangements	(497	) 299
Loss (gain) on disposal of assets	112	(20
Net gain on derivatives	—	(759
Unrealized foreign exchange loss (gain), net	89	(2,403
Bad debt expense, net of recoveries	—	578
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	8,237	(29,021
Inventories	13,579	(79,544
Refundable income taxes	(10,031	) (122
Prepaid expenses and other current assets	(943	) 1,008
Intangibles and other long-term assets	456	(944
Accounts payable	(14,882	) 31,353
Accrued payroll and related liabilities	(14,056	) (9,360
Other accrued liabilities	836	(1,368
Accrued income taxes	(9,741	) 15,165
Environmental liabilities	(323	) (278
Other long-term liabilities	(136	) (134
Distributed equity in earnings of joint ventures	1,400	3,405
Net cash provided by operating activities	41,369	20,279
Cash flows from investing activities:		
Capital expenditures	(43,178	) (46,284
Acquisitions, net of cash acquired	—	(165,919
Joint venture receipts (payments), net	(335	) (1,118
Proceeds from sale of assets	519	290
Net cash used in investing activities	(42,994	) (213,031
Cash flows from financing activities:		
Proceeds from line of credit	211,000	311,000
Repayment of line of credit	(211,000	) (311,000
Borrowings from long-term debt	315,661	413,000
Repayment of long-term debt	(305,986	) (193,298
Debt financing fees	—	(5,114
Repurchase of Class A common stock	(3,117) —
Taxes paid related to net share settlement of share-based payment arrangements	(840	) (1,880
Excess tax benefit from share-based payment arrangements	497	(299
Stock options exercised	498	279
Contributions from noncontrolling interests	2,104	—
Distributions to noncontrolling interests	(2,368) (1,219

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Contingent consideration paid relating to business acquisitions	(1,469) —	
Dividends paid	(932	) (1,400)
Net cash provided by financing activities	4,048	210,069	
Effect of exchange rate changes on cash	(165	) 586	
Net increase in cash and cash equivalents	2,258	17,903	
Cash and cash equivalents as of beginning of period	49,462	30,342	
Cash and cash equivalents as of end of period	\$51,720	\$48,245	

The accompanying Notes to the Unaudited Condensed Consolidated Financial Statements are an integral part of these statements.

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 (“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. Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to the rules and regulations of the SEC. In the opinion of management, all normal, recurring adjustments considered necessary for a fair presentation have been included. 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, 2011. The results for the three and six months ended February 29, 2012 and February 28, 2011 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 \$35 million as of February 29, 2012 and \$40 million as of August 31, 2011.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents and accounts receivable. The majority of cash and cash equivalents are maintained with two major financial institutions (Bank of America and Wells Fargo Bank, N.A.). Balances in these institutions exceeded the Federal Deposit Insurance Corporation insured amount of \$250,000 as of February 29, 2012. Concentration of credit risk with respect to accounts receivable is limited because a large number of geographically diverse customers make up the Company’s customer base. The Company controls credit risk through credit approvals, credit limits, letters of credit, cash deposits and monitoring procedures. The Company is exposed to a residual credit risk with respect to open letters of credit by virtue of the possibility of the failure of a bank providing a letter of credit. The Company had \$87 million and \$90 million of open letters of credit relating to accounts receivable as of February 29, 2012 and August 31, 2011, respectively.

Fair Value Measurements

Fair value is measured using inputs from the three levels of the fair value hierarchy. Classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The three levels are described as follows:

- Level 1 – Unadjusted quoted prices in active markets for identical assets and liabilities.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the determination of the fair value of the asset or liability, either directly or indirectly.
- Level 3 – Unobservable inputs that are significant to the determination of the fair value of the asset or liability.

When developing the fair value measurements, the Company uses quoted market prices whenever available or seeks to maximize the use of observable inputs and minimize the use of unobservable inputs when quoted market prices are not available. See Note 8 - Redeemable Noncontrolling Interest and Note 10 - Derivative Financial Instruments for further detail.

Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, debt and derivative contracts. The carrying amounts of the non-derivative financial instruments approximate fair value, including debt primarily at variable interest rates. The Company uses the market approach to value its financial assets and liabilities, determined using available market information.

Derivatives

The Company records derivative instruments in other assets or other liabilities in the Unaudited Condensed Consolidated Balance Sheets at fair value and changes in the fair value are either recognized in accumulated other comprehensive income (loss) in the

6

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited Condensed Consolidated Balance Sheets or net income in the Unaudited Condensed Consolidated Statements of Income, as applicable, depending on the nature of the underlying exposure, whether the derivative has been designated as a hedge, and if designated as a hedge, the extent to which the hedge is effective. Amounts included in accumulated other comprehensive income (loss) are reclassified to earnings in the period in which earnings are impacted by the hedged items or in the period that the hedged transaction is deemed no longer likely to occur. For cash flow hedges, a formal assessment is made, both at the hedge's inception and on an ongoing basis, to determine whether the derivatives that are designated as hedging instruments have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. To the extent the hedge is determined to be ineffective, the ineffective portion is immediately recognized in earnings. When available, quoted market prices or prices obtained through external sources are used to measure a contract's fair value. The fair value of these instruments is a function of underlying forward commodity prices, related volatility, counterparty creditworthiness and duration of the contracts. Cash flows from derivatives are recognized in the Unaudited Condensed Consolidated Statements of Cash Flows in a manner consistent with the underlying transactions. See Note 10 - Derivative Financial Instruments.

Derivative contracts for commodities used in normal business operations that are settled by physical delivery, among other criteria, are eligible for and may be designated as normal purchases and normal sales. Contracts that qualify as normal purchases or normal sales are not marked-to-market. The Company does not use derivative instruments for trading or speculative purposes.

Redeemable Noncontrolling Interest

The Company has issued common stock of one of its subsidiaries to a noncontrolling interest holder of that subsidiary that is redeemable both at the option of the holder and upon the occurrence of an event that is not solely within the Company's control. Since redemption of the noncontrolling interest is outside of the Company's control, this interest is presented on the Unaudited Condensed Consolidated Balance Sheets in the mezzanine section under the caption "Redeemable noncontrolling interest." If the interest were to be redeemed, the Company would be required to purchase all of such interest at fair value on the date of redemption. As such, the redeemable noncontrolling interest is measured at fair value at each reporting period. Any adjustments to the carrying amount of the redeemable noncontrolling interest for changes in fair value prior to exercise of the redemption option are determined after the attribution of net income or loss of the subsidiary and are recorded to retained earnings. See Note 8 - Redeemable Noncontrolling Interest for further detail.

Reclassifications

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

Note 2 - Recent Accounting Pronouncements

In May 2011, an accounting standard update was issued to clarify existing fair value measurement guidance and expand the disclosure requirements for fair value measurements estimated using unobservable inputs (Level 3 inputs). New disclosures are required to report quantitative information about the unobservable inputs used in the measurement of Level 3 valuations and to include the valuation process used to determine the fair value of the item and the sensitivity of the measurement to changes in unobservable inputs. This standard will be effective for the Company for the third quarter of fiscal year 2012. The standard is unlikely to impact the fair value measurement of any of the Company's existing assets, liabilities, or equity valuations, but the additional disclosures will be required for the Company's redeemable noncontrolling interest, which is measured using Level 3 inputs.

In June 2011, an accounting standard update was issued regarding the presentation of other comprehensive income in the financial statements. The standard eliminates the option of presenting other comprehensive income as part of the statement of changes in stockholders' equity and instead requires the entity to present other comprehensive income as either a single statement of comprehensive income combined with net income or as two separate but consecutive statements. This amendment will be effective for the Company for fiscal year 2013 and interim periods therein. The Company currently reports other comprehensive income in the summary of changes in equity and comprehensive income and will be required to update the presentation of comprehensive income to be in compliance with the new standard.

In September 2011, an accounting standard update was issued that simplifies how an entity tests goodwill for impairment by allowing an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

is required. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company will adopt this standard for the goodwill impairment test to be performed in fiscal 2013. Upon adoption, this standard will impact how the Company assesses goodwill for impairment but will not change the measurement or recognition of a potential goodwill impairment charge.

In December 2011, an accounting standard update was issued increasing disclosures regarding offsetting assets and liabilities. For financial instruments and derivative instruments, the standard requires disclosure of the gross amounts of recognized assets and liabilities, the amounts offset on the balance sheet, and the amounts subject to the offsetting requirements but not offset on the balance sheet. The standard is effective for the Company for fiscal year 2014 and interim periods therein and is to be applied retrospectively. The adoption of this standard is not expected to have a significant impact on the Company's consolidated financial position, results of operations or cash flows.

Note 3 - Inventories, net

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

	February 29, 2012	August 31, 2011
Processed and unprocessed scrap metal	\$220,365	\$241,093
Semi-finished steel products (billets)	15,557	9,237
Finished goods	53,783	54,395
Supplies	35,113	30,395
Inventories, net	\$324,818	\$335,120

Note 4 - Business Combinations

During fiscal 2011, the Company made 10 acquisitions accounted for as business combinations. The total purchase price of these acquisitions of \$316 million, comprising \$294 million in cash and \$22 million in non-cash consideration (\$20 million in shares of a subsidiary and \$2 million in contingent consideration), 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 price over the fair value of the identifiable net assets acquired of \$248 million was recorded as goodwill.

The following unaudited pro forma financial information represents the combined results of our operations for the three and six months ended February 28, 2011, as if all of the fiscal 2011 acquisitions had occurred as of September 1, 2009 (in thousands):

	Three Months Ended February 28, 2011	Six Months Ended February 28, 2011
Revenues	\$747,829	\$1,466,512
Operating income ⁽¹⁾	\$53,330	\$89,585
Net income ⁽¹⁾	\$36,661	\$60,149
Net income attributable to SSI ⁽¹⁾	\$34,685	\$56,328

⁽¹⁾ Excludes nonrecurring executive compensation paid to the management of acquired companies that will not be incurred in the future.

These pro forma results are not necessarily indicative of what actual results would have been had these acquisitions occurred for the periods presented. In addition, the pro forma results are not intended to be a projection of future results and do not reflect any synergies that may be achieved from combining operations.

Note 5 - Goodwill

In the second quarter of fiscal 2012, the Company performed its annual goodwill impairment testing by comparing the fair value of each reporting unit with its carrying value, including goodwill. As a result of this testing, the Company determined that the fair value of each of its reporting units was substantially in excess of its respective carrying value and the goodwill balance was not impaired. The Company will continue to monitor its goodwill for possible future impairment.

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The gross changes in the carrying amount of goodwill by reporting segment for the six months ended February 29, 2012 were as follows (in thousands):

	Metals Recycling Business	Auto Parts Business	Total
Balance as of August 31, 2011	\$464,646	\$163,159	\$627,805
Purchase price adjustment	1,540	—	1,540
Purchase accounting adjustments	370	—	370
Foreign currency translation adjustment	(1,417	) (219	) (1,636
Balance as of February 29, 2012	\$465,139	\$162,940	\$628,079

There were no accumulated goodwill impairment charges as of February 29, 2012.

Note 6 - Short-Term Borrowings

The Company has an unsecured, uncommitted \$25 million credit line with Wells Fargo Bank, N.A. The term of this credit facility was recently extended to March 1, 2013. Interest rates are set by the bank at the time of borrowing. The Company had no borrowings outstanding under this facility as of February 29, 2012 and August 31, 2011. 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.

Note 7 - Commitments and 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 liabilities were established.

Changes in the Company's environmental liabilities for the six months ended February 29, 2012 were as follows (in thousands):

	Balance as of August 31, 2011	Liabilities Established (Released), Net	Payments and other	Balance as of February 29, 2012	Short-Term	Long-Term
Metals Recycling Business	\$25,655	\$ (300	) \$74	\$25,429	\$2,506	\$22,923
Auto Parts Business	15,200	—	—	15,200	554	14,646
Total	\$40,855	\$ (300	) \$74	\$40,629	\$3,060	\$37,569

Metals Recycling Business ("MRB")

As of February 29, 2012, MRB had environmental liabilities 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

In December 2000, the Company was 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 which are part of or 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.

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.

On March 30, 2012, the LWG submitted to the EPA and made available on its website a draft feasibility study (“draft FS”) for the Site based on approximately ten years of work and \$100 million in costs classified by the LWG as investigation related. The Company obtained a copy of the draft FS on the same day. The draft FS identifies ten possible remedial alternatives which range in estimated cost from approximately \$170 million to \$250 million (net present value) for the least costly alternative to approximately \$1.08 billion to \$1.76 billion (net present value) for the most costly and estimates a range of two to 28 years to implement the remedial work, depending on the selected alternative. The draft FS does not determine who is responsible for remediation costs, define the precise cleanup boundaries or select remedies. The draft FS will be reviewed, and may be subject to revisions prior to its approval, by the EPA. While the draft FS is an important step in the EPA’s development of a proposed plan for addressing the Site, a final decision on the nature and extent of the required remediation will occur only after the EPA has prepared a proposed plan for public review and issued a record of decision (“ROD”). Currently available information indicates that the EPA does not expect to issue its final ROD selecting a remedy for the Site until at least 2013. Responsibility for implementing and funding EPA’s selected remedy will be determined in a separate allocation process.

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, the Company believes it is not possible to reasonably estimate the amount or range of costs which it is likely or reasonably possible that the Company may incur in connection with the Site, although such costs could be material to the Company’s financial position, results of operations, cash flows or liquidity. Among the facts currently not known or available are detailed information on the history of ownership of and the nature of the uses of and activities and operations performed on each property within the Site, which are factors that will play a substantial role in determining the allocation of investigation and remedy costs among the PRPs. 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. The Company previously recorded a liability for its estimated share of the costs of the investigation of \$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 liabilities 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 MRB Sites

As of February 29, 2012, the Company had environmental liabilities related to various MRB sites other than Portland Harbor of \$24 million. The liabilities relate to the potential future remediation of soil contamination, groundwater contamination and storm water runoff issues and were not individually material at any site. No material environmental compliance enforcement proceedings are currently pending related to these sites.

Auto Parts Business (“APB”)

As of February 29, 2012, the Company had environmental liabilities related to various APB sites of \$15 million. The liabilities relate to the potential future remediation of soil contamination, groundwater contamination and storm water runoff issues and were not individually material at any site. 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 is based on an annual production capacity of 950 thousand tons. The permit was first issued in 1998 and was renewed through March 1, 2012. The Company timely filed a renewal application, which allows for existing permit conditions to remain in force until the permit is renewed or a new permit is issued.

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SMB had no environmental liabilities as of February 29, 2012.

Other than the Portland Harbor Superfund site, which is discussed above, management currently believes that adequate provision has been made for the potential impact of these issues and that the ultimate outcomes will not have a material adverse effect on the Unaudited 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 in any given period.

In addition, we are party to various legal proceedings arising in the normal course of our business. We do not anticipate that the resolution of legal proceedings arising in the normal course of business will have a material adverse effect on our business, results of operations, financial condition, or cash flows.

Note 8 - Redeemable Noncontrolling Interest

In March 2011, the Company, through a wholly-owned acquisition subsidiary, acquired substantially all of the metals recycling business assets of Amix Salvage & Sales Ltd. As part of the purchase consideration, the Company issued the seller common shares equal to 20% of the issued and outstanding capital stock of the Company's acquisition subsidiary. Under the terms of an agreement related to the acquisition, the noncontrolling interest holder has the right to require the Company to purchase its 20% interest in the Company's acquisition subsidiary for fair value. The noncontrolling interest becomes redeemable within 60 days after the later of (i) the third anniversary of the date of the acquisition and (ii) the date on which certain principals of the minority shareholder are no longer employed by the Company. The conditions for redemption of the noncontrolling interest had not been met as of February 29, 2012.

As of February 29, 2012, the fair value of the redeemable noncontrolling interest was \$21 million. The Company estimates fair value using Level 3 inputs under the fair value hierarchy based on standard valuation techniques using a discounted cash flow analysis. The determination of fair value requires management to apply significant judgment in formulating estimates and assumptions. These estimates and assumptions primarily include forecasts of future cash flows based on management's best estimate of future sales and operating costs; pricing expectations; capital expenditures; working capital requirements; discount rates; growth rates; tax rates; and general market conditions.

Following is a reconciliation of the changes in the redeemable noncontrolling interest for the six months ended February 29, 2012 (in thousands):

	Fiscal 2012	
Balance as of August 31, 2011	\$19,053	
Net loss attributable to noncontrolling interest	(198)
Currency translation adjustment	217	
Capital contributions from noncontrolling interest holder	2,104	
Balance as of February 29, 2012	\$21,176	

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Changes in Equity and Comprehensive Income

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

	Fiscal 2012			Fiscal 2011		
	SSI shareholders equity	Noncontrolling interests	Total equity	SSI shareholders equity	Noncontrolling interests	Total equity
Balances - September 1 (Beginning of period)	\$ 1,094,712	\$ 6,524	\$ 1,101,236	\$ 975,326	\$ 4,306	\$ 979,632
Net income ⁽¹⁾	16,645	1,660	18,305	48,619	2,432	51,051
Other comprehensive income (loss), net of tax ⁽²⁾	(2,151	) —	(2,151	) 3,828	—	3,828
Distributions to noncontrolling interests	—	(2,368	) (2,368	) —	(1,219	) (1,219
Share repurchases	(3,117	) —	(3,117) —	—	—
Restricted stock withheld for taxes	(840	) —	(840	) (1,880	) —	(1,880
Stock options exercised	498	—	498	279	—	279
Share-based compensation	6,271	—	6,271	6,692	—	6,692
Excess tax benefit (deficiency) from stock options exercised and restricted stock units vested	216	—	216	(299	) —	(299
Cash dividends (\$0.034 per share)	(927	) —	(927	) (936	) —	(936
Balances - February 29, 2012 and February 28, 2011 (End of period)	\$ 1,111,307	\$ 5,816	\$ 1,117,123	\$ 1,031,629	\$ 5,519	\$ 1,037,148

Net income attributable to noncontrolling interests for the six months ended February 29, 2012 excludes a net loss (1) of \$198 thousand allocable to the redeemable noncontrolling interest, which is reported in the mezzanine section of the Unaudited Condensed Consolidated Balance Sheets. See Note 8 - Redeemable Noncontrolling Interest.

Other comprehensive income (loss), net of tax for the six months ended February 29, 2012 excludes \$(217) thousand relating to foreign currency translation adjustments for the redeemable noncontrolling interest, which is (2) reported in the mezzanine section of the Unaudited Condensed Consolidated Balance Sheets. See Note 8 - Redeemable Noncontrolling Interest.

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The components of comprehensive income for the three and six months ended February 29, 2012 and February 28, 2011 were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	2/29/2012	2/28/2011	2/29/2012	2/28/2011
Net income	\$10,365	\$32,134	\$18,107	\$51,051
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment ⁽¹⁾	5,172	2,877	(2,529)	) 3,537
Change in net unrealized gain on cash flow hedges ⁽²⁾	28	—	28	117
Pension obligations, net ⁽³⁾	66	88	133	174
Other comprehensive income (loss), net of tax	5,266	2,965	(2,368)	) 3,828
Total comprehensive income	15,631	35,099	15,739	54,879
Less amounts attributable to noncontrolling interests:				
Net income attributable to noncontrolling interests	(735)	) (1,309)	) (1,462)	) (2,432)
Foreign currency translation adjustment attributable to redeemable noncontrolling interest	(669)	) —	217	—
Amounts attributable to noncontrolling interests:	(1,404)	) (1,309)	) (1,245)	) (2,432)
Comprehensive income attributable to SSI	\$14,227	\$33,790	\$14,494	\$52,447

(1) Net of tax expense (benefit) of \$343 thousand, \$581 thousand, \$(125) thousand and \$952 thousand for each respective period.

(2) Net of tax expense of \$16 thousand, \$0 thousand, \$16 thousand and \$66 thousand for each respective period.

(3) Net of tax expense of \$39 thousand, \$52 thousand, \$78 thousand and \$106 thousand for each respective period.

Note 10 - Derivative Financial Instruments

Foreign Currency Exchange Rate Risk Management

The Company entered into forward contracts during fiscal 2011 to mitigate exposure to exchange rate fluctuations on Euro-denominated fixed asset purchases, which were designated as cash flow hedges for accounting purposes. These foreign currency forward contracts are measured using forward exchange rates based on observable exchange rates quoted in an active market and are classified as a Level 1 fair value measurement under the fair value hierarchy. In the first quarter of fiscal 2012, the Company determined that the forecasted transaction was no longer probable, de-designated these contracts as hedges and subsequently terminated the contracts. The nominal amount and fair value of these forward contracts, the amounts reclassified from accumulated other comprehensive income (loss) and the realized losses recorded in other income (expense), net during the period were not material to the Unaudited Condensed Consolidated Financial Statements.

Note 11 - Share-based Compensation

In the first quarter of fiscal 2012, the Compensation Committee granted 143,718 restricted stock units (“RSU”) to its key employees and officers under the Company’s 1993 Stock Incentive Plan. The majority of the RSUs have a five-year term and vest 20% per year commencing June 1, 2012. The estimated fair value of the RSUs granted is based on the market closing price of the underlying Class A common stock on the date of grant and totaled \$6 million. The compensation expense associated with the RSUs is recognized over the requisite service period of the awards, net of forfeitures.

In the second quarter of fiscal 2012, the Company granted a deferred stock unit (“DSU”) award to each of its non-employee directors under the Company’s Deferred Compensation Plan for Non-Employee Directors. 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. One DSU gives the director the right to receive one share of Class A common stock at a future date. The grant included a total of 18,202 shares that will vest on the day before the Company's 2013 annual meeting, subject to continued Board service. The total fair value of these awards was not material.

Note 12 - Income Taxes

The effective tax rate for the Company's continuing operations for the three and six months ended February 29, 2012 was 31.5% compared to 32.9% and 32.8% for the three and six months ended February 28, 2011, 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 is as follows:

	Three Months Ended		Six Months Ended	
	2/29/2012	2/28/2011	2/29/2012	2/28/2011
Federal statutory rate	35.0	% 35.0	% 35.0	% 35.0
State taxes, net of credits	(3.7	) 1.0	(1.5	) 1.0
Foreign income taxed at different rates	0.2	(2.1	) (0.6	) (1.7
Section 199 deduction	(1.2	) (0.6	) (1.4	) (0.9
Non-deductible officers' compensation	0.9	0.3	0.8	0.3
Noncontrolling interests	(2.3	) (0.9	) (2.2	) (1.1
Foreign interest income	2.0	—	1.2	—
Other	0.6	0.2	0.2	0.2
Effective tax rate	31.5	% 32.9	% 31.5	% 32.8

The Company files federal and state income tax returns in the U.S. and foreign tax returns in Puerto Rico and Canada. The federal statute of limitations has expired for fiscal 2007 and prior years. The Internal Revenue Service is currently examining the Company's federal income tax returns for fiscal years 2009 and 2010, and Canadian and several state tax authorities are currently examining returns for fiscal years 2005 to 2009.

Note 13 - Net Income Per Share

The following table sets forth the information used to compute basic and diluted net income per share attributable to SSI (in thousands):

	Three Months Ended		Six Months Ended	
	2/29/2012	2/28/2011	2/29/2012	2/28/2011
Income from continuing operations	\$10,365	\$32,123	\$18,107	\$51,017
Net income attributable to noncontrolling interests	(735	) (1,309	) (1,462	) (2,432
Income from continuing operations attributable to SSI	9,630	30,814	16,645	48,585
Income from discontinued operations, net of tax	—	11	—	34
Net income attributable to SSI	\$9,630	\$30,825	\$16,645	\$48,619
Computation of shares:				
Weighted average common shares outstanding, basic	27,509	27,627	27,480	27,595
Incremental common shares attributable to dilutive stock options, performance share awards, DSUs and RSUs	272	317	254	323
Weighted average common shares outstanding, diluted	27,781	27,944	27,734	27,918

Common stock equivalent shares of 57,364 and 92,107 were considered antidilutive and were excluded from the calculation of diluted net income per share for the three and six months ended February 29, 2012, respectively, compared to 27,194 and 48,678 common stock equivalent shares, respectively, for the three and six months ended February 28, 2011.

Note 14 - Related Party Transactions

The Company purchases recycled metal from its joint venture operations at prices that approximate fair market value. These purchases totaled \$13 million for the three months ended February 29, 2012 and February 28, 2011, and \$23 million for the six months ended February 29, 2012 and February 28, 2011. Advances to these joint ventures were \$1 million and less than \$1 million for the three months ended February 29, 2012 and February 28, 2011, respectively, and less than \$1 million and \$1 million for the six months ended February 29, 2012 and February 28, 2011,

respectively. The Company owed \$2 million to joint ventures as of February 29, 2012 and August 31, 2011.

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.

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In connection with the acquisition of the metals recycling assets of Amix Salvage & Sales Ltd., the Company entered into a series of agreements to obtain barging and other services and lease property with entities owned by the minority shareholder of the Company's subsidiary that operates its MRB facilities in Vancouver, British Columbia and Alberta, Canada. The Company paid \$2 million and \$5 million, primarily for barging services, under these agreements for the three and six months ended February 29, 2012, respectively. Amounts payable to entities affiliated with this minority shareholder were \$2 million as of February 29, 2012 related to a purchase price adjustment.

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 less than \$1 million and \$1 million for the three months ended February 29, 2012 and February 28, 2011, respectively, and \$1 million for the six months ended February 29, 2012 and February 28, 2011. 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 each of the three and six months ended February 29, 2012 and February 28, 2011. In addition, in July 2011, the Company leased a parcel of land in San Jose from a company of which Mr. Klauer is the sole shareholder. The initial term of this lease expired on January 31, 2012, and the Company exercised its option to renew the lease through July 31, 2012. The rent paid to Mr. Klauer's company for the three and six months ended February 29, 2012 was less than \$1 million.

Certain members of the Schnitzer family own significant interests in, or are related to owners of, Schnitzer Investment Corp. ("SIC"), which is engaged in the real estate business and was a subsidiary of the Company prior to 1989. SIC is considered a related party for financial reporting purposes. 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 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 amounts receivable from (payable to) SIC vary from period to period because of the timing of incurring legal and consulting fees, payments for cost reimbursements and insurance recoveries. As of February 29, 2012, amounts payable to SIC under this agreement were less than \$1 million, compared to amounts receivable from SIC of less than \$1 million as of August 31, 2011.

Note 15 - Segment Information

The accounting standards for reporting information about operating segments define operating segments as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is the Chief Executive Officer. The Company is organized by line of business. While the Chief Executive Officer evaluates results in a number of different ways, the line of business management structure is the primary basis for which the allocation of resources and financial results are assessed. Under the aforementioned criteria, the Company operates in three operating and 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.

MRB buys and processes ferrous and nonferrous metal for sale to foreign and other domestic steel producers or their representatives and to SMB. MRB also purchases ferrous metal from other processors for shipment directly to SMB.

APB purchases used and salvaged vehicles, sells parts from those vehicles through its retail facilities and wholesale operations, and sells the remaining portion of the vehicles to metal recyclers, including MRB.

SMB operates a steel mini-mill that produces a wide range of finished steel products using recycled metal and other raw materials.

Intersegment sales from MRB to SMB are made at rates that approximate export market prices for shipments from the West Coast of the U.S. In addition, the Company has intersegment sales of autobodies from APB to MRB at rates that approximate market prices. These intercompany sales tend to produce intercompany profits which are not recognized until the finished products are ultimately sold to third parties.

SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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.

The table below illustrates the Company's operating results from continuing operations by reporting segment (in thousands):

	Three Months Ended		Six Months Ended	
	2/29/2012	2/28/2011	2/29/2012	2/28/2011
Revenues:				
Metals Recycling Business:				
Revenues	\$781,933	\$637,028	\$1,510,371	\$1,228,736
Less: Intersegment revenues	(39,986)	(39,049)	(98,700)	(70,758)
MRB external customer revenues	741,947	597,979	1,411,671	1,157,978
Auto Parts Business:				
Revenues	78,232	72,533	162,285	139,214
Less: Intersegment revenues	(18,090)	(18,738)	(39,593)	(33,949)
APB external customer revenues	60,142	53,795	122,692	105,265
Steel Manufacturing Business:				
Revenues	84,523	70,068	164,424	133,703
Total revenues	\$886,612	\$721,842	\$1,698,787	\$1,396,946

The table below illustrates the reconciliation of the Company's segment operating income (loss) to income from continuing operations before income taxes (in thousands):

	Three Months Ended		Six Months Ended	
	2/29/2012	2/28/2011	2/29/2012	2/28/2011
Metals Recycling Business	\$19,952	\$41,691	\$33,051	\$67,225
Auto Parts Business	8,708	15,957	19,150	29,996
Steel Manufacturing Business	(868)	(711)	349	(2,746)
Segment operating income	27,792	56,937	52,550	94,475
Corporate and eliminations	(9,805)	(11,000)	(19,595)	(20,098)
Operating income	17,987	45,937	32,955	74,377
Other income (expense)	(2,855)	1,931	(6,520)	1,549
Income from continuing operations before income taxes	\$15,132	\$47,868	\$26,435	\$75,926

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

	February 29, 2012	August 31, 2011
Metals Recycling Business ⁽¹⁾	\$1,658,143	\$1,668,778
Auto Parts Business	319,665	304,060
Steel Manufacturing Business	324,247	324,596
Total segment assets	2,302,055	2,297,434
Corporate and eliminations	(428,268)	(407,265)
Total assets	\$1,873,787	\$1,890,169

(1) MRB total assets include \$18 million and \$17 million as of February 29, 2012 and August 31, 2011, respectively, for investments in joint venture partnerships.

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 three and six months ended February 29, 2012 and February 28, 2011. 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, 2011 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, cyclicalities and changes in the markets we sell into; strategic direction; changes to manufacturing and production processes; the cost of compliance with environmental and other laws; expected tax rates, deductions and credits; 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," "opinions," "forecasts," "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 the effects of changes in domestic and global economic conditions and a number of other 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, 2011. Examples of these risks include: potential environmental cleanup costs related to the Portland Harbor Superfund site; volatile supply and demand conditions affecting prices and volumes in the markets for both our products and raw materials we purchase; difficulties associated with acquisitions and integration of acquired businesses; the impact of goodwill impairment charges; the inability of customers to fulfill their contractual obligations; the impact of foreign currency fluctuations; potential limitations on our ability to access credit facilities; the impact of the consolidation in the steel industry; the impact of imports of foreign steel into the U.S.; inability to realize expected benefits from investments in technology; freight rates and availability of transportation; product liability claims; costs associated with compliance with environmental regulations; the adverse impact of climate change; inability to obtain or renew business licenses and permits; compliance with greenhouse gas emission regulations; reliance on employees subject to collective bargaining agreements; and the impact of the underfunded status of multiemployer plans in which we participate.

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”), that collectively provide an end-of-life cycle solution for a variety of 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 15 - 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 the demand and prices for recycled metal in foreign and domestic markets. Our deep water port facilities on both the East and West coasts of the U.S. (in Everett, Massachusetts; Oakland, California; Portland,

SCHNITZER STEEL INDUSTRIES, INC.

Oregon; Tacoma, Washington; and Providence, Rhode Island) and access to public deep water port facilities (in Kapolei, Hawaii and Salinas, Puerto Rico) allow us to efficiently meet the global demand for ferrous scrap metal by shipping bulk cargoes to steel manufacturers located in Europe, Asia, Central America and Africa. Our exports of nonferrous processed scrap metal are shipped in containers through various public docks to specialty steelmakers, foundries, aluminum sheet and ingot manufacturers, copper refineries and smelters, brass and bronze ingot manufacturers and wire and cable producers globally. We also transport both ferrous and nonferrous metals by truck and rail to meet regional domestic demand. In particular, our processing facilities in the Southeastern U.S. also provide efficient access to the automobile and steel manufacturing industries in that region.

Executive Overview of Financial Results for the Second Quarter of Fiscal 2012

In the second quarter of fiscal 2012, we generated consolidated revenues of \$887 million, an increase of 23% from the \$722 million of revenues achieved in the second quarter of fiscal 2011. The increase was primarily due to higher sales volumes achieved by each of our segments and incremental revenues from fiscal 2011 acquisitions of \$33 million.

Operating income for the quarter decreased by \$28 million, or 61%, to \$18 million when compared with the prior year quarter. Our results were adversely impacted by the significant market volatility and rapid decline in selling prices that occurred in the first quarter of fiscal 2012 caused mainly by an escalation in the European financial crisis. The carry over effect of these weaker conditions resulted in a compression of operating margins on shipments made in the early part of the second quarter of fiscal 2012. While selling prices rebounded in the second quarter compared to the first quarter's trough, they fluctuated due to cautious customer demand. The impact of a weak market environment together with the effect of mild winter weather conditions in the U.S., which eased customer concerns regarding availability of materials for sale, contributed to continuing softness in selling prices. As a result, operating margins of both MRB and APB declined from the prior year. In addition, selling, general and administrative ("SG&A") expenses increased by \$8 million, or 19%, primarily due to the absence in the current year of \$6 million of favorable customer contract settlements that were recorded in the second quarter of fiscal 2011.

The following items summarize our consolidated financial results for the second quarter of fiscal 2012:

- Revenues of \$887 million, compared to \$722 million in the second quarter of fiscal 2011;
- Operating income of \$18 million, compared to \$46 million in the second quarter of fiscal 2011;
- Net income attributable to SSI of \$10 million, or \$0.35 per share (diluted), compared to \$31 million, or \$1.10 per share (diluted), in the second quarter of fiscal 2011;
- Net cash provided by operating activities of \$41 million in the first six months of fiscal 2012, compared to \$20 million in the prior year; and
- Debt, net of cash, of \$362 million as of February 29, 2012, compared to \$354 million as of August 31, 2011 (see the reconciliation of Debt, net of cash in Non-GAAP Financial Measures at the end of this Item 2).

The following items highlight the financial results for our operating segments for the second quarter of fiscal 2012:

- MRB revenues and operating income of \$782 million and \$20 million, respectively, compared to \$637 million and \$42 million in the second quarter of fiscal 2011, respectively;
- APB revenues and operating income of \$78 million and \$9 million, respectively, compared to \$73 million and \$16 million in the second quarter of fiscal 2011, respectively; and
- SMB revenues and operating loss of \$85 million and \$(1) million, respectively, compared to \$70 million and \$(1) million in the second quarter of fiscal 2011, respectively.

SCHNITZER STEEL INDUSTRIES, INC.

Results of Operations

(\$ in thousands)	Three Months Ended			Six Months Ended				
	2/29/2012	2/28/2011	% Change	2/29/2012	2/28/2011	% Change		
Revenues:								
Metals Recycling Business	\$781,933	\$637,028	23	%	\$1,510,371	\$1,228,736	23	%
Auto Parts Business	78,232	72,533	8	%	162,285	139,214	17	%
Steel Manufacturing Business	84,523	70,068	21	%	164,424	133,703	23	%
Intercompany revenue eliminations ⁽¹⁾	(58,076)	(57,787)	1	%	(138,293)	(104,707)	32	%
Total revenues	886,612	721,842	23	%	1,698,787	1,396,946	22	%
Cost of goods sold:								
Metals Recycling Business	735,844	577,363	27	%	1,422,300	1,123,051	27	%
Auto Parts Business	55,562	44,410	25	%	115,021	85,639	34	%
Steel Manufacturing Business	83,576	68,955	21	%	160,581	133,173	21	%
Intercompany cost of goods sold eliminations ⁽¹⁾	(57,895)	(57,872)	—	%	(138,599)	(106,461)	30	%
Total cost of goods sold	817,087	632,856	29	%	1,559,303	1,235,402	26	%
SG&A expense:								
Metals Recycling Business	27,004	18,943	43	%	56,869	40,390	41	%
Auto Parts Business	13,962	12,166	15	%	28,114	23,579	19	%
Steel Manufacturing Business	1,815	1,824	—	%	3,494	3,276	7	%
Corporate ⁽²⁾	9,589	11,100	(14	)%	19,885	21,663	(8)%
Total SG&A expense	52,370	44,033	19	%	108,362	88,908	22	%
Income from joint ventures:								
Metals Recycling Business	(867)	(969)	(11	)%	(1,849)	(1,930)	(4)%
Change in intercompany profit elimination ⁽³⁾	35	(15)	NM		16	189	(92)%
Total joint venture income	(832)	(984)	(15	)%	(1,833)	(1,741)	5	%
Operating income (loss):								
Metals Recycling Business	19,952	41,691	(52	)%	33,051	67,225	(51)%
Auto Parts Business	8,708	15,957	(45	)%	19,150	29,996	(36)%
Steel Manufacturing Business	(868)	(711)	22	%	349	(2,746)	NM	
Corporate expense	(9,589)	(11,100)	(14	)%	(19,885)	(21,663)	(8)%
Change in intercompany profit elimination ⁽⁴⁾								