

SCHNITZER STEEL INDUSTRIES INC

Form 10-Q

January 08, 2015

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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 November 30, 2014

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.)

299 SW Clay St., Suite 350

Portland, OR

(Address of principal executive offices)

(503) 224-9900

(Registrant's telephone number, including area code)

97201

(Zip 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 26,478,539 shares of Class A common stock, par value of \$1.00 per share, and 305,900 shares of Class B common stock, par value of \$1.00 per share, outstanding as of January 5, 2015.

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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,<br>2014 | August 31,<br>2014 |
|---|----------------------|--------------------|
| Assets  |                      |                    |
| Current assets:   |                      |                    |
| Cash and cash equivalents   | \$14,666             | \$25,672           |
| Accounts receivable, net of allowance for doubtful accounts of \$2,672 and \$2,720                                | 155,597              | 189,359            |
| Inventories   | 244,268              | 216,172            |
| Deferred income taxes   | 10,281               | 6,865              |
| Refundable income taxes   | 3,871                | 1,756              |
| Prepaid expenses and other current assets   | 21,915               | 24,108             |
| Total current assets  | 450,598              | 463,932            |
| Property, plant and equipment, net of accumulated depreciation of \$669,903 and \$659,872                         | 507,970              | 523,433            |
| Investments in joint venture partnerships   | 15,021               | 14,624             |
| Goodwill  | 322,956              | 325,903            |
| Intangibles, net of accumulated amortization of \$10,476 and \$15,612   | 8,968                | 9,835              |
| Other assets  | 16,663               | 17,483             |
| Total assets  | \$1,322,176          | \$1,355,210        |
| Liabilities and Equity  |                      |                    |
| Current liabilities:  |                      |                    |
| Short-term borrowings   | \$471                | \$523              |
| Accounts payable  | 73,558               | 103,453            |
| Accrued payroll and related liabilities   | 20,302               | 32,127             |
| Environmental liabilities   | 1,127                | 1,062              |
| Accrued income taxes  | 42                   | 3,202              |
| Other accrued liabilities   | 39,447               | 36,903             |
| Total current liabilities   | 134,947              | 177,270            |
| Deferred income taxes   | 25,911               | 22,746             |
| Long-term debt, net of current maturities   | 340,355              | 318,842            |
| Environmental liabilities, net of current portion   | 47,026               | 47,287             |
| Other long-term liabilities   | 13,090               | 13,088             |
| Total liabilities   | 561,329              | 579,233            |
| Commitments and contingencies (Note 5)  |                      |                    |
| 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, 26,477 and 26,384 shares issued and outstanding | 26,477               | 26,384             |
| Class B common stock – 25,000 shares \$1.00 par value authorized, 306 and 306 shares issued and outstanding       | 306                  | 306                |
| Additional paid-in capital  | 19,952               | 19,164             |
| Retained earnings   | 729,971              | 737,571            |
| Accumulated other comprehensive loss  | (20,785)             | (12,641)           |
| Total SSI shareholders' equity  | 755,921              | 770,784            |
| Noncontrolling interests  | 4,926                | 5,193              |

|                              |             |             |
|------------------------------|-------------|-------------|
| Total equity                 | 760,847     | 775,977     |
| Total liabilities and equity | \$1,322,176 | \$1,355,210 |

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

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

|   | Three Months Ended November 30, |            |
|---|---------------------------------|------------|
|   | 2014                            | 2013       |
| Revenues  | \$555,590                       | \$587,745  |
| Operating expense:                                  |                                 |            |
| Cost of goods sold                                  | 510,022                         | 542,417    |
| Selling, general and administrative                 | 45,367                          | 47,550     |
| Income from joint ventures                          | (500                            | ) (409     |
| Restructuring charges and other exit-related costs  | 623                             | 1,812      |
| Operating income (loss)                             | 78                              | (3,625     |
| Interest expense                                    | (2,424                          | ) (2,702   |
| Other income, net                                   | 753                             | 176        |
| Loss before income taxes                            | (1,593                          | ) (6,151   |
| Income tax (expense) benefit                        | (8                              | ) 784      |
| Net loss  | (1,601                          | ) (5,367   |
| Net income attributable to noncontrolling interests | (871                            | ) (861     |
| Net loss attributable to SSI                        | \$(2,472                        | ) \$(6,228 |
| Net loss per share attributable to SSI:             |                                 |            |
| Basic   | \$(0.09                         | ) \$(0.23  |
| Diluted   | \$(0.09                         | ) \$(0.23  |
| Weighted average number of common shares:           |                                 |            |
| Basic   | 26,944                          | 26,755     |
| Diluted   | 26,944                          | 26,755     |
| Dividends declared per common share                 | \$0.1875                        | \$0.1875   |

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

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SCHNITZER STEEL INDUSTRIES, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 (Unaudited, in thousands)

|  | Three Months Ended November |            |   |
|--|-----------------------------|------------|---|
|  | 30,                         | 2013       |   |
|  | 2014                        | 2013       |   |
| Net loss   | \$(1,601                    | ) \$(5,367 | ) |
| Other comprehensive income (loss), net of tax:           |                             |            |   |
| Foreign currency translation adjustments                 | (7,272                      | ) (891     | ) |
| Cash flow hedges, net                                    | (908                        | ) 121      |   |
| Pension obligations, net                                 | 36                          | 44         |   |
| Total other comprehensive loss, net of tax               | (8,144                      | ) (726     | ) |
| Comprehensive loss                                       | (9,745                      | ) (6,093   | ) |
| Less net income attributable to noncontrolling interests | (871                        | ) (861     | ) |
| Comprehensive loss attributable to SSI                   | \$(10,616                   | ) \$(6,954 | ) |

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

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

|   | Three Months Ended November 30, |             |
|---|---------------------------------|-------------|
|   | 2014                            | 2013        |
| Cash flows from operating activities:   |                                 |             |
| Net loss  | \$(1,601)                       | ) \$(5,367) |
| Adjustments to reconcile net loss to cash (used in) provided by operating activities: |                                 |             |
| Depreciation and amortization   | 18,883                          | 21,019      |
| Deferred income taxes   | 101                             | (317)       |
| Undistributed equity in earnings of joint ventures                                    | (500)                           | ) (409)     |
| Share-based compensation expense  | 2,932                           | 3,868       |
| Excess tax benefit from share-based payment arrangements                              | (65)                            | ) (20)      |
| Gain on disposal of assets  | (436)                           | ) (304)     |
| Unrealized foreign exchange (gain) loss, net  | (454)                           | ) 342       |
| Bad debt expense (recoveries), net  | (19)                            | ) 856       |
| Changes in assets and liabilities, net of acquisitions:                               |                                 |             |
| Accounts receivable   | 30,577                          | 57,375      |
| Inventories   | (25,774)                        | ) (39,083)  |
| Income taxes  | (6,074)                         | ) (1,949)   |
| Prepaid expenses and other current assets   | 2,391                           | (181)       |
| Intangibles and other long-term assets  | 179                             | 90          |
| Accounts payable  | (24,851)                        | ) (4,404)   |
| Accrued payroll and related liabilities   | (11,722)                        | ) (4,284)   |
| Other accrued liabilities   | 260                             | (1,730)     |
| Environmental liabilities   | 350                             | (306)       |
| Other long-term liabilities   | (376)                           | ) 2         |
| Distributed equity in earnings of joint ventures                                      | 145                             | 645         |
| Net cash (used in) provided by operating activities                                   | (16,054)                        | ) 25,843    |
| Cash flows from investing activities:   |                                 |             |
| Capital expenditures  | (10,027)                        | ) (14,380)  |
| Joint venture payments, net   | —                               | (63)        |
| Proceeds from sale of assets  | 883                             | 673         |
| Acquisitions, net of cash acquired  | —                               | (2,147)     |
| Net cash used in investing activities   | (9,144)                         | ) (15,917)  |
| Cash flows from financing activities:   |                                 |             |
| Proceeds from line of credit  | 48,000                          | 147,500     |
| Repayment of line of credit   | (48,000)                        | ) (156,000) |
| Borrowings from long-term debt  | 70,848                          | 119,269     |
| Repayment of long-term debt   | (49,192)                        | ) (98,472)  |
| Taxes paid related to net share settlement of share-based payment arrangements        | (1,343)                         | ) (628)     |
| Excess tax benefit from share-based payment arrangements                              | 65                              | 20          |
| Stock options exercised   | —                               | 11          |
| Distributions to noncontrolling interest  | (1,138)                         | ) (495)     |
| Dividends paid  | (5,063)                         | ) (4,990)   |
| Net cash provided by financing activities   | 14,177                          | 6,215       |
| Effect of exchange rate changes on cash   | 15                              | 312         |
| Net (decrease) increase in cash and cash equivalents                                  | (11,006)                        | ) 16,453    |

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|   |           |           |
|---|-----------|-----------|
| Cash and cash equivalents as of beginning of period | 25,672    | 13,481    |
| Cash and cash equivalents as of end of period       | \$ 14,666 | \$ 29,934 |

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

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SCHNITZER STEEL INDUSTRIES, INC.

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 data 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 statement 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, 2014. The results for the three months ended November 30, 2014 and 2013 are not necessarily indicative of the results of operations for the entire fiscal year.

Accounting Changes

In July 2013, an accounting standards update was issued that clarifies the financial statement presentation of certain unrecognized tax benefits. The amendments require that an unrecognized tax benefit be presented as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent that such carryforwards and losses are not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, in which case the unrecognized tax benefit should be presented in the financial statements as a liability. The Company adopted the new requirement in the first quarter of fiscal 2015 with no significant impact to the Condensed Consolidated Financial Statements.

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 representing outstanding checks in excess of funds on deposit of \$18 million and \$35 million as of November 30, 2014 and August 31, 2014, respectively.

Other Assets

The Company’s other assets, exclusive of prepaid expenses, consist primarily of receivables from insurers, notes and other contractual receivables, and assets held for sale. Other assets are reported within either prepaid expenses and other current assets or other assets in the Condensed Consolidated Balance Sheets based on their expected use either during or beyond the current operating cycle of one year from the reporting date. As of August 31, 2014, other assets were reported net of an allowance for credit losses on notes and other contractual receivables of \$8 million. During the first quarter of fiscal 2015, the contractual receivables against which the \$8 million allowance for credit losses was recorded were written off. As of November 30, 2014 and August 31, 2014, the Company reported \$3 million of assets held for sale within prepaid expenses and other current assets in the Condensed Consolidated Balance Sheets.

Derivative Financial Instruments

The Company records derivative instruments in prepaid expenses and other current assets or other accrued liabilities in the Condensed Consolidated Balance Sheets at fair value, and changes in the fair value are either recognized in other comprehensive income (loss) in the Condensed Consolidated Statements of Comprehensive Loss or net income (loss) in the Condensed Consolidated Statements of Operations, 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 loss are reclassified to earnings in the period in which earnings are impacted by the hedged items, in the period that the hedged transaction is deemed no longer likely to occur, or in the period that the derivative is terminated. 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 derivative instrument's fair value. The fair value of these

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SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

instruments is a function of underlying forward commodity prices or foreign currency exchange rates, related volatility, counterparty creditworthiness and duration of the contracts. Cash flows from derivatives are recognized in the Condensed Consolidated Statements of Cash Flows in a manner consistent with the underlying transactions. See Note 9 - Derivative Financial Instruments for further detail.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents, accounts receivable, notes and other contractual receivables and derivative financial instruments. The majority of cash and cash equivalents are maintained with two major financial institutions (Bank of America and Wells Fargo Bank, N.A.). Balances with these institutions exceeded the Federal Deposit Insurance Corporation insured amount of \$250,000 as of November 30, 2014. 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 or other collateral, 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 \$70 million and \$74 million of open letters of credit relating to accounts receivable as of November 30, 2014 and August 31, 2014, respectively. The counterparties to the Company's derivative financial instruments are major financial institutions.

Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, debt and derivative contracts. The Company uses the market approach to value its financial assets and liabilities, determined using available market information. The net carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term nature of these instruments. For long-term debt, which is primarily at variable interest rates, fair value is estimated using observable inputs (Level 2) and approximates its carrying value. Derivative contracts are reported at fair value. See Note 9 - Derivative Financial Instruments for further detail.

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.

Restructuring Charges

Restructuring charges consist of severance, contract termination and other restructuring-related costs. A liability for severance costs is typically recognized when the plan of termination has been communicated to the affected employees and is measured at its fair value at the communication date. Contract termination costs consist primarily of costs that will continue to be incurred under operating leases for their remaining terms without economic benefit to the Company. A liability for contract termination costs is recognized at the date the Company ceases using the rights conveyed by the lease contract and is measured at its fair value, which is determined based on the remaining contractual lease rentals reduced by estimated sublease rentals. A liability for other restructuring-related costs is measured at its fair value in the period in which the liability is incurred. See Note 6 - Restructuring Charges and Other Exit-Related Costs for further detail.

Note 2 - Recent Accounting Pronouncements

In April 2014, an accounting standard update was issued that amends the requirements for reporting discontinued operations, which may include a component of an entity or a group of components of an entity. The amendments limit discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have, or will have, a major effect on an entity's operations and financial results. The amendments require expanded disclosure about the assets, liabilities, revenues and expenses of discontinued operations. Further, the amendments require an entity to disclose the pretax profit or loss of an individually significant component that is being disposed of that does not qualify for discontinued operations reporting. The standard is applicable to the Company and is to be applied prospectively to all disposals or classifications as held for sale of components that occur

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SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

beginning in the first quarter of fiscal 2016, and interim periods within that fiscal year, and all businesses that, on acquisition, are classified as held for sale that occur beginning in the first quarter of fiscal 2016, and interim periods within that fiscal year. Upon adoption, the standard will impact how the Company assesses and reports discontinued operations.

In May 2014, an accounting standard update was issued that clarifies the principles for recognizing revenue. The guidance is applicable to all contracts with customers regardless of industry-specific or transaction-specific fact patterns. Further, the guidance requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. The standard is effective for the Company beginning in the first quarter of fiscal 2018, including interim periods within that fiscal year. Early application is not permitted. Upon becoming effective, the Company will apply the amendments in the updated standard either retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application. The Company is evaluating the impact of adopting this standard on its consolidated financial position, results of operations and cash flows.

## Note 3 - Inventories

Inventories consisted of the following (in thousands):

|                                       | November 30,<br>2014 | August 31, 2014 |
|---------------------------------------|----------------------|-----------------|
| Processed and unprocessed scrap metal | \$129,294            | \$106,877       |
| Semi-finished goods (billets)         | 11,875               | 12,920          |
| Finished goods                        | 64,460               | 59,039          |
| Supplies                              | 38,639               | 37,336          |
| Inventories                           | \$244,268            | \$216,172       |

## Note 4 - Goodwill

The Company tests the goodwill in each of its reporting units annually on July 1 and upon the occurrence of certain triggering events or substantive changes in circumstances that indicate that the fair value of goodwill may be impaired. There were no triggering events identified during the first quarter of fiscal 2015 requiring an interim goodwill impairment test. A lack of recovery of market conditions in the metals recycling industry from current levels, a sustained trend of weaker than anticipated Company financial performance including the pace and extent of operating margin and volume recovery, a lack of recovery or further decline in the Company's share price from current levels for a sustained period of time, or an increase in the market-based weighted average cost of capital, among other factors, could significantly impact the impairment analysis and may result in future goodwill impairment charges that, if incurred, could have a material adverse effect on the Company's financial condition and results of operations.

The gross changes in the carrying amount of goodwill by reporting segment for the three months ended November 30, 2014 were as follows (in thousands):

|   | Metals Recycling<br>Business | Auto Parts<br>Business | Total     |
|---|------------------------------|------------------------|-----------|
| Balance as of August 31, 2014           | \$146,108                    | \$179,795              | 325,903   |
| Foreign currency translation adjustment | (1,717                       | ) (1,230               | ) (2,947  |
| Balance as of November 30, 2014         | \$144,391                    | \$178,565              | \$322,956 |

Accumulated goodwill impairment charges were \$321 million as of November 30, 2014 and August 31, 2014.

## Note 5 - 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.

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Changes in the Company's environmental liabilities for the three months ended November 30, 2014 were as follows (in thousands):

| Reporting Segment         | Balance as of<br>August 31,<br>2014 | Liabilities<br>Established<br>(Released), Net | Payments<br>and Other | Balance as of<br>November 30,<br>2014 | Short-Term | Long-Term |
|---------------------------|-------------------------------------|---|-----------------------|---------------------------------------|------------|-----------|
| Metals Recycling Business | \$30,139                            | \$195   | \$(331 )              | \$30,003                              | \$496      | \$29,507  |
| Auto Parts Business       | 17,822                              | —   | (49 )                 | 17,773                                | 554        | 17,219    |
| Corporate                 | 388                                 | —   | (11 )                 | 377                                   | 77         | 300       |
| Total                     | \$48,349                            | \$195   | \$(391 )              | \$48,153                              | \$1,127    | \$47,026  |

## Metals Recycling Business ("MRB")

As of November 30, 2014, MRB had environmental liabilities of \$30 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.

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 the 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 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 is being revised by the EPA and the revisions may be significant and could materially impact the scope or cost of remediation. 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 2017 or commence remediation activities until 2024. Responsibility for implementing and funding the EPA's selected remedy will be determined in a separate allocation process, which is currently underway.

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 and liquidity. Among the facts currently not known or available

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SCHNITZER STEEL INDUSTRIES, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 November 30, 2014, the Company had environmental liabilities related to various MRB sites other than Portland Harbor of \$29 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.

**Auto Parts Business ("APB")**

As of November 30, 2014, the Company had environmental liabilities related to various APB sites of \$18 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.

**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 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 has since been renewed through February 1, 2018.

SMB had no environmental liabilities as of November 30, 2014.

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, the Company is party to various legal proceedings arising in the normal course of business. Management believes that adequate provisions have been made for these contingencies. The Company does not anticipate that the resolution of legal proceedings arising in the normal course of business will have a material adverse effect on its results of operations, financial condition, or cash flows.

Note 6 - Restructuring Charges and Other Exit-Related Costs

In the fourth quarter of fiscal 2012, the Company undertook a number of restructuring initiatives designed to extract greater synergies from the significant acquisitions and technology investments made in recent years, achieve further integration between MRB and APB, and realign the Company's organization to support its future growth and decrease operating expenses by streamlining functions and reducing organizational layers (the "Q4'12 Plan").

In the first quarter of fiscal 2014, the Company announced and began implementing additional restructuring initiatives to further reduce its annual operating expenses through headcount reductions, productivity improvements, procurement savings and other operational efficiencies (the "Q1'14 Plan").

In the first quarter of fiscal 2015, the Company announced and began implementing additional productivity initiatives at APB to improve profitability through a combination of revenue drivers and cost reduction initiatives (the "Q1'15 Plan").

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In addition to the restructuring charges recorded in connection with these initiatives, the Company incurred other exit-related costs consisting of asset impairments related to site closures. The Company did not incur other exit-related costs during the three months ended November 30, 2014 and 2013.

Restructuring charges were comprised of the following (in thousands):

|                                      | Three Months Ended November 30, 2014 |            |               | Three Months Ended November 30, 2013 |            |               |
|--------------------------------------|--------------------------------------|------------|---------------|--------------------------------------|------------|---------------|
|                                      | Q1'14 Plan                           | Q1'15 Plan | Total Charges | Q4'12 Plan                           | Q1'14 Plan | Total Charges |
| Restructuring charges:               |                                      |            |               |                                      |            |               |
| Severance costs                      | \$27                                 | \$—        | \$27          | \$26                                 | \$1,076    | \$1,102       |
| Contract termination costs           | 253                                  | —          | 253           | 462                                  | 38         | 500           |
| Other restructuring costs            | —                                    | 343        | 343           | —                                    | 210        | 210           |
| Total restructuring charges          | \$280                                | \$343      | \$623         | \$488                                | \$1,324    | \$1,812       |
|                                      |                                      |            | Total Charges |                                      |            |               |
|                                      |                                      |            | Q4'12 Plan    | Q1'14 Plan                           | Q1'15 Plan | Total         |
| Total restructuring charges to date  |                                      |            | \$13,549      | \$6,050                              | \$343      | \$19,942      |
| Total expected restructuring charges |                                      |            | \$13,550      | \$6,150                              | \$2,200    | \$21,900      |

The following illustrates the reconciliation of the restructuring liability by major type of costs for the three months ended November 30, 2014 (in thousands):

|                            | Q1'14 Plan        |         |                    | Q1'15 Plan         |                   |         | All Plans          |                    |                       |                        |
|----------------------------|-------------------|---------|--------------------|--------------------|-------------------|---------|--------------------|--------------------|-----------------------|------------------------|
|                            | Balance 8/31/2014 | Charges | Payments and Other | Balance 11/30/2014 | Balance 8/31/2014 | Charges | Payments and Other | Balance 11/30/2014 | Total Charges to Date | Total Expected Charges |
| Severance costs            | \$669             | \$27    | \$(294)            | \$402              | \$—               | \$—     | \$—                | \$—                | \$9,818               | \$10,700               |
| Contract termination costs | 500               | 253     | (167)              | 586                | —                 | —       | —                  | —                  | 5,306                 | 5,400                  |
| Other restructuring costs  | —                 | —       | —                  | —                  | —                 | 343     | —                  | 343                | 4,818                 | 5,800                  |
| Total                      | \$1,169           | \$280   | \$(461)            | \$988              | \$—               | \$343   | \$—                | \$343              | \$19,942              | \$21,900               |

The Q4'12 Plan was substantially completed in fiscal 2014 and all further activity is immaterial. As of November 30, 2014 and August 31, 2014, the restructuring liability for the Q4'12 Plan was \$1 million and related to contract terminations.

The amounts of restructuring charges and other exit-related costs relating to each segment were as follows (in thousands):

|                             | Three Months Ended |         | Total Charges to Date | Total Expected Charges |
|-----------------------------|--------------------|---------|-----------------------|------------------------|
|                             | November 30, 2014  | 2013    |                       |                        |
| Restructuring charges:      |                    |         |                       |                        |
| Metals Recycling Business   | \$255              | \$1,291 | \$8,934               | \$9,000                |
| Auto Parts Business         | 374                | 61      | 1,903                 | 3,750                  |
| Unallocated (Corporate)     | (6)                | ) 460   | 9,105                 | 9,150                  |
| Total restructuring charges | 623                | 1,812   | 19,942                | 21,900                 |
| Other exit-related costs:   |                    |         |                       |                        |

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|  |       |         |          |
|--|-------|---------|----------|
| Metals Recycling Business                                | —     | —       | 566      |
| Total exit-related costs                                 | —     | —       | 566      |
| Total restructuring charges and other exit-related costs | \$623 | \$1,812 | \$20,508 |

The Company does not allocate restructuring charges and other exit-related costs to the segments' operating results because management does not include this information in its measurement of the performance of the operating segments.

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## Note 7 - Changes in Equity

The following is a summary of the changes in equity for the three months ended November 30, 2014 and 2013 (in thousands):

|  | Fiscal 2015            |                          |              | Fiscal 2014            |                          |              |
|--|------------------------|--------------------------|--------------|------------------------|--------------------------|--------------|
|  | SSI Shareholder Equity | Noncontrolling Interests | Total Equity | SSI Shareholder Equity | Noncontrolling Interests | Total Equity |
| Balance - September 1 (Beginning of period)  | \$ 770,784             | \$ 5,193                 | \$ 775,977   | \$ 776,558             | \$ 4,641                 | \$ 781,199   |
| Net income (loss)  | (2,472)                | ) 871                    | (1,601)      | ) (6,228)              | ) 861                    | (5,367)      |
| Other comprehensive loss, net of tax   | (8,144)                | ) —                      | (8,144)      | ) (726)                | ) —                      | (726)        |
| Distributions to noncontrolling interests  | —                      | (1,138)                  | (1,138)      | ) —                    | (495)                    | (495)        |
| Restricted stock withheld for taxes  | (1,343)                | ) —                      | (1,343)      | ) (628)                | ) —                      | (628)        |
| Stock options exercised  | —                      | —                        | —            | 11                     | —                        | 11           |
| Share-based compensation   | 2,932                  | —                        | 2,932        | 3,868                  | —                        | 3,868        |
| Excess tax deficiency from stock options exercised and restricted stock units vested | (708)                  | ) —                      | (708)        | ) (589)                | ) —                      | (589)        |
| Dividends  | (5,128)                | ) —                      | (5,128)      | ) (5,002)              | ) —                      | (5,002)      |
| Balance - November 30 (End of period)  | \$ 755,921             | \$ 4,926                 | \$ 760,847   | \$ 767,264             | \$ 5,007                 | \$ 772,271   |

## Note 8 - Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss, net of tax, for the three months ended November 30, 2014 and 2013 were as follows:

|   | Fiscal 2015                              |                          |  |            | Fiscal 2014                              |                          |  |           |
|---|--|--------------------------|--|------------|--|--------------------------|--|-----------|
|   | Foreign Currency Translation Adjustments | Pension Obligations, net | Net Unrealized Gain (Loss) on Cash Flow Hedges | Total      | Foreign Currency Translation Adjustments | Pension Obligations, net | Net Unrealized Gain (Loss) on Cash Flow Hedges | Total     |
| Balances - September 1 (Beginning of period)                  | \$(10,663)                               | \$ (2,036)               | ) \$ 58  | \$(12,641) | \$(6,423)                                | ) \$ (2,817)             | ) \$(121)                                      | \$(9,361) |
| Other comprehensive loss before reclassifications             | (7,272)                                  | ) —                      | (1,712)  | (8,984)    | ) (891)                                  | ) —                      | —  | (891)     |
| Income tax benefit  | —  | —                        | 428  | 428        | —  | —                        | —  | —         |
| Other comprehensive loss before reclassifications, net of tax | (7,272)                                  | ) —                      | (1,284)  | (8,556)    | ) (891)                                  | ) —                      | —  | (891)     |
|   | —  | 49                       | 501  | 550        | —  | 69                       | 98   | 167       |

|   |             |            |          |             |            |            |     |            |
|---|-------------|------------|----------|-------------|------------|------------|-----|------------|
| Amounts reclassified<br>from accumulated other<br>comprehensive loss                |             |            |          |             |            |            |     |            |
| Income tax (benefit)<br>expense   | —           | (13 )      | (125 )   | (138 )      | —          | (25 )      | 23  | (2 )       |
| Amounts reclassified<br>from accumulated other<br>comprehensive loss, net<br>of tax | —           | 36         | 376      | 412         | —          | 44         | 121 | 165        |
| Net periodic other<br>comprehensive income<br>(loss)                                | (7,272 )    | 36         | (908 )   | (8,144 )    | (891 )     | 44         | 121 | (726 )     |
| Balances - November<br>30 (End of period)   | \$(17,935 ) | \$(2,000 ) | \$(850 ) | \$(20,785 ) | \$(7,314 ) | \$(2,773 ) | \$— | \$(10,087) |

Reclassifications from accumulated other comprehensive loss, both individually and in the aggregate, were immaterial to the impacted captions in the Unaudited Condensed Consolidated Statements of Operations.



The RSUs have a five-year term and vest 20% per year commencing October 31, 2015. The fair value of the RSUs granted was based on the market closing price of the underlying Class A common stock on the grant date and totaled \$6 million. The compensation expense associated with the RSUs is recognized over the requisite service period of the awards, net of forfeitures.

The performance-based awards have a two-year performance period consisting of the Company's fiscal 2015 and fiscal 2016. The performance targets are based on the Company's EBITDA (weighted at 50%) and return on equity (weighted at 50%) for the two years of the performance period, with award payouts ranging from a threshold of 50% to a maximum of 200% for each portion of the awards. Awards will be paid in Class A common stock as soon as practicable after October 31 following the end of the performance period. The estimated fair value of the performance-based awards at the date of grant was \$6 million.

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## Note 11 - Income Taxes

The effective tax rate for the Company's operations for the three months ended November 30, 2014 was an expense of 0.5% compared to a benefit of 12.7% for the three months ended November 30, 2013.

A reconciliation of the difference between the federal statutory rate and the Company's effective rate is as follows:

|  | Three Months Ended November 30, |                     |   |   |
|--|---------------------------------|---------------------|---|---|
|  | 2014 <sup>(1)</sup>             | 2013 <sup>(1)</sup> |   |   |
| Federal statutory rate                     | 35.0                            | % 35.0              |   | % |
| State taxes, net of credits                | —                               | 2.5                 |   |   |
| Foreign income taxed at different rates    | (28.5                           | ) (6.5              | ) | ) |
| Section 199 deduction                      | 0.1                             | (1.0                | ) | ) |
| Non-deductible officers' compensation      | —                               | 0.3                 |   |   |
| Noncontrolling interests                   | 0.1                             | (0.9                | ) | ) |
| Research and development credits           | —                               | (0.1                | ) | ) |
| Valuation allowance on deferred tax assets | (7.0                            | ) (17.0             | ) | ) |
| Unrecognized tax benefits                  | (0.2                            | ) —                 |   |   |
| Other                                      | —                               | 0.4                 |   |   |
| Effective tax rate                         | (0.5                            | )% 12.7             |   | % |

(1) For periods with reported pre-tax losses, the effect of reconciling items with positive signs is tax benefit in excess of the benefit calculated by applying the federal statutory rate to the pre-tax loss.

The effective tax rate for the first quarter of fiscal 2015 and 2014 was lower than the statutory rate primarily due to the impact of the financial performance of certain foreign operations, which are taxed at more favorable rates, and the impact of recording a full valuation allowance on the current period benefit associated with certain foreign operations losses.

The Company files federal and state income tax returns in the U.S. and foreign tax returns in Puerto Rico and Canada. For U.S. federal income tax returns, fiscal years 2011 to 2014 remain subject to examination and the income tax return for fiscal year 2012 is currently under examination. Canada and multiple state tax authorities are currently examining the Company's tax returns for fiscal years 2009 to 2012.

## Note 12 - Net Loss Per Share

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

|   | Three Months Ended November 30, |            |   |   |
|---|---------------------------------|------------|---|---|
|   | 2014                            | 2013       |   |   |
| Net loss  | \$(1,601                        | ) \$(5,367 | ) | ) |
| Net income attributable to noncontrolling interests   | (871                            | ) (861     | ) | ) |
| Net loss attributable to SSI  | \$(2,472                        | ) \$(6,228 | ) | ) |
| Computation of shares:  |                                 |            |   |   |
| Weighted average common shares outstanding, basic   | 26,944                          | 26,755     |   |   |
| Incremental common shares attributable to dilutive stock options, performance share awards, DSUs and RSUs | —                               | —          |   |   |
| Weighted average common shares outstanding, diluted   | 26,944                          | 26,755     |   |   |

Common stock equivalent shares of 1,365,414 and 1,106,990 were considered antidilutive and were excluded from the calculation of diluted net loss per share for the three months ended November 30, 2014 and 2013, respectively.

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NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Related Party Transactions

The Company purchases recycled metal from its joint venture operations at prices that approximate fair market value. These purchases totaled \$7 million for the three months ended November 30, 2014 and 2013. Amounts receivable from joint venture partners were \$1 million as of November 30, 2014 and August 31, 2014.

Thomas D. Klauer, Jr., who had been President of the Company's Auto Parts Business, prior to his retirement on January 5, 2015, 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 five 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, 2014 and 2013, respectively. The partnership leases properties from entities in which Mr. Klauer has ownership interests under agreements that expire in March 2016 with options to renew the leases, upon expiration, for multiple periods. The rent paid by the partnership to the entities in which Mr. Klauer has ownership interests was less than \$1 million for the three months ended November 30, 2014 and 2013.

Certain members of the Schnitzer family own significant interests in, or are related to owners of, MMGL Corp, ("MMGL," formerly known as Schnitzer Investment Corp.), which is engaged in the real estate business and was a subsidiary of the Company prior to 1989. MMGL is considered a related party for financial reporting purposes. The Company and MMGL are both potentially responsible parties with respect to Portland Harbor, which has been designated as a Superfund site since December 2000. The Company and MMGL 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 MMGL with respect to the Portland scrap metal operations property. The Company and MMGL have agreed to an equitable cost sharing arrangement with respect to defense costs under which MMGL will pay 50% of the legal and consulting costs, net of insurance recoveries. The amounts receivable from (payable to) MMGL vary from period to period because of the timing of incurring legal and consulting fees, payments for cost reimbursements and insurance recoveries. Amounts receivable from MMGL under this agreement were less than \$1 million and \$1 million as of November 30, 2014 and August 31, 2014.

Note 14 - Segment Information

The accounting standards for reporting information about operating segments define operating segments as components of an enterprise that engages in business activities from which it may earn revenues and incur expenses and for which discrete 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 market prices for shipments from the West Coast of the U.S. In addition, the Company has intersegment sales of autobodyes 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.

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 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. In addition, the Company does not allocate restructuring charges and other exit-related costs to the segment operating income because management does not include this information in its measurement of the performance of the operating segments. Because of this unallocated income

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

and expense, the operating income of each reporting segment does not reflect the operating income the reporting segment would report as a stand-alone business.

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

|                                | Three Months Ended November 30, |           |
|--------------------------------|---------------------------------|-----------|
|                                | 2014                            | 2013      |
| Revenues:                      |                                 |           |
| Metals Recycling Business:     |                                 |           |
| Revenues                       | \$456,278                       | \$490,309 |
| Less: Intersegment revenues    | (55,282)                        | (49,751)  |
| MRB external customer revenues | 400,996                         | 440,558   |
| Auto Parts Business:           |                                 |           |
| Revenues                       | 80,921                          | 79,635    |
| Less: Intersegment revenues    | (21,545)                        | (20,571)  |
| APB external customer revenues | 59,376                          | 59,064    |
| Steel Manufacturing Business:  |                                 |           |
| Revenues                       | 95,218                          | 88,123    |
| Total revenues                 | \$555,590                       | \$587,745 |

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

|  | Three Months Ended November 30, |           |
|--|---------------------------------|-----------|
|  | 2014                            | 2013      |
| Metals Recycling Business                          | \$1,922                         | \$590     |
| Auto Parts Business                                | 1,961                           | 5,609     |
| Steel Manufacturing Business                       | 6,207                           | 1,744     |
| Segment operating income                           | 10,090                          | 7,943     |
| Restructuring charges and other exit-related costs | (623)                           | (1,812)   |
| Corporate and eliminations                         | (9,389)                         | (9,756)   |
| Operating income (loss)                            | 78                              | (3,625)   |
| Interest expense                                   | (2,424)                         | (2,702)   |
| Other income, net                                  | 753                             | 176       |
| Loss before income taxes                           | \$(1,593)                       | \$(6,151) |

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

|  | November 30, 2014 | August 31, 2014 |
|--|-------------------|-----------------|
| Metals Recycling Business <sup>(1)</sup> | \$1,331,320       | \$1,343,771     |
| Auto Parts Business                      | 359,260           | 361,411         |
| Steel Manufacturing Business             | 356,348           | 350,344         |
| Total segment assets                     | 2,046,928         | 2,055,526       |
| Corporate and eliminations               | (724,752)         | (700,316)       |
| Total assets                             | \$1,322,176       | \$1,355,210     |

(1) MRB total assets include \$15 million as of November 30, 2014 and August 31, 2014 for investments in joint venture partnerships.



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## SCHNITZER STEEL INDUSTRIES, INC.

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

This section includes a discussion of our operations for the three months ended November 30, 2014 and 2013. 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, 2014 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, which may include statements regarding trends, cyclicalities and changes in the markets we sell into; strategic direction; changes to manufacturing and production processes; the cost of and the status of any agreements or actions related to our 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; benefits, savings or additional costs from business realignment, cost containment and productivity improvement 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 reports filed with the Securities and Exchange Commission, 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 of our most recent annual report on Form 10-K.

Examples of these risks include: potential environmental cleanup costs related to the Portland Harbor Superfund site; the impact of general economic conditions; 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 impact of long-lived asset impairment charges; the realization of expected cost reductions related to restructuring initiatives; the benefit of business realignment, cost containment and productivity improvement programs and initiatives; the inability of customers to fulfill their contractual obligations; the impact of foreign currency fluctuations; potential limitations on our ability to access capital resources and existing credit facilities; restrictions on our business and financial covenants under our bank credit agreement; 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; impact of equipment upgrades and failures on production; product liability claims; the impact of impairment of our deferred tax assets; the impact of a cybersecurity incident; 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.



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## SCHNITZER STEEL INDUSTRIES, INC.

## General

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

We operate in three reporting segments: the Metals Recycling Business ("MRB"), the Auto Parts Business ("APB") and the Steel Manufacturing Business ("SMB"), which collectively provide an end-of-life cycle solution for a variety of products through our integrated businesses. We use operating income to measure our segments' performance.

Restructuring charges and other exit-related costs are not allocated to segment operating income because we do not include this information in our measurement of the segments' 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 of each reporting segment does not reflect the operating income the reporting segment would report as a stand-alone business. For further information regarding our reporting segments, see Note 14 - Segment Information in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report.

Our results of operations depend in large part on the demand and prices for recycled metal in foreign and domestic markets and on the supply of raw materials, including end-of-life vehicles, available to be processed at our facilities. Our deep water port facilities on both the East and West Coasts of the U.S. (in Everett, Massachusetts; Providence, Rhode Island; Oakland, California; Portland, Oregon; and Tacoma, Washington) and access to public deep water port facilities (in Kapolei, Hawaii; and Salinas, Puerto Rico) allow us to efficiently meet the global demand for recycled ferrous metal by shipping bulk cargoes to steel manufacturers located in Asia, Europe, Africa, the Middle East ("EAME"), and Central America. Our exports of nonferrous recycled 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, rail and barge in order to transfer scrap metal between our facilities for further processing, to load shipments at our export facilities and to meet regional domestic demand.

## Executive Overview of Financial Results for the First Quarter of Fiscal 2015

We generated consolidated revenues of \$556 million in the first quarter of fiscal 2015, a decrease of 5% from the \$588 million of consolidated revenues in the first quarter of fiscal 2014. Overall consolidated revenues decreased primarily due to lower average net selling prices for ferrous metal and reduced sales volumes of export ferrous metal as a result of continued weak market conditions. Weak export demand for ferrous metal resulted primarily from a combination of global steelmaking overcapacity and a strengthening of the U.S. currency during the period. These impacts were only partially offset by higher average selling prices for our finished steel products compared to the prior year period. Consolidated operating income was slightly above break-even in the first quarter of fiscal 2015, compared to a consolidated operating loss of \$4 million in the first quarter of fiscal 2014. Adjusted consolidated operating income in the first quarter of fiscal 2015, which excludes the impact of reselling or modifying the terms of certain previously contracted bulk ferrous shipments and restructuring and other exit-related costs, was \$6 million compared to an adjusted consolidated operating loss of \$2 million in the first quarter of fiscal 2014 (see the reconciliation of adjusted consolidated operating income (loss) in Non-GAAP Financial Measures at the end of Item 2). Export net selling prices for shipments of recycled ferrous metal in the first quarter of fiscal 2015 declined sharply by approximately \$80 per ton, or 20%, compared to the end of the fourth quarter of fiscal 2014 due to weaker global demand. In an environment of declining commodity selling prices as experienced in the first quarter of fiscal 2015, average inventory costs did not decrease as quickly as purchase costs for raw materials, resulting in a substantial adverse effect on cost of goods sold and compression of operating margins at MRB and APB. The lower price environment during the quarter also adversely impacted the supply of scrap metal, which led to lower processed volumes further compressing operating margins at MRB. In the first quarter of fiscal 2015, the operating results of MRB were adversely impacted by \$6 million from the resale or modification of the terms, each at significantly lower prices, of certain previously contracted ferrous bulk shipments for delivery during the quarter. These adverse effects were partially offset by the benefits from productivity initiatives, primarily at MRB, and an increase in operating income at SMB of \$4 million primarily as a

result of higher selling prices for finished steel products and higher rolling mill utilization. The combination of these effects resulted in improved consolidated operating results in the first quarter of fiscal 2015 compared to the prior year quarter. Consolidated operating results in the first quarter of fiscal 2014 also included \$1 million of operating losses related to store locations acquired or opened by APB during the prior twelve months and the recognition of bad debt expense of \$1 million by SMB.

In fiscal 2014, we implemented restructuring and productivity initiatives to reduce our annual operating expenses by approximately \$40 million, with the full annual benefit expected to be achieved in fiscal 2015. In the first quarter of fiscal 2015, we achieved a benefit of approximately \$10 million, compared to a benefit of approximately \$4 million in the prior year period. The reduction in expenses was from a combination of headcount reductions, implementation of operational efficiencies, reduced lease costs and other productivity improvements. We initiated and implemented additional productivity initiatives at APB in the first quarter of

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SCHNITZER STEEL INDUSTRIES, INC.

fiscal 2015 to improve profitability through a combination of revenue drivers and cost reduction initiatives. In addition to the measures announced in October 2014 with a targeted annual improvement of \$7 million, we have identified incremental cost reduction and productivity initiatives aimed at reducing selling, general and administrative ("SG&A") expense and have increased the overall targeted annual improvement at APB to \$14 million, with approximately 50% of that amount expected to benefit fiscal 2015, primarily in the second half, and the full annual run rate expected to be achieved in fiscal 2016.

The following items summarize our consolidated financial results for the first quarter of fiscal 2015:

• Revenues of \$556 million, compared to \$588 million in the first quarter of fiscal 2014;

• Slightly above break-even operating results, compared to an operating loss of \$4 million in the first quarter of fiscal 2014;

• Adjusted operating income of \$6 million, compared to adjusted operating loss of \$2 million in the first quarter of fiscal 2014 (see reconciliation of adjusted consolidated operating income (loss) in Non-GAAP Financial Measures at the end of Item 2);

• Net loss attributable to SSI of \$2 million, or \$(0.09) per diluted share, compared to net loss attributable to SSI of \$6 million, or \$(0.23) per diluted share, in the first quarter of fiscal 2014;

• Adjusted net income attributable to SSI of \$2 million, or \$0.08 per diluted share, compared to adjusted net loss attributable to SSI of \$5 million, or \$(0.18) per diluted share, in the first quarter of fiscal 2014 (see the reconciliation of adjusted net income (loss) and adjusted diluted earnings per share in Non-GAAP Financial Measures at the end of Item 2);

• Net cash used in operating activities of \$16 million, compared to net cash provided by operating activities of \$26 million in the prior year period; and

• Debt, net of cash, of \$326 million as of November 30, 2014, compared to \$294 million as of August 31, 2014 (see the reconciliation of debt, net of cash in Non-GAAP Financial Measures at the end of Item 2).

The following items highlight the financial results for our reporting segments for the first quarter of fiscal 2015:

• MRB revenues and operating income of \$456 million and \$2 million, respectively, compared to \$490 million and \$1 million, respectively, in the first quarter of fiscal 2014;

• APB revenues and operating income of \$81 million and \$2 million, respectively, compared to \$80 million and \$6 million, respectively, in the first quarter of fiscal 2014; and

• SMB revenues and operating income of \$95 million and \$6 million, respectively, compared to \$88 million and \$2 million, respectively, in the first quarter of fiscal 2014.

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## SCHNITZER STEEL INDUSTRIES, INC.

## Results of Operations

| (\$ in thousands)   | Three Months Ended November 30, |            |          |
|---|---------------------------------|------------|----------|
|   | 2014                            | 2013       | % Change |
| Revenues:   |                                 |            |          |
| Metals Recycling Business   | \$456,278                       | \$490,309  | (7)%     |
| Auto Parts Business   | 80,921                          | 79,635     | 2%       |
| Steel Manufacturing Business                                      | 95,218                          | 88,123     | 8%       |
| Intercompany revenue eliminations <sup>(1)</sup>                  | (76,827 )                       | (70,322 )  | 9%       |
| Total revenues  | 555,590                         | 587,745    | (5)%     |
| Cost of goods sold:   |                                 |            |          |
| Metals Recycling Business   | 433,879                         | 468,601    | (7)%     |
| Auto Parts Business   | 65,298                          | 59,383     | 10%      |
| Steel Manufacturing Business                                      | 87,304                          | 83,680     | 4%       |
| Intercompany cost of goods sold eliminations <sup>(1)</sup>       | (76,459 )                       | (69,247 )  | 10%      |
| Total cost of goods sold  | 510,022                         | 542,417    | (6)%     |
| Selling, general and administrative expense:                      |                                 |            |          |
| Metals Recycling Business   | 21,004                          | 21,483     | (2)%     |
| Auto Parts Business   | 13,662                          | 14,643     | (7)%     |
| Steel Manufacturing Business                                      | 1,707                           | 2,699      | (37)%    |
| Corporate <sup>(2)</sup>  | 8,994                           | 8,725      | 3%       |
| Total selling, general and administrative expense                 | 45,367                          | 47,550     | (5)%     |
| (Income) loss from joint ventures:                                |                                 |            |          |
| Metals Recycling Business   | (527 )                          | (365 )     | 44%      |
| Change in intercompany profit elimination <sup>(3)</sup>          | 27                              | (44 )      | NM       |
| Total income from joint ventures                                  | (500 )                          | (409 )     | 22%      |
| Operating income:   |                                 |            |          |
| Metals Recycling Business   | 1,922                           | 590        | 226%     |
| Auto Parts Business   | 1,961                           | 5,609      | (65)%    |
| Steel Manufacturing Business                                      | 6,207                           | 1,744      | 256%     |
| Segment operating income  | 10,090                          | 7,943      | 27%      |
| Restructuring charges and other exit-related costs <sup>(4)</sup> | (623 )                          | (1,812 )   | (66)%    |
| Corporate expense <sup>(2)</sup>                                  | (8,994 )                        | (8,725 )   | 3%       |
| Change in intercompany profit elimination <sup>(5)</sup>          | (395 )                          | (1,031 )   | (62)%    |
| Total operating income (loss)                                     | \$78                            | \$(3,625 ) | NM       |

MRB sells ferrous recycled metal to SMB at rates per ton that approximate U.S. West Coast market prices. In

(1) addition, APB sells ferrous and nonferrous material to MRB at prices that approximate local market rates. These intercompany revenues and cost of goods sold are eliminated in consolidation.

Corporate expense consists primarily of unallocated expenses for services that benefit all three reporting segments.

(2) As a consequence of this unallocated expense, the operating income of each segment does not reflect the operating income the segment would have as a stand-alone business.

The joint ventures sell recycled metal to MRB and to SMB at prices that approximate local market rates, which

(3) produces intercompany profit. This intercompany profit is eliminated while the products remain in inventory and is not recognized until the finished products are sold to third parties.

Restructuring charges consist of expense for severance, contract termination and other restructuring costs that

(4) management does not include in its measurement of the performance of the operating segments. Other exit-related costs consist of asset impairments related to site closures.

(5) Intercompany profits are not recognized until the finished products are sold to third parties; therefore, intercompany profit is eliminated while the products remain in inventory.



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## SCHNITZER STEEL INDUSTRIES, INC.

## Revenues

Consolidated revenues in the first quarter of fiscal 2015 were \$556 million, a decrease of 5% compared to the same period in the prior year. The decrease was primarily due to lower average net selling prices for ferrous metal and reduced sales volumes of export ferrous metal as a result of continued weak market conditions. Weak export demand for ferrous metal resulted primarily from a combination of global steelmaking overcapacity and a strengthening of the U.S. currency during the period. These impacts were only partially offset by higher average selling prices for our finished steel products compared to the prior year period.

## Operating Income

Consolidated operating income in the first quarter of fiscal 2015 was slightly above break-even compared to a consolidated operating loss of \$4 million in the same period in the prior year. Adjusted consolidated operating income in the first quarter of fiscal 2015, which excludes the impact of reselling or modifying the terms of certain previously contracted bulk ferrous shipments and restructuring and other exit-related costs, was \$6 million compared to an adjusted consolidated operating loss of \$2 million in the first quarter of fiscal 2014 (see reconciliation of adjusted consolidated operating income (loss) in Non-GAAP Financial Measures at the end of Item 2). Export net selling prices for shipments of recycled ferrous metal in the first quarter of fiscal 2015 declined sharply by approximately \$80 per ton, or 20%, compared to the end of the fourth quarter of fiscal 2014 due to weaker global demand. In an environment of declining commodity selling prices as experienced in the first quarter of fiscal 2015, average inventory costs did not decrease as quickly as purchase costs for raw materials, resulting in a substantial adverse effect on cost of goods sold and compression of operating margins at MRB and APB. The lower price environment during the quarter also adversely impacted the supply of scrap metal, which led to lower processed volumes further compressing operating margins at MRB. In the first quarter of fiscal 2015, the operating results of MRB were adversely impacted by \$6 million from the resale or modification of the terms, each at significantly lower prices, of certain previously contracted ferrous bulk shipments for delivery during the quarter. Due to the sharp decline in selling prices that occurred during the first quarter of fiscal 2015, the revised prices associated with these shipments were significantly lower than the prices in the original sales contracts entered into between August and October 2014. These adverse effects were partially offset by the benefits from productivity and cost saving initiatives on cost of goods sold and SG&A expense and an increase in operating income at SMB of \$4 million primarily as a result of higher selling prices for finished steel products and higher rolling mill utilization. The combination of these effects resulted in improved consolidated operating results in the first quarter of fiscal 2015 compared to the prior year quarter. Consolidated operating results in the first quarter of fiscal 2014 also included \$1 million of operating losses related to store locations acquired or opened by APB during the prior twelve months and the recognition of bad debt expense of \$1 million by SMB. Consolidated operating income in the first quarter of fiscal 2015 included restructuring charges and other exit-related costs of \$1 million consisting of severance, contract termination, and other restructuring costs, compared to charges of \$2 million in the prior year period. These charges relate to restructuring initiatives under three separate plans announced in the fourth quarter of fiscal 2012 (the "Q4'12 Plan"), the first quarter of fiscal 2014 (the "Q1'14 Plan") and the first quarter of fiscal 2015 (the "Q1'15 Plan"), respectively.

In the first quarter of fiscal 2014, we initiated the Q1'14 Plan and began implementing restructuring and productivity initiatives to further reduce our annual operating expenses by approximately \$30 million, which was subsequently increased to \$40 million later in the fiscal year. We achieved approximately \$29 million of benefit in fiscal 2014, with the full annual benefit expected to be achieved in fiscal 2015. In the first quarter of fiscal 2015, we achieved a benefit of \$10 million, compared to a benefit of \$4 million in the prior year quarter. The majority of the reduction in operating expenses occurred at MRB and resulted from a combination of headcount reductions, implementation of operational efficiencies, reduced lease costs and other productivity improvements. We expect to incur restructuring charges of approximately \$6 million in connection with the Q1'14 Plan, which were substantially incurred in fiscal 2014. The remaining charges are expected to be incurred by the end of fiscal 2017. The vast majority of these charges require us to make cash payments.

In the first quarter of fiscal 2015, we initiated the Q1'15 Plan and started implementing additional productivity initiatives at APB to improve profitability through a combination of revenue drivers and cost reduction initiatives. In addition to the measures announced in October 2014 with a targeted annual improvement of \$7 million, we have

identified incremental cost reduction and productivity initiatives aimed at reducing selling, general and administrative expense in connection with the Q1'15 Plan and have increased the overall targeted annual improvement at APB to \$14 million, with approximately 50% of that amount expected to benefit fiscal 2015, primarily in the second half, and the full annual run rate expected to be achieved in fiscal 2016. We expect to incur restructuring charges of approximately \$2 million in connection with the Q1'15 Plan, substantially all of which are expected to be incurred in fiscal 2015. The vast majority of these charges require us to make cash payments.

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## SCHNITZER STEEL INDUSTRIES, INC.

Restructuring charges and other exit-related costs for the three months ended November 30, 2014 and 2013 were comprised of the following (in thousands):

|                             | Three Months Ended November 30, 2014 |            |               | Three Months Ended November 30, 2013 |            |               |
|-----------------------------|--------------------------------------|------------|---------------|--------------------------------------|------------|---------------|
|                             | Q1'14 Plan                           | Q1'15 Plan | Total Charges | Q4'12 Plan                           | Q1'14 Plan | Total Charges |
| Restructuring charges:      |                                      |            |               |                                      |            |               |
| Severance costs             | \$27                                 | \$—        | \$27          | \$26                                 | \$1,076    | \$1,102       |
| Contract termination costs  | 253                                  | —          | 253           | 462                                  | 38         | 500           |
| Other restructuring costs   | —                                    | 343        | 343           | —                                    | 210        | 210           |
| Total restructuring charges | \$280                                | \$343      | \$623         | \$488                                | \$1,324    | \$1,812       |

See Note 6 - Restructuring Charges and Other Exit-Related Costs in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report for additional details on restructuring charges.

**Income Tax Expense**

Our effective tax rate for the first quarter of fiscal 2015 was an expense of 0.5% compared to a benefit of 12.7% for the same period in the prior year.

The effective tax rate for the first quarter of fiscal 2015 and 2014 was lower than the federal statutory rate of 35% primarily due to the impact of the financial performance of certain foreign operations, which are taxed at more favorable rates, and the impact of recording a full valuation allowance on the current period benefit associated with certain foreign operations losses.

The effective tax rate for fiscal 2015 is expected to be approximately 27%, subject to financial performance for the remainder of the year.

**Financial Results by Segment**

We operate our business across three reporting segments: MRB, APB and SMB. Additional financial information relating to these reporting segments is contained in Note 14 - Segment Information in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report.

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## SCHNITZER STEEL INDUSTRIES, INC.

## Metals Recycling Business

| (\$ in thousands, except for prices)                                | Three Months Ended November 30, |           |          |
|---|---------------------------------|-----------|----------|
|   | 2014                            | 2013      | % Change |
| Ferrous revenues  | \$337,578                       | \$369,555 | (9)%     |
| Nonferrous revenues   | 112,593                         | 113,154   | —%       |
| Other   | 6,107                           | 7,600     | (20)%    |
| Total segment revenues  | 456,278                         | 490,309   | (7)%     |
| Cost of goods sold  | 433,879                         | 468,601   | (7)%     |
| Selling, general and administrative expense                         | 21,004                          | 21,483    | (2)%     |
| Income from joint ventures  | (527)                           | (365)     | 44%      |
| Segment operating income  | \$1,922                         | \$590     | 226%     |
| Average ferrous recycled metal sales prices (\$/LT): <sup>(1)</sup> |                                 |           |          |
| Domestic  | \$344                           | \$356     | (3)%     |
| Foreign   | \$319                           | \$344     | (7)%     |
| Average   | \$328                           | \$348     | (6)%     |
| Ferrous sales volume (LT, in thousands):                            |                                 |           |          |
| Domestic  | 334                             | 323       | 3%       |
| Foreign   | 605                             | 655       | (8)%     |
| Total ferrous sales volume (LT, in thousands)                       | 939                             | 978       | (4)%     |
| Average nonferrous sales price (\$/pound) <sup>(1)</sup>            | \$0.85                          | \$0.89    | (4)%     |
| Nonferrous sales volumes (pounds, in thousands)                     | 127,473                         | 123,941   | 3%       |
| Outbound freight included in cost of goods sold                     | \$34,489                        | \$32,583  | 6%       |

LT = Long Ton, which is 2,240 pounds

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

## Revenues

Revenues in the first quarter of fiscal 2015 decreased by 7% compared to the prior year period primarily due to lower average net selling prices for ferrous metal and reduced sales volumes of export ferrous metal as a result of continued weak market conditions. Weak export demand for ferrous metal resulted primarily from a combination of global steelmaking overcapacity and a strengthening of the U.S. currency during the period.

## Segment Operating Income

Operating income for the first quarter of fiscal 2015 was \$2 million compared to \$1 million in the prior year period. Adjusted operating income in the first quarter of fiscal 2015, which excludes the impact of reselling or modifying the terms of certain previously contracted bulk ferrous shipments, was \$8 million, compared to \$1 million in the prior year period (see reconciliation of adjusted MRB operating income in Non-GAAP Financial Measures at the end of Item 2). Export net selling prices for shipments of recycled ferrous metal in the first quarter of fiscal 2015 declined sharply by approximately \$80 per ton, or 20%, compared to the end of the fourth quarter of fiscal 2014 due to weaker global demand. In an environment of declining commodity selling prices as experienced in the first quarter of fiscal 2015, average inventory costs did not decrease as quickly as purchase costs for raw materials, resulting in a substantial adverse effect on cost of goods sold and compression of operating margins. The lower price environment during the quarter also adversely impacted the supply of scrap metal, which led to lower processed volumes further compressing operating margins. In the first quarter of fiscal 2015, the operating results of MRB were adversely impacted by \$6 million from the resale or modification of the terms, each at significantly lower prices, of certain previously contracted ferrous bulk shipments for delivery during the quarter. Due to the sharp decline in selling prices that occurred during the first quarter of fiscal 2015, the revised prices associated with these shipments were significantly lower than the prices in the original sales contracts entered into between August and October 2014. The benefits from productivity and cost saving initiatives on cost of goods sold and SG&A expense partially offset the adverse effects of the continued weak market conditions resulting in improved operating results in the first quarter of fiscal 2015 compared

to the prior year quarter, which also experienced constrained supply conditions and operating margin compression, but comparably lower benefits from productivity and cost saving initiatives.

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## SCHNITZER STEEL INDUSTRIES, INC.

## Auto Parts Business

| (\$ in thousands)                           | Three Months Ended November 30, |          |          |
|---|---------------------------------|----------|----------|
|   | 2014                            | 2013     | % Change |
| Revenues                                    | \$80,921                        | \$79,635 | 2 %      |
| Cost of goods sold                          | 65,298                          | 59,383   | 10 %     |
| Selling, general and administrative expense | 13,662                          | 14,643   | (7) %    |
| Segment operating income                    | \$1,961                         | \$5,609  | (65) %   |
| Number of stores at period end              | 62                              | 62       | — %      |
| Cars purchased (in thousands)               | 97                              | 91       | 7 %      |

## Revenues

Revenues in the first quarter of fiscal 2015 increased by 2% compared to the prior year period primarily due to higher sales volumes, including from new stores acquired or opened in fiscal 2014, partially offset by lower commodity prices.

## Segment Operating Income

Operating income for the first quarter of fiscal 2015 decreased by 65% compared to the same period in the prior year. The benefits on operating margins from higher volumes were more than offset by a compression in operating margins primarily due to the sharp reduction in ferrous commodity selling prices during the first quarter of fiscal 2015, which led to an adverse effect on cost of goods sold from average inventory costs not decreasing as quickly as purchase costs for raw materials.

## Steel Manufacturing Business

| (\$ in thousands, except for price)                                 | Three Months Ended November 30, |          |          |
|---|---------------------------------|----------|----------|
|   | 2014                            | 2013     | % Change |
| Revenues  | \$95,218                        | \$88,123 | 8 %      |
| Cost of goods sold  | 87,304                          | 83,680   | 4 %      |
| Selling, general and administrative expense                         | 1,707                           | 2,699    | (37) %   |
| Segment operating income  | \$6,207                         | \$1,744  | 256 %    |
| Finished steel products average sales price (\$/ton) <sup>(1)</sup> | \$683                           | \$657    | 4 %      |
| Finished steel products sold (tons, in thousands)                   | 127                             | 128      | (1) %    |
| Rolling mill utilization  | 72                              | % 65     | %        |

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

## Revenues

Revenues for the first quarter of fiscal 2015 increased by 8% compared to the same period in the prior year due to increased average selling prices as a result of higher demand in our West Coast markets mainly driven by improved non-residential construction.

## Segment Operating Income

Operating income for the first quarter of fiscal 2015 increased significantly compared to the prior year period due to higher average sales prices for finished steel products, higher rolling mill utilization and benefits from productivity improvements, which generated higher operational efficiencies. Operating income for the first quarter of fiscal 2014 included recognition of bad debt expense of \$1 million.

## Liquidity and Capital Resources

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

## Sources and Uses of Cash

We had cash balances of \$15 million and \$26 million as of November 30, 2014 and August 31, 2014, respectively. Cash balances are intended to be used primarily for working capital, capital expenditures, acquisitions, dividends and share repurchases. We use excess cash on hand to reduce amounts outstanding under our credit facilities. As of November 30, 2014, debt, net of cash, was

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SCHNITZER STEEL INDUSTRIES, INC.

\$326 million compared to \$294 million as of August 31, 2014 (refer to Non-GAAP Financial Measures below), an increase of \$32 million mainly as a result of higher net working capital primarily due to the timing of inventory purchases and sales. Our cash balances as of November 30, 2014 and August 31, 2014 include \$4 million which are indefinitely reinvested in Puerto Rico and Canada.

Operating Activities

Net cash used in operating activities in the first three months of fiscal 2015 was \$16 million, compared to net cash provided by operating activities of \$26 million in the first three months of fiscal 2014.

Sources of cash in the first three months of fiscal 2015 included a \$31 million decrease in accounts receivable due to the timing of sales and collections. Uses of cash included in the first three months of fiscal 2015 included a \$26 million increase in inventory due to higher volumes on hand including the impact of timing of purchases and sales and a \$25 million decrease in accounts payable due to the timing of payments.

Sources of cash in the first three months of fiscal 2014 included a \$57 million decrease in accounts receivable due to the timing of sales and collections. Uses of cash included a \$39 million increase in inventory due to higher volumes on hand including the impact of timing of purchases and sales.

Investing Activities

Net cash used in investing activities in the first three months of fiscal 2015 was \$9 million, compared to \$16 million in the first three months of fiscal 2014.

Cash used in investing activities in the first three months of fiscal 2015 included capital expenditures of \$10 million to upgrade our equipment and infrastructure, compared to \$14 million in the first three months of fiscal 2014.

Financing Activities

Net cash provided by financing activities in the first three months of fiscal 2015 was \$14 million, compared \$6 million in the first three months of fiscal 2014.

Cash used in financing activities in the first three months of fiscal 2015 was primarily due to \$22 million in net borrowings of debt (refer to Non-GAAP Financial Measures below) mainly used to support higher net working capital primarily due to the timing of inventory purchases and sales. Uses of cash included \$5 million for dividends.

Cash provided by financing activities in the first three months of fiscal 2014 was primarily due to \$12 million in net borrowings of debt (refer to Non-GAAP Financial Measures below) mainly used to support capital expenditures. Uses of cash included \$5 million for dividends.

Credit Facilities

Our unsecured committed bank credit facility, which provides for revolving loans of \$670 million and C\$30 million, matures in April 2017 pursuant to a credit agreement with Bank of America, N.A. as administrative agent, and other lenders party thereto. Interest rates on outstanding indebtedness under the agreement are based, at our option, on either the London Interbank Offered Rate (or the Canadian equivalent) plus a spread of between 1.25% and 2.25%, with the amount of the spread based on a pricing grid tied to our leverage ratio, or the greater of the prime rate, the federal funds rate plus 0.5% or the British Bankers Association LIBOR Rate plus 1.75%. In addition, annual commitment fees are payable on the unused portion of the credit facility at rates between 0.15% and 0.35% based on a pricing grid tied to our leverage ratio.

We had borrowings outstanding under the credit facility of \$327 million as of November 30, 2014 and \$305 million as of August 31, 2014. The weighted average interest rate on amounts outstanding under this facility was 1.94% and 1.91% as of November 30, 2014 and August 31, 2014, respectively.

We also have an unsecured, uncommitted \$25 million credit line with Wells Fargo Bank, N.A. that expires March 1, 2015. Interest rates are set by the bank at the time of borrowing. We had no borrowings outstanding under this line of credit as of November 30, 2014 and August 31, 2014.

We use these credit facilities to fund working capital requirements, acquisitions, capital expenditures, dividends and share repurchases. The two bank credit agreements contain various representations and warranties, events of default and financial and other covenants which could limit or restrict our ability to create liens, raise additional capital, enter into transactions with affiliates,

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SCHNITZER STEEL INDUSTRIES, INC.

acquire and dispose of businesses, guarantee debt, and consolidate or merge. The financial covenants include a consolidated fixed charge coverage ratio, defined as the four-quarter rolling sum of consolidated adjusted EBITDA less defined maintenance capital expenditures divided by consolidated fixed charges, and a consolidated leverage ratio, defined as consolidated funded indebtedness divided by the sum of consolidated net worth and consolidated funded indebtedness. We refer to the Forms 8-K dated February 14, 2011 and April 16, 2012, which include as attachments copies of the unsecured committed bank credit agreement, as amended, for the detailed methodology for calculating the financial covenants.

As of November 30, 2014, we were in compliance with these financial covenants. The consolidated fixed charge coverage ratio is required to be no less than 1.50 to 1 and was 2.53 to 1 as of November 30, 2014. The consolidated leverage ratio is required to be no more than 0.55 to 1 and was 0.32 to 1 as of November 30, 2014. While we expect to remain in compliance with these covenants, there can be no assurance that we will be able to do so in the event of a sustained deterioration from current market conditions or other negative factors which adversely impact our results of operations and financial position, and lead to a trend of consolidated operating losses. If we do not maintain compliance with our financial covenants and are unable to obtain an amendment or waiver from our lenders, a breach of either covenant would constitute an event of default and allow the lenders to exercise remedies under the agreements, the most severe of which is the termination of the credit facility under our committed bank credit agreement and acceleration of the amounts owed under both agreements. In such case, we would be required to evaluate available alternatives and take appropriate steps to obtain alternative funds. There can be no assurance that any such alternative funds, if sought, could be obtained or, if obtained, would be adequate or on acceptable terms.

In addition, as of November 30, 2014 and August 31, 2014, we had \$8 million of long-term tax-exempt bonds outstanding that mature in January 2021.

Capital Expenditures

Capital expenditures totaled \$10 million for the first three months of fiscal 2015, compared to \$14 million for the same period in the prior year. We currently plan to invest up to \$40 million in capital expenditures on upgrades in fiscal 2015, similar to the upgrades in fiscal 2014, exclusive of any capital expenditures for growth projects, using cash generated from operations and available lines of credit.

Dividends

On October 30, 2014 our Board of Directors declared a dividend for the first quarter of fiscal 2015 of \$0.1875 per common share, which equates to an annual cash dividend of \$0.75 per common share. The dividend was paid on November 24, 2014.

Environmental Compliance

Our commitment to sustainable recycling and to operating our business in an environmentally responsible manner requires us to continue to invest in facilities that improve our environmental presence in the communities in which we operate. As part of our capital expenditures, we invested \$2 million in capital expenditures for environmental projects during the first three months of fiscal 2015, and plan to invest up to \$12 million for such projects in fiscal 2015. These projects include investments in storm water systems and equipment to ensure ongoing compliance with air quality and other environmental regulations.

We have been identified by the United States Environmental Protection Agency (“EPA”) as 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”). A group of PRPs is conducting an investigation and study to identify and characterize the contamination at the Site and develop alternative approaches to remediation of the contamination. On March 30, 2012 the group submitted to the EPA a draft feasibility study (“draft FS”) based on approximately ten years of work and \$100 million in costs classified as investigation-related. 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 is being revised by the EPA and the revisions may be significant and could materially impact the scope or cost of remediation. 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 2017 or commence remediation activities until 2024. Responsibility for implementing and funding the EPA's selected remedy will be determined in a separate allocation process, which is currently underway. 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, we believe it is not reasonably possible to estimate the amount or range of

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SCHNITZER STEEL INDUSTRIES, INC.

costs which we are likely or which are reasonably possible to incur in connection with the Site, although such costs could be material to our financial position, results of operations, future cash flows and liquidity. Any material liabilities recorded in the future related to the Site could result in our failure to maintain compliance with certain covenants in our debt agreements. Significant cash outflows in the future related to the Site could reduce the amounts available for borrowing that could otherwise be used for investment in capital expenditures, acquisitions, dividends and share repurchases. See Note 5 - Commitments and Contingencies in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report.

Assessment of Liquidity and Capital Resources

Historically, our available cash resources, internally generated funds, credit facilities and equity offerings have financed our acquisitions, capital expenditures, working capital and other financing needs.

We generally believe our current cash resources, internally generated funds, existing credit facilities and access to the capital markets will provide adequate short-term and long-term liquidity needs for acquisitions, capital expenditures, working capital, dividends, share repurchases, joint ventures, debt service requirements and environmental obligations. However, in the event of a sustained market deterioration, we may need additional liquidity, which would require us to evaluate available alternatives and take appropriate steps to obtain sufficient additional funds. There can be no assurance that any such supplemental funding, if sought, could be obtained or, if obtained, would be adequate or on acceptable terms.

Off-Balance Sheet Arrangements

None.

Contractual Obligations

There were no material changes related to contractual obligations and commitments from the information provided in our Annual Report on Form 10-K for the fiscal year ended August 31, 2014.

We maintain stand-by letters of credit to provide support for certain obligations, including workers' compensation and performance bonds. At November 30, 2014, we had \$16 million outstanding under these arrangements.

Critical Accounting Policies and Estimates

We reaffirm our critical accounting policies and estimates as described in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of our Annual Report on Form 10-K for the year ended August 31, 2014, except for the following:

Goodwill

There were no triggering events identified during the first quarter of fiscal 2015 requiring an interim impairment test of goodwill allocated to our reporting units. A lack of recovery of market conditions in the metals recycling industry from current levels, a trend of weaker than anticipated Company financial performance including the pace and extent of operating margin and volume recovery, a lack of recovery or further decline in our share price from current levels for a sustained period of time, or an increase in the market-based weighted average cost of capital, among other factors, could significantly impact our impairment analysis and may result in future goodwill impairment charges which, if incurred, could have a material adverse effect on our financial condition and results of operations. See Note 4 - Goodwill in the Notes to the Unaudited Condensed Consolidated Financial Statements, Part 1, Item 1 of this report for further detail.

Recently Issued Accounting Standards

For a description of recent accounting pronouncements that may have an impact on our financial condition, results of operations or cash flows, see Note 2 - Recent Accounting Pronouncements in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report.



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## SCHNITZER STEEL INDUSTRIES, INC.

## Non-GAAP Financial Measures

## Debt, net of cash

Debt, net of cash is the difference between (i) the sum of long-term debt and short-term debt (i.e., total debt) and (ii) cash and cash equivalents. We believe that debt, net of cash is a useful measure for investors because, as cash and cash equivalents can be used, among other things, to repay indebtedness, netting this against total debt is a useful measure of our leverage.

The following is a reconciliation of debt, net of cash (in thousands):

|   | November 30, 2014 | August 31, 2014 |
|---|-------------------|-----------------|
| Short-term borrowings                     | \$471             | \$523           |
| Long-term debt, net of current maturities | 340,355           | 318,842         |
| Total debt                                | 340,826           | 319,365         |
| Less: cash and cash equivalents           | 14,666            | 25,672          |
| Total debt, net of cash                   | \$326,160         | \$293,693       |

## Net borrowings (repayments) of debt

Net borrowings (repayments) of debt is the sum of borrowings from long-term debt, repayments of long-term debt, proceeds from line of credit, and repayment of line of credit. We present this amount as the net change in borrowings (repayments) for the period because we believe it is useful for investors as a meaningful presentation of the change in debt.

The following is a reconciliation of net borrowings (repayments) of debt (in thousands):

|                                     | Three Months Ended November 30, |           |
|-------------------------------------|---------------------------------|-----------|
|                                     | 2014                            | 2013      |
| Borrowings from long-term debt      | \$70,848                        | \$119,269 |
| Proceeds from line of credit        | 48,000                          | 147,500   |
| Repayment of long-term debt         | (49,192)                        | (98,472)  |
| Repayment of line of credit         | (48,000)                        | (156,000) |
| Net borrowings (repayments) of debt | \$21,656                        | \$12,297  |

Adjusted consolidated operating income (loss), adjusted MRB operating income, adjusted net income (loss) and adjusted diluted earnings per share attributable to SSI

We present adjusted consolidated operating income (loss), adjusted MRB operating income, adjusted net income (loss) attributable to SSI and adjusted diluted earnings per share attributable to SSI because we believe these measures provide a meaningful presentation of our results from core business operations excluding adjustments for restructuring charges and other exit-related costs that are not related to core underlying business operations and improve the period-to-period comparability of our results from core business operations. To improve comparability of our operating performance between periods, these measures also exclude the impact on operating results in fiscal 2015 from the resale or modification of the terms, each at significantly lower prices, of certain previously contracted ferrous bulk shipments for delivery during the first quarter of fiscal 2015. Due to the sharp decline in selling prices that occurred during the first quarter of fiscal 2015, the revised prices associated with these shipments were significantly lower than the prices in the original sales contracts entered into between August and October 2014.

The following is a reconciliation of the adjusted consolidated operating income (loss), adjusted MRB operating income, adjusted net income (loss) attributable to SSI and adjusted diluted earnings per share attributable to SSI (in thousands, except per share data):

|   | Three Months Ended November 30, |           |
|---|---------------------------------|-----------|
|   | 2014                            | 2013      |
| Consolidated operating income (loss):                             |                                 |           |
| As reported   | \$78                            | \$(3,625) |
| Restructuring charges and other exit-related costs                | 623                             | 1,812     |
| Resale or modification of certain previously contracted shipments | 5,581                           | —         |
| Adjusted  | \$6,282                         | \$(1,813) |



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## SCHNITZER STEEL INDUSTRIES, INC.

|  |           |             |   |
|--|-----------|-------------|---|
| MRB operating income:  |           |             |   |
| As reported  | \$ 1,922  | \$ 590      |   |
| Resale or modification of certain previously contracted shipments                        | 5,581     | —           |   |
| Adjusted   | \$ 7,503  | \$ 590      |   |
| Net income (loss) attributable to SSI:   |           |             |   |
| As reported  | \$ (2,472 | ) \$ (6,228 | ) |
| Restructuring charges and other exit-related costs, net of tax                           | 474       | 1,279       |   |
| Resale or modification of certain previously contracted shipments, net of tax            | 4,156     | —           |   |
| Adjusted   | \$ 2,158  | \$ (4,949   | ) |
| Diluted earnings per share attributable to SSI:  |           |             |   |
| As reported  | \$ (0.09  | ) \$ (0.23  | ) |
| Restructuring charges and other exit-related costs, net of tax, per share                | 0.02      | 0.05        |   |
| Resale or modification of certain previously contracted shipments, net of tax, per share | 0.15      | —           |   |
| Adjusted   | \$ 0.08   | \$ (0.18    | ) |

We believe that these non-GAAP financial measures allow for a better understanding of our operating and financial performance. These non-GAAP financial measures should be considered in addition to, but not as a substitute for, the most directly comparable U.S. GAAP measures. Although we find these non-GAAP financial measures useful in evaluating the performance of our business, our reliance on these measures is limited because the adjustments often have a material impact on our condensed consolidated financial statements presented in accordance with GAAP. Therefore, we typically use these adjusted amounts in conjunction with our GAAP results to address these limitations.

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## SCHNITZER STEEL INDUSTRIES, INC.

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

## Commodity Price Risk

We are exposed to commodity price risk, mainly associated with variations in the market price for finished steel products, ferrous and nonferrous metals, including scrap metal, autobody and other commodities. The timing and magnitude of industry cycles are difficult to predict and are impacted by general economic conditions. We respond to increases and decreases in forward selling prices by adjusting purchase prices on a timely basis. We actively manage our exposure to commodity price risk and monitor the actual and expected spread between forward selling prices and purchase costs and processing and shipping expense. Sales contracts are based on prices negotiated with our customers, and generally orders are placed 30 to 60 days ahead of the shipment date. However, financial results may be negatively impacted when forward selling prices fall more quickly than we can adjust purchase prices or when customers fail to meet their contractual obligations. We assess the net realizable value of inventory (“NRV”) each quarter based upon contracted sales orders and estimated future selling prices. Based on contracted sales and estimates of future selling prices at November 30, 2014, a 10% decrease in the selling price per ton of finished steel products would have caused an NRV inventory write down of \$3 million at SMB. A 10% decrease in the selling price of inventory would not have had a material NRV impact on MRB or APB as of November 30, 2014.

## Interest Rate Risk

There have been no material changes to our disclosure regarding interest rate risk set forth in Item 7A. Quantitative and Qualitative Disclosures About Market Risk included in our Annual Report on Form 10-K for the year ended August 31, 2014.

## Credit Risk

As of November 30, 2014 and August 31, 2014, 44% and 39%, respectively, of our trade accounts receivable balance was covered by letters of credit. Of the remaining balance as of November 30, 2014 and August 31, 2014, 96% was less than 60 days past due.

## Foreign Currency Exchange Rate Risk

We are exposed to foreign currency exchange rate risk, mainly associated with sales transactions and related accounts receivable denominated in the U.S. Dollar by our Canadian subsidiary with a functional currency of the Canadian Dollar. In certain instances, we use derivatives to manage some portion of this risk. Our derivatives are agreements with independent counterparties that provide for payments based on a notional amount. As of November 30, 2014, all of our derivative transactions were related to actual or anticipated economic transactions in the normal course of business. A change in foreign exchange rates by 10% would have changed the fair value of these contracts reported in our Condensed Consolidated Balance Sheets by \$5 million at November 30, 2014.

## ITEM 4. CONTROLS AND PROCEDURES

## Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives. Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, has completed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of November 30, 2014, our disclosure controls and procedures were effective at the reasonable assurance level.

## Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 5 - Commitments and Contingencies in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item I, incorporated by reference herein.

In fiscal 2013, the Commonwealth of Massachusetts advised us of alleged violations of environmental requirements, including but not limited to those related to air emissions and hazardous waste management, at our operations in the Commonwealth. We have been discussing resolution of the alleged violations with the Commonwealth representatives and have reached an agreement in principle to resolve certain of the alleged violations. No enforcement proceeding has been filed to date and we do not believe that the outcome of this matter will be material to our financial position, results of operations, cash flows or liquidity.

The State of California and the Alameda County District Attorney are investigating alleged violations of environmental requirements, including but not limited to those related to air emissions and hazardous waste management, at one of our operations in the State. We have been discussing resolution of the alleged violations with the government representatives and have reached an agreement in principle to resolve certain of the alleged violations. No enforcement proceedings have been filed to date and we do not believe that the outcome of this investigation will be material to our financial position, results of operations, cash flows or liquidity.

ITEM 1A. RISK FACTORS

There have been no material changes to our risk factors reported or new factors identified since the filing of our Annual Report on Form 10-K for the year ended August 31, 2014, which was filed with the Securities and Exchange Commission on October 28, 2014.

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ITEM 6. EXHIBITS

Exhibit Number Exhibit Description

|       |   |
|-------|---|
| 10.1* | Form of Long-Term Incentive Award Agreement under the 1993 Stock Incentive Plan used for awards granted in fiscal 2015.   |
| 10.2* | Fiscal 2015 Annual Performance Bonus Program for Tamara L. Lundgren.  |
| 31.1  | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2  | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1  | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2  | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 101   | The following financial information from Schnitzer Steel Industries, Inc.'s Quarterly Report on Form 10-Q for the quarter ended November 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Operations for the three months ended November 30, 2014 and 2013, (ii) Condensed Consolidated Balance Sheets as of November 30, 2014, and August 31, 2014, (iii) Condensed Consolidated Statements of Comprehensive Loss for the three months ended November 30, 2014 and 2013; (iv) Condensed Consolidated Statements of Cash Flows for the three months ended November 30, 2014 and 2013; and (v) the Notes to Condensed Consolidated Financial Statements. |

\* Management contract or compensatory plan or arrangement.

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SIGNATURES

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

SCHNITZER STEEL INDUSTRIES, INC.  
(Registrant)

Date: January 8, 2015

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

Date: January 8, 2015

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