F5 NETWORKS INC
Form 10-K
November 21, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended September 30, 2012

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to .

Commission File Number 000-26041

F5 Networks, Inc.

(Exact name of Registrant as specified in its charter)

WASHINGTON	**91-1714307**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

401 Elliott Ave West

Seattle, Washington 98119

(Address of principal executive offices)

(206) 272-5555

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common stock, no par value	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of March 30, 2012, the aggregate market value of the Registrant s Common Stock held by non-affiliates of the Registrant was $10,633,270,453 based on the closing sales price of the Registrant s Common Stock on the NASDAQ Global Select Market on that date.

As of November 15, 2012, the number of shares of the Registrant s common stock outstanding was 79,050,364.

DOCUMENTS INCORPORATED BY REFERENCE

Information required in response to Part III of this Form 10-K (Items 10, 11, 12, 13 and 14) is hereby incorporated by reference to the specified portions of the Registrant s Definitive Proxy Statement for the Annual Shareholders Meeting for fiscal year 2012, which Definitive Proxy Statement shall be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days of the end of the fiscal year to which this Report relates.

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F5 NETWORKS, INC.

ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended September 30, 2012

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Trademarks and Tradenames

F5, F5 Networks, F5 [DESIGN], F5 Management Pack, BIG-IP, CloudFucious, Data Manager, VIPRION, WA, WAN Optimization Manager, WOM, APM, Application Security Manager, ASM, Local Traffic Manager, LTM, Global Traffic Manager, GTM, IBR, Link Controller, Enterprise Manager, Traffic Management Operating System, TMOS, WANJet, FirePass, WebAccelerator, TrafficShield, iControl, TCP Express, Fast Application Proxy, 3DNS, iRules, iRules on Demand, Packet Velocity, ZoneRunner, OneConnect, AskF5, Intelligent Compression, Transparent Data Reduction, TDR, L7 Rate Shaping, LC, IPv6 Gateway, SSL Acceleration, Fast Cache, iHealth, Intelligent Browser Referencing, Message Security Module, PSM, MSM, Netcelera, Protocol Security Module, DEVCENTRAL, DEVCENTRAL [DESIGN], Edge Client, Edge Gateway, EM, IQUERY, Real Traffic Policy Builder, STRONGBOX, SYN Check, Access Policy Manager, Acopia, Acopia Networks, Advanced Client Authentication, Advanced Routing, ARX, Cloud Extender, CMP, DSI, DNS Express, DSC, Edge Portal, iApps, iSession, ScaleN, SuperVIP, UNITY, vCMP, Clustered Multiprocessing, COHESION, ELEVATE, ENGAGE, GUARDIAN, OpenBlox, OpenBloX [DESIGN], Rosetta Diameter Gateway, Signaling Delivery Controller, SDC, Traffix Diameter Load Balancer, Traffix, Traffix Systems, Traffix Systems (DESIGN), VAULT, and virtual Clustered Multiprocessing are trademarks or service marks of F5 Networks, Inc., or its subsidiaries in the U.S. and other countries. Any other trademarks, service marks and/or trade names appearing in this document are the property of their respective owners.

Unless the context otherwise requires, in this Annual Report on Form 10-K, the terms F5 Networks, the Company, we, us, and our refer to F5 Networks, Inc. and its subsidiaries. Our fiscal year ends on September 30, and fiscal years are referred to by the calendar year in which they end. For example, fiscal year 2012 and fiscal 2012 refer to the fiscal year ended September 30, 2012.

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. These statements include, but are not limited to, statements about our plans, objectives, expectations, strategies, intentions or other characterizations of future events or circumstances and are generally identified by the words expects, anticipates, intends, plans, believes, seeks, estimates, and similar expressions. These forward-looking statements are based on current information and expectations and are subject to a number of risks and uncertainties. Our actual results could differ materially and adversely from those expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under Item 1A. Risk Factors below and in other documents we file from time to time with the Securities and Exchange Commission. We assume no obligation to revise or update any such forward-looking statements.

Item 1. ***Business***

General

F5 Networks is a leading provider of Application Delivery Networking (ADN) technology that secures and optimizes the delivery of network-based applications and the security, performance and availability of servers, and other network resources. As strategic points of control within and between networks, our products collectively create a dynamic control plane that simplifies connecting users to applications in the fastest, most secure and highly available way possible. Our approach reduces the complexity and cost of data center operations whether our customers have a traditional data center or have a private cloud, public cloud or hybrid approach.

Our principal products are application delivery controllers (ADCs) that include our BIG-IP family of appliances and our line of scalable VIPRION systems. These products are typically deployed in front of web and application servers, balancing traffic and performing compute-intensive functions such as encrypting and un-encrypting transmissions, screening traffic for security threats, maintaining open connections with servers,

speeding the flow of traffic, managing access to applications and data and a variety of other functions that improve the security, performance, and availability of applications. We also offer virtual editions (software only versions) of our ADN software (referred to as VEs) that can run on physical or virtual servers and allow our customers to deploy our products in virtualized and cloud environments.

By offloading functions from servers, our BIG-IP and VIPRION products make servers more efficient, reduce the number of servers needed to run specific applications, lower the cost of power and cooling, and drive down operating costs by simplifying the management of servers and applications. In virtual environments, this allows customers to increase the density of virtual servers running on physical servers and reduces the added complexity of managing a dynamic environment.

The core of our ADN technology is our full-proxy Traffic Management Operating System (TMOS) that enables our products to inspect and modify the content of IP traffic flows to and from servers at network speed and supports a broad and growing array of functions that enhance the security, performance and availability of applications. iRules, a scripting language based on Tool Command Language (TCL), is a unique feature of TMOS that enables customers and third parties to write customized rules to inspect and modify traffic. TMOS also supports a common software interface called iControl, which enables our products to communicate with one another and with third-party products, including custom and commercial enterprise applications. TMOS is designed to support the addition of new functionality as software modules and to exploit the performance-enhancing features of our purpose-built hardware platforms. Correspondingly, our hardware architecture integrates industry standard components with components we design ourselves to optimize TMOS and deliver performance that is demonstrably superior to competing products.

Just as our ADCs make many servers look like one, our ARX storage virtualization products sit in front of network attached storage (NAS), making multiple storage devices from different vendors look like a single device to the individual clients, servers and applications that use them. In addition, ARX products simplify the migration of data between storage devices, the addition of new storage devices, and the distribution of files across tiers of storage, including cloud storage services, that reflect their relative immediacy or importance.

In February 2012, we expanded our capabilities in the service provider market with the acquisition of Traffix Systems, a pioneer and industry leader in Diameter signaling technology. Diameter is the protocol used to control traffic for the new generation of mobile networks.

In connection with our products, we offer a broad range of services including consulting, training, installation, maintenance and other technical support services.

F5 Networks was incorporated on February 26, 1996 in the State of Washington. Our headquarters is in Seattle, Washington, and our mailing address is 401 Elliott Avenue West, Seattle, Washington 98119. The telephone number at our executive offices is (206) 272-5555. We have subsidiaries or branch offices in Argentina, Australia, Brazil, Chile, China, Colombia, France, Germany, Hong Kong, Italy, Japan, Mexico, Netherlands, New Zealand, Russia, Singapore, South Korea, Spain, and the United Kingdom. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available free of charge on our website, www.f5.com, as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission.

Industry Background

Growth and Evolution of IP-Based Infrastructures

Internet Protocol (IP) is a communications language used to transmit data over the Internet. For more than two decades, large business and government organizations have been gradually replacing older data center architectures with IP-based infrastructures, deploying new IP-based applications and replacing or upgrading legacy applications with new IP-enabled versions. At the same time, organizations have become more

geographically dispersed, and increasingly mobile workforces depend on access to corporate applications and data from remote locations and a variety of client devices including smartphones, tablets and laptops.

Within the past three years, the information technology landscape has changed dramatically as organizations have responded to the slowdown in the global economy by using technologies such as virtualization and the growing availability and sophistication of cloud computing to reduce capital and operating costs and enhance the flexibility and efficiency of their information infrastructures. These efforts are reflected in the ongoing trend toward data center consolidation that includes a reduction in both the number and size of data centers. In addition, a growing number of organizations are turning to social networking and other online vehicles to help target customers and compete more effectively in an environment of reduced consumer spending. The rapid growth of social networks such as Facebook and Twitter, coupled with the explosion of mobile devices and applications, has challenged the abilities of content and service providers to keep up with and monetize the growing demand for IP-based services.

Along with the growth of Internet traffic, the proliferation of unstructured data such as voice, video, images, email, spreadsheets and formatted text files continues to present an enormous and increasing challenge to IT organizations. Historically, IT organizations have responded to this challenge primarily by adding more storage. File virtualization is a relatively new technology that enables organizations to store and manage files across a heterogeneous array of storage devices and lower their overall cost of storage.

Emergence of the Dynamic Data Center

From a broad perspective, the goal of IT organizations is to optimize the secure delivery of applications and data to users wherever they are and whenever they need them. To achieve these goals, IT organizations are embracing virtualization technologies that enable them to group or partition data center resources to meet user demand and reconfigure these virtual resources easily and quickly as demand changes. The recent surge of interest in Software Defined Networks highlights the latest move to reduce costs, increase the flexibility, and simplify the deployment and management of IT infrastructure through virtualization. Many organizations are also taking advantage of the growing availability of external cloud resources as a flexible, secure and reliable alternative to owning and managing everything themselves. As a result, IT infrastructure has become increasingly dynamic, complex and reliant on IP-based networks for the delivery of applications and data. At the same time, these changes have created new challenges to the security of IP networks and the applications and data accessible over the Internet. Within the past year, sophisticated denial of service attacks have exposed a major vulnerability in the security perimeter of corporate networks by overwhelming firewalls and effectively shutting down the networks. In addition, many network-level security threats are directly related to the improper use of the same protocols applications depend on to transmit data over the wire. Intrusion detection and prevention devices, which rely on signature databases of known threats, afford some protection against these types of attack. However, they offer no protection against many of the most common threats, including information leakage, content spoofing, cross-site request forgery or day zero attacks designed to exploit a variety of application vulnerabilities.

In addition to preventing the threat of attacks designed to disrupt, destroy or block access to network applications, organizations are faced with the equally daunting challenge of controlling access to applications and data. The proliferation of mobile devices has given users with smart phones, tablets, and laptops the ability to access corporate data centers from virtually anywhere. This, in turn, has increased the difficulty of ensuring that mobile users are able to access applications and data for which they are authorized, and that applications and data are protected from access by unauthorized users.

Need to Optimize the Secure Delivery of Applications and Data

With the ongoing evolution and increasing complexity of IT infrastructures, there is a growing need to optimize the secure delivery of applications and data over IP networks. IP-based traffic passing between client

devices and servers is divided into discrete packets that travel by multiple routes to their destination where they are reassembled. The disassembly, routing, and reassembly of transmissions are relatively straightforward and require little intelligence. By contrast, managing, inspecting, modifying, redirecting and securing application traffic going to and from servers requires intelligent systems capable of performing a broad array of functions. Broadly speaking, all of those functions are aspects of application delivery networking.

ADCs dynamically manage the flow of traffic between users and servers (physical or virtual), making them look like a single resource to the user. In addition they free up resources by offloading common network functions, such as encryption, IPv4/IPv6 translation, compression, authentication, rate-shaping, and a variety of specialized functions, including network and application security services, policy management, and WAN optimization, that would otherwise run on the servers or be coded into the applications. Since most large enterprises have hundreds if not thousands of servers and applications, it is not practical to replicate these functions on each server or within each virtual instance of an application. Doing so would take up valuable network resources and reduce the number of applications that could run on each server. Maintenance costs would be prohibitive and the net result would be a negative impact on the overall performance of servers and applications. Offloading specific functions onto point solutions can eliminate those problems but introduces a new set of challenges. Using point solutions from multiple vendors can create interoperability issues, and problems that do occur can be difficult to troubleshoot. From a security standpoint, it is also much more difficult to audit traffic passing through multiple devices. Providing a comprehensive set of integrated application delivery features and functions on a single, high-performance platform simplifies management of the device and the servers it sits in front of and reduces overall capital and operating costs. File virtualization delivers similar benefits by reducing the cost and complexity of file storage.

Along with other types of IP traffic, the volume of file-based information created and accessed by Internet users and network applications is growing rapidly. File virtualization allows IT organizations to map individual users and applications to a single device that can distribute files across a heterogeneous array of storage devices, keep track of their location, and retrieve them as needed. File virtualization devices maximize storage utilization and simplify the migration of data from one vendor s storage devices to another s. They can also be programmed to allocate files across tiers of storage systems, matching the cost, capacity, and performance of the storage devices to the type of information being stored, frequency of usage, and relative importance, substantially reducing both the capital and operating costs associated with file storage.

F5 s Strategy

Our goal is to lead the industry in delivering network architectures that integrate IP networks with applications and data, enabling the delivery of dynamic services in the data center. Those services include security, optimization and orchestration of data center operations and resources, as well as coordination of services spanning multiple data centers. Our products are designed to be strategic points of control in the IT infrastructure that allow business policies to be implemented where information is exchanged. This enables organizations to respond quickly to changing business needs, improve costly and time consuming business processes and develop new sources of revenue through highly differentiated offerings. Key components of our strategy include:

Offering a complete, integrated application delivery product suite.

Since the introduction of our TMOS architecture for application delivery networking, we have developed TMOS-based versions of our own legacy products, such as Local Traffic Manager (LTM), Global Traffic Manager (GTM) and Link Controller, and acquired technology, including Application Security Manager (ASM), WebAccelerator, WAN Optimization Module (WOM), Edge Gateway and Application Policy Manager (APM). All of these products are currently available as integrated software modules on our BIG-IP family of ADCs. We believe this approach sharply differentiates our products from our competitors offerings and provides customers

with an expanding array of integrated application delivery networking solutions that can be customized to meet their specific needs.

Investing in technology to meet evolving customer needs.

We continue to invest in research and development to provide our customers with comprehensive, integrated solutions. In application delivery networking, our product development efforts leverage the unique attributes of our software-based platforms to deliver new features and functions that address the complex, changing needs of our customers. Although the bulk of our investment in application delivery and file virtualization technologies is software development, concurrent development of tightly integrated, high-performance hardware is a key part of our investment strategy. We also look for opportunities to acquire technologies that will enable us to broaden the scope of our offerings and expand into adjacent markets.

Expanding our addressable market.

Since the introduction of TMOS, we have continually expanded our addressable market and the definition of application delivery through the acquisition and development of new technology. In 2003, for example, we entered the market for secure remote access through the acquisition of uRoam, Inc. and its FirePass, SSL VPN technology that has become the core of our current APM offering. The following year we entered the web application firewall market with the acquisition of Magnifire Websystems, Inc. and its TrafficShield security appliance, which became the foundation of our Application Security Module (ASM). As we developed these security modules, we leveraged the full proxy capabilities of TMOS to enhance and add new security features to our LTM product, and in January 2012 we received certification of BIG-IP LTM from ICSA Labs as a network firewall. While each of these products address a different element of the broader security market, they are all integral components of our comprehensive security offering and tightly integrated with LTM and the other features and functions available on our ADC products. As a result of this strategy and our development and acquisition of technology in other related markets such as WAN optimization, Diameter switching and routing, and classification, we believe our current addressable market is significantly larger than the ADC market as it has been traditionally defined by industry analysts.

Continuing to build and expand relationships with strategic technology partners.

To compete successfully against Cisco Systems, Inc. and other large competitors who have an established presence in our target accounts, we have developed strategic technology partnerships with enterprise software vendors, such as Microsoft, Oracle, VMware and others, who often have an established or growing presence in those accounts. By taking advantage of our open application programming interface, called iControl, these vendors can equip their applications to control our products in the network, enhancing overall application performance. In return, they provide us significant leverage in the selling process by recommending our products to their customers. We have also worked closely with several of these vendors to develop configurations of our products, called iApps, that are specifically designed to simplify deployment and optimize the performance of their applications. These solutions are available as templates which allow quick and easy configuration of our products for specific applications. We plan to continue building on our existing relationships and to extend our competitive edge by developing new strategic partnerships with other technology leaders, including providers of Software Defined Networking solutions.

Leveraging DevCentral, our online community of network architects and developers.

Customization of our products using iRules enhances their stickiness by allowing customers to solve problems in both their applications and their networks that would be difficult if not impossible to solve by other means. To promote the use of iRules, we host an online community, DevCentral, where network architects and developers can discuss and share the ways in which they use iRules to solve problems and enhance the security, performance and availability of applications. A corollary benefit is that many of the iRules solutions posted by

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DevCentral participants have become standard features in new releases of TMOS. DevCentral also provides a valuable window into our customers constantly evolving needs.

F5 Solutions

We design integrated software products that run on purpose-built hardware and are also available as virtual (software only) editions. Our products function as strategic points of control in IP networks, inspecting, modifying and directing traffic to optimize the security, availability and delivery of applications and data to any user, anywhere. We believe our products offer the most intelligent architecture and advanced functionality in the marketplace along with performance and flexibility that enable organizations to simplify management of their data center operations and integrate disparate resources to reduce operating costs, enhance productivity and improve service to employees, customers and partners.

Application Delivery Networking

Since 2004 we have expanded the breadth of features and functionality we offer well beyond the scope of application delivery networking as it has been traditionally defined. Today, we offer solutions that include application security, secure remote access, WAN optimization and access policy management, opening up large opportunities in several adjacent markets. Many of the features and functions that differentiate our products are built into TMOS, our full-proxy operating system. Others are available as software modules that run on TMOS.

Software

The core of our technology is TMOS, our Traffic Management Operating System, introduced in September 2004. The full-proxy characteristics of the TMOS architecture enable our products to intercept, inspect and act on the contents of traffic from virtually every type of IP-enabled application. In addition, the modularity of the TMOS architecture allows us to deliver tightly integrated solutions that secure, optimize and ensure the availability of applications and the networks they run on.

Traffic Management Operating System (TMOS)

Since TMOS was launched, we have introduced two major upgrades, adding hundreds of new features designed to interpret and act on specific content in the traffic passing between users and applications. TMOS Version 11, announced in July 2011, includes enhancements to iRules, a built-in programming language, that allows customers to create or modify policies that provide direct, granular control over how our products act on traffic at any moment within the application transaction or flow. In addition, Version 11 includes several new features and functions that are unique to our products:

- iApps is a set of portable, customizable, reusable templates that enable the rapid and predictable deployment of our products in front of more than 20 applications from vendors including Microsoft, Oracle, VMware, Citrix, BEA, and SAP. iApps also allows customers and partners to create templates that simplify the deployment and provisioning of their own applications.

- Scale^{N} is a set of three unique capabilities that enhance the flexibility of our products:

  - Clustered Multiprocessing (CMP) allows customers to cluster and aggregate multiple processors (cores) within a BIG-IP appliance and across blades in our VIPRION chassis products.

  - Virtual Clustered Multiprocessing (vCMP) enables the creation of separate virtual ADCs within an appliance or chassis, each running a separate instance of TMOS with a different configuration and assigned to a different application.

  - Device Service Clustering (DSC) gives customers the ability to group devices and services across an array of ADCs (appliances, VIPRION chassis, or virtual editions). Devices can be added to or removed

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from a DSC without disrupting application services, and application services can be independently managed within the cluster. TMOS Version 11 also includes a number of new security features that enhance the ability of our products to protect networks and applications against denial of service attacks and other types of security threats. Other enhancements include centralized management of multiple devices and improved visibility that allows customers to monitor and record the performance of applications and users.

Feature Modules

Many of the basic network functions our products perform are embedded as standard features in TMOS and available to our customers at no extra cost. These features include:

Advanced Client Authentication: Reduces costs and frees up server cycles by eliminating the need to manage and enforce authentication individually across applications.

Advanced Routing: Allows our products to manage the routing information used by traffic traversing networks and to share that information with other devices.

Fast Cache: Improves server and application performance by eliminating the need for servers to handle repeated requests for identical content.

Intelligent Compression: Reduces the volume of outgoing traffic as necessary to optimize transmission to individual users.

IPv6 Gateway: Provides complete translation and load-balancing between v4 and v6 networks, and directs traffic across mixed IPv6 and IPv4 devices.

L7 Rate Shaping: Reserves bandwidth for higher priority applications to ensure that low-priority traffic doesn t interfere with critical business applications.

Protocol Security: Prevents security attacks directed at HTTP, SMTP and FTP servers.

SSL Acceleration: Frees up valuable space on physical and virtual servers by offloading compute-intensive SSL encryption and decryption. Basic SSL Acceleration is included with every product. Depending on the hardware platform, customers can purchase up to 200,000 transactions per second of incremental performance.

Product Modules

In addition to the features and functions embedded in TMOS, we offer a family of integrated software solutions that cover a broad range of application-aware network functions from load-balancing to application security. Depending on a number of factors, including the hardware platform they have purchased, the application they are running, and their performance and security requirements, customers may purchase one or more of these modules in addition to Local Traffic Manager (LTM), which is included with every hardware product. The following software modules are currently available on all BIG-IP and VIPRION products except BIG-IP 1600:

Local Traffic Manager (LTM): LTM, which provides intelligent load-balancing and traffic management, is standard on all BIG-IP appliances and VIPRION chassis-based systems. As a strategic point of control between servers and users, LTM manages the flow and distribution of all traffic passing through our products, ensuring that applications are secure, fast and available.

Global Traffic Manager (GTM): GTM automatically directs users to the closest or best-performing data center based on business policy, geolocation, and volume spikes, regardless of their cause. When users try to access a data center that is overloaded or unreachable, GTM automatically and seamlessly directs them to a secondary data center. It also automates the process of tracking and managing interdependencies among individual

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services in distributed applications. In addition, GTM enhances DNS security by automatically scaling to absorb a rapid increase in queries resulting from a denial of service attack.

Access Policy Manager (APM): APM provides secure, granular, context-aware control of access to applications while simplifying authentication, authorization, and accounting (AAA) management. An optional endpoint security service validates client devices to protect organizations from viruses or malware infections, accidental data loss, and rogue device access. This allows users to apply repeatable access policies across many applications and servers with centralized visibility of their authorization infrastructure. APM s Visual Policy Editor makes it easy to create individual and group access policies for many different identities, locations, and web authentication environments. APM also provides dynamic access control by creating access control lists based on user identity, IP address, and attributes such as group membership pulled from standard directory services.

Application Security Manager (ASM): ASM is an application firewall that provides comprehensive, proactive, application-layer protection against both generalized and targeted attacks. Combining a positive security model (deny all unless allowed) with signature-based detection, ASM can prevent day-zero attacks in addition to known security threats.

Link Controller: For organizations with more than one Internet Service Provider (ISP), Link Controller monitors the health and availability of each connection. In the event of a failure, traffic is dynamically directed across other available links so users and external customers stay connected. Link Controller includes an optional compression feature that reduces WAN link bandwidth for lower ISP costs and cuts down on bandwidth bottlenecks for faster application delivery.

WAN Optimization Manager (WOM): WOM integrates application delivery with WAN optimization technologies, enabling traditional acceleration functions, such as SSL offloading, compression, caching, and traffic prioritization, to combine with optimization technologies like symmetric adaptive compression and application quality of service. As the foundation for site-to-site communication, iSessions, a basic feature of TMOS, allows any two BIG-IP devices to be deployed symmetrically, creating a secure site-to-site connection, improving transfer rates and bandwidth usage, and offloading applications for more efficient data center to data center WAN communication.

WebAccelerator: WebAccelerator speeds web transactions by optimizing individual network object requests, connections, and end-to-end transactions from the browser through to databases. WebAccelerator enhances web application performance from any location, speeding up interactive performance, improving download times, utilizing bandwidth more efficiently, and dramatically reducing the cost and response time of delivering Web-enabled applications to distributed users where it is not possible to deploy an end-point device. Devices running WebAccelerator can also be placed at key remote locations to provide acceleration to end-users above and beyond TCP optimizations and HTTP compression.

Message Security: Reputation-based, perimeter anti-spam solution that extends security for message applications to the edge of the corporate network and eliminates unwanted e-mail.

Virtual ADCs

All our product modules are also available as virtual editions (software only versions) of BIG-IP (referred to as BIG-IP VEs), designed to run on standard servers and to supplement our hardware products in hybrid environments that utilize both our hardware and software based solutions. BIG-IP VEs also give our customers a cost-effective way to test and configure our products and help determine which systems and modules will best meet their specific needs in production environments.

Hardware

All of our purpose-built hardware platforms are designed to enhance the performance of our software. Currently we offer two lines of ADN products: our BIG-IP family of ADCs; and our scalable, chassis-based VIPRION ADCs. Both BIG-IP and VIPRION run TMOS and support all of our product software modules. We

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also sell specialty appliances that integrate specific software services and are only available as standalone products.

Data sheets for all of our hardware platforms are available in the products section of our website.

BIG-IP Application Delivery Controllers

Products in our family of BIG-IP application delivery controllers differ primarily in their performance characteristics resulting from the hardware components and configurations that make up each system. Our current family of BIG-IP appliances includes BIG-IP 1600, BIG-IP 3600, BIG-IP 3900, BIG-IP 6900, BIG-IP 8900, BIG-IP 8950, and BIG-IP 11050.

VIPRION Application Delivery Controllers

Currently we offer two products in our line of chassis-based application delivery controllers. VIPRION 4480 and VIPRION 2400 both consist of a chassis with slots for one to four blades, each equipped with two dual-core processors. VIPRION s unique architecture distributes traffic across all available processors and allows customers to add or remove blades without disrupting traffic. It also helps customers simplify their networks by consolidating ADCs, saving management costs as well as power, space, and cooling in the datacenter.

Our high-end VIPRION application delivery controller was introduced in January 2008. Since then, new blades introduced in January 2010 and April 2012 each doubled the overall performance of the platform, enabling our current VIPRION 4480 to handle up to ten million Layer 7 requests per second.

VIPRION 2400, introduced in June 2011, was designed to make the VIPRION architecture available to customers who want the features and benefits of the platform but do not require the top-end performance of VIPRION 4480. A VIPRION 2400 chassis with one blade has a retail price comparable to the mid-range of our BIG-IP product family, and a fully-loaded VIPRION 2400 (chassis with four blades) can handle up to 4 million Layer 7 requests per second.

Both VIPRION products support all the features, functions and capabilities of TMOS Version 11, including clustered multiprocessing (CMP), virtual clustered multiprocessing (vCMP), and device service clustering (DSC).

Specialty Appliances

Access Policy Manager

BIG-IP Access Policy Manager (APM), which is available as a software module on our BIG-IP and VIPRION platforms, is also available as a standalone appliance. BIG-IP APM 1600 is a flexible, high-performance access and security solution that provides unified global access to business-critical applications and networks. APM consolidates remote access, web access management, VDI, and other resources in a single policy control point that provides easy-to-manage access policies. BIG-IP APM is also the first remote access solution to deliver full support for both IPv4 and IPv6.

Edge Gateway

BIG-IP Edge Gateway is an advanced remote access product that provides context-aware, policy controlled, secure remote access to applications at LAN speed. Edge Gateway integrates our SSL VPN remote access technology with application acceleration and optimization services at the edge of the network, giving customers remote access, access control, site-to-site security, and application acceleration on one efficient, scalable, cost-effective platform. An optional endpoint security service validates client devices with policy to protect organizations from viruses or malware infections, accidental data loss, and rogue device access.

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Edge Gateway is available as a standalone solution on the BIG-IP 1600, 3600, 3900, 6900 and 8900 platforms.

Enterprise Manager

Enterprise Manager provides a single, centralized management console for our application delivery controllers. Enterprise Manager allows customers with dozens or hundreds of our products to discover and view those products in a single window, and to upgrade or modify the software on those products simultaneously. This lowers the cost and simplifies the task of deploying, managing and maintaining our products and reduces the likelihood of error when blanket changes are implemented.

Enterprise Manager is available on three hardware platforms Enterprise Manager 4000, Enterprise Manager 3000, and Enterprise Manager 500 and as a virtual edition.

Traffix Signaling Delivery Controller

In February 2012, F5 completed the acquisition of Traffix Systems, a pioneer and industry leader in Diameter signaling and routing. The Diameter signaling protocol is a de facto standard adopted by service providers to deal with the massive increase in signaling traffic that has accompanied the industry s transition to 4G/LTE networks. The Traffix Signaling Delivery Controller (SDC) is a single platform consolidating Traffix s widely deployed Diameter Gateway, Diameter Load Balancer and Diameter Router solutions to deliver cost-effective connectivity, scalability and control to service providers migrating from legacy infrastructures to LTE and IMS networks. Traffix SDC solutions include interoperability of legacy and next-generation networks, mobile and fixed elements, and all third-party vendors. As a single Diameter platform fully compliant with 3GPP standards, the Traffix SDC enables operators to save up to 70% on OPEX and CAPEX and benefit from higher mobile data performance and an optimized experience for subscribers.

Data Solutions

F5 s data solutions products address many of the problems associated with managing today s rapidly expanding file storage infrastructure. The ARX product family is a series of high performance, enterprise-class, intelligent file virtualization devices that simplify the management of file storage environments and lower total storage costs by automating data management tasks and eliminating the disruption associated with storage management operations.

Currently, the ARX series includes three products. ARX 500 and ARX 2000 are stand-alone devices that can support up to 600 and 6,000 users, respectively. ARX 4000 is a fixed form-factor device supporting 10 gigabit Ethernet, capable of managing more than 2 billion files, and able to support up to 12,000 users. ARX is also available in a virtual edition.

To enable our customers to take advantage of inexpensive cloud storage alternatives, we offer ARX Cloud Extender, a software solution that works in concert with the automated storage tiering capabilities of ARX to extend the file storage infrastructure seamlessly from the data center to the cloud.

Product Development

We believe our future success depends on our ability to maintain technology leadership by continuing to improve our products and by developing new products to meet the changing needs of our customers. Our product development organization employs a standard process for the development, documentation and quality control of software and systems that is designed to meet these goals. This process includes working with our business development and marketing teams, product managers, customers and partners to identify new or improved solutions that meet the evolving needs of our addressable markets.

Our principal software engineering team is located in our headquarters in Seattle, Washington. Product development for FirePass, APM, WOM and WebAccelerator is located in San Jose, California. ASM and Traffix SDC product development is located in Tel Aviv, Israel. ARX product development is located in Lowell, Massachusetts. Our hardware engineering team is located in Spokane, Washington. In addition, we maintain a dedicated facility for product testing and quality control in Tomsk, Russia. Members of all our product development teams collaborate closely with one another to ensure the interoperability and performance of our hardware and software systems.

During the fiscal years ended September 30, 2012, 2011 and 2010, we had research and product development expenses of $177.4 million, $138.9 million, and $118.3 million, respectively.

Customers

Our customers include a wide variety of enterprise customers and service providers among Fortune 1000 and Business Week Global 1000 companies, including those in technology, telecommunications, financial services, transportation, education, manufacturing and healthcare, along with government customers. In fiscal year 2012, sales outside of the Americas represented 42.4% of our net revenues. Refer to Note 10 of our consolidated financial statements included in this Annual Report on Form 10-K for additional information regarding our revenues by geographic area.

Sales and Marketing

Sales

We sell our products and services to large enterprise customers and service providers through a variety of channels, including distributors, value-added resellers (VARs) and systems integrators. A substantial amount of our revenue for fiscal year 2012 was derived from these channel sales. Our sales teams work closely with our channel partners and also sell our products and services directly to major accounts.

F5 sales teams. Our inside sales team generates and qualifies leads for regional sales managers and helps manage accounts by serving as a liaison between the field and internal corporate resources. Our field sales personnel are located in major cities in four sales regions: the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and the Asia Pacific region (APAC). Field sales personnel work closely with our channel partners to assist them, as necessary, in the sale of our products and services to their customers. We also sell our products and services directly to customers, primarily large enterprises, whose accounts are managed by our major account services team. Field systems engineers support our regional sales managers and channel partners by participating in joint sales calls and providing pre-sale technical resources as needed.

Distributors and VARs. As a key component of our sales strategy, we have established relationships with a number of large national and international distributors, local and specialized distributors and VARs. We derive a majority of our product sales from these distributors and VARs.

Our agreements with these channel partners are not exclusive and do not prevent them from selling competitive products. These agreements typically have terms of one year with no obligation to renew, and typically do not provide for exclusive sales territories or minimum purchase requirements.

For fiscal year 2012, sales to two of our worldwide distributors, Avnet Technology Solutions and Ingram Micro, Inc. represented 17.1% and 13.8% of our total revenues, respectively. Our agreements with these distributors are standard, non-exclusive distribution agreements that renew automatically on an annual basis and can be terminated by either party with 30 days prior written notice. The agreements grant Avnet Technology Solutions and Ingram Micro, Inc. the right to distribute our products to resellers in North America and certain other territories internationally, with no minimum purchase requirements.

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Systems integrators. We also market our products through strategic relationships with systems integrators, including Dell Services, HP Enterprise Services and IBM Global Services, who include our products as core components of application or network-based solutions they deploy for their customers. In most cases, systems integrators do not directly purchase our products for resale to their customers. Instead they typically recommend our products as part of broader solutions, such as enterprise resource planning (ERP) or customer relationship management (CRM) solutions that incorporate our products for high availability and enhanced performance.

Marketing

Our marketing strategy is driven by the belief that our continued success depends on our ability to understand and anticipate the dynamic needs of our addressable markets and to develop valuable solutions that meet those needs. In line with this belief, our marketing organization works directly with customers, partners and our product development teams to identify and create innovative solutions to further enhance our leadership position. In addition, our business development team, which is a component of our marketing organization, closely monitors technology companies in adjacent and complementary markets for opportunities to acquire or partner with those whose solutions are complementary to ours and could enable us to expand our addressable market.

Another key component of our marketing strategy is to develop and expand our iControl partnerships. Working closely with our partners, we have developed customizable solutions templates called iApps that help ensure the successful deployment and delivery of their applications over the network. These solution templates have been integrated into TMOS Version 11 and allow customers to configure our products quickly and easily to optimize the performance of specific applications from major software vendors such as Microsoft, Oracle, VMware, and others.

To support the growing number of developers using our products, including network and application architects, we continue to promote and expand DevCentral, our on-line community website that provides technical resources to customers, prospects and partners wanting to extend and optimize F5 solutions using iRules. A key aspect of DevCentral is an on-line forum where developers as well as application and network architects discuss and share solutions they have written with iRules. At the end of fiscal year 2012, DevCentral had more than 111,000 registered members.

We also engage in a number of marketing programs and initiatives aimed at promoting our brand and creating market awareness of our technology and products. These include actively participating in industry trade shows and joint marketing events with channel and technology partners, and briefing industry analysts and members of the trade press on our latest products, business relationships and technology partnerships. In addition, we market our products to chief information officers and other information technology professionals through targeted advertising, direct mail and high-profile Web events.

Backlog

At the end of fiscal years 2012 and 2011, we had product backlog of approximately $38.8 million and $40.9 million, respectively. Backlog represents orders confirmed with a purchase order for products to be shipped generally within 90 days to customers with approved credit status. Orders are subject to cancellation, rescheduling by customers or product specification changes by customers. Although we believe that the backlog orders are firm, purchase orders may be cancelled by the customer prior to shipment without significant penalty. For this reason, we believe that our product backlog at any given date is not a reliable indicator of future revenues.

Customer Service and Technical Support

We believe that our ability to provide consistent, high-quality customer service and technical support is a key factor in attracting and retaining large enterprise customers. Accordingly, we offer a broad range of support

services that include installation, phone support, hardware repair and replacement, software updates, online tools, consulting and training services.

We provide these services directly to end users and also utilize a multi-tiered support model, leveraging the capabilities of our channel partners when applicable. Our technical support staff is strategically located in regional service centers to support our global customer base.

Prior to the installation of our products, our services personnel work with customers to analyze their network needs and determine the best way to deploy our products and configure product features and functions to meet those needs. Our services personnel also provide on-site installation and training services to help customers make optimal use of product features and functions.

Our customers typically purchase a one-year maintenance contract which entitles them to an array of services provided by our technical support team. Maintenance services provided under the contract include online updates, software error correction releases, hardware repair and replacement, and, in the majority of cases, round-the-clock call center support. Free updates of our software are available to customers with a current maintenance contract. Our technical support team also offers seminars and training classes for customers on the configuration and use of products, including local and wide area network system administration and management. In addition, we have a professional services team able to provide a full range of fee-based consulting services, including comprehensive network management, documentation and performance analysis, and capacity planning to assist in predicting future network requirements.

As part of our maintenance service, we offer an online, automated, self-help customer support function called Ask F5 that provides answers to many commonly asked questions, allowing customers to get information and solve problems quickly while significantly reducing the number of calls to our support desk. This enables us to provide comprehensive customer support while keeping our support-related expenses at a manageable, consistent level. We also offer an online service called iHealth, which allows customers to diagnose up-to-the-minute snapshots of their BIG-IP systems. Diagnoses include tailored feedback about configuration issues or code defects, a description of the issue, recommendations for resolution, and a link to further information in the AskF5 Knowledge Base.

Manufacturing

We outsource the manufacturing of our pre-configured hardware platforms to third party contract manufacturers for assembly according to our specifications.

Flextronics manufactures our ADC product line, and Sanmina-SCI manufactures our ARX product line. The subcontracting activity at Flextronics and Sanmina-SCI encompasses prototype builds, full production and direct fulfillment. Our contract manufacturers perform the following activities on our behalf; material procurement, PCB assembly and test, final assembly, system test, quality control, direct shipment and warranty repairs. We provide a rolling forecast that allows our contract manufacturers to stock component parts and other materials, plan capacity and build finished goods inventory in anticipation of end user demand. Each of the contract manufacturers procures components in volumes consistent with our forecast, necessary to assemble the products and tests the products according to our specifications. Products are then shipped to our distributors, value-added resellers, or end users. Generally, we do not own the components. Title to the products transfers from the contract manufacturers to us and then to our customers upon delivery at a designated shipment location. If the components are unused or the products are not sold within specified periods of time, we may incur carrying charges or obsolete material charges for components that our contract manufacturers purchased to build products to meet our forecast or customer orders.

Hardware platforms for our products consist primarily of commodity parts and certain custom components designed and approved by our hardware engineering group. Most of our components are purchased from sources

which we believe are readily available from other suppliers. However, several components used in the assembly of our products are purchased from a single or limited source.

During fiscal year 2010, we transitioned certain sub-assembly and testing processes of our BIG-IP products from Flextronics s facilities in Milpitas, California, to the Flextronics facility in ZhuHai, China. All sub-assemblies are configured and final tested at Flextronics s Milpitas, California for distribution to our end users.

Competition

The expanding capabilities of our product offerings have enabled us to address a growing array of market opportunities, many of which are outside the bounds of the application delivery networking market as defined and measured by industry analysts such as Gartner Group, Dell Oro and others. In addition to server load-balancing and other functions normally associated with application delivery, our suite of integrated product modules has expanded our addressable market into security, WAN optimization, policy management, and Diameter signaling, where we compete with a growing number of companies not included among traditional ADC vendors. The ability to create custom network services using iRules has also enabled us, our customers, and our partners to design solutions to problems for which there is no off-the-shelf solution. As a result, we believe the traditional definitions of our market do not encompass all of the features, functions and capabilities of our products or accurately represent the addressable market for those products.

Within the more narrowly defined traditional ADC market, several companies sell server load-balancing products. These include Brocade Communications Systems, Inc., Cisco Systems, Inc., Citrix Systems, Inc., Radware Ltd., and a number of smaller competitors: A10 Networks, Array Networks, Inc., Barracuda Networks, Inc., and Riverbed Technology, which recently acquired Zeus Technology Ltd.

In related ADC markets we compete with the following:

- Cisco, Juniper Networks and Checkpoint Systems, in the network firewall market;
- Juniper in the secure remote access market;
- Imperva and Citrix in the web application firewall market;
- Riverbed Technology and Silver Peak Systems in the WAN optimization market; and
- Tekelec and Acme Packet in the Diameter signaling market.

The principal competitive factors in the markets in which we compete include product features and performance, customer support, brand recognition, the scope of distribution and sales channels and pricing. Certain of our competitors have and may in the future adopt aggressive pricing policies to gain market share. However, because of the superior performance, broad functionality and unique capabilities of our products, which have resulted in high levels of customer satisfaction and growing brand awareness, we believe that we can and will compete effectively against such pricing policies.

Intellectual Property

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We have obtained 124 patents in the United States, 11 foreign patents and have applications pending for various aspects of our technology. Our future success depends in part on our ability to protect our proprietary rights to the technologies used in our principal products. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use trade secrets or other information that we regard as proprietary. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. Any issued patent may not preserve our proprietary position, and competitors or others may develop technologies

similar to or superior to our technology. Our failure to enforce and protect our intellectual property rights could harm our business, operating results and financial condition.

In addition to our own proprietary software, we incorporate software licensed from several third-party sources into our products. These licenses generally renew automatically on an annual basis. We believe that alternative technologies for these licenses are available both domestically and internationally.

Employees

As of September 30, 2012, we had 3,029 full-time employees, including 774 in product development, 1,278 in sales and marketing, 654 in professional services and technical support and 323 in finance, administration and operations. None of our employees is represented by a labor union. We have experienced no work stoppages and believe that our employee relations are good.

Executive Officers of the Registrant

The following table sets forth certain information with respect to our executive officers as of November 21, 2012:

Name	Age	Position
John McAdam	61	

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

	For The Three Months Ended November 30,	
	2005[1]	2004
Revenues	$ 341,231	$ 198,961
Operating Expenses:		
Cost of goods sold	285,106	139,752
Selling, general and administrative	40,344[2]	11,867
Environmental matter	—	500 [3]
Income from wholly-owned operations	15,781	46,842
Income from joint ventures	1,752	20,464
Operating income	17,533	67,306
Other income (expense):		
Interest expense	(435)	(284)
Other income (expense)	55,534 [4]	(148)
	55,099	(432)
Income before income tax and minority interests	72,632	66,874

Income tax provision		(31,135)		(23,272)
Income before minority interests		41,497		43,602
Minority interests, net of tax		(153)		(666)
Pre-acquisition interests, net of tax		186		—
Net income	$	41,530	$	42,936
Net income per share - basic:	$	1.36	$	1.41
Net income per share - diluted:	$	1.34	$	1.38

(1) The Company elected to consolidate results of two of the businesses acquired through the Hugo Neu Corporation ("HNC") separation and termination agreement as though the transaction had occurred at the beginning of the fiscal 2006, instead of the date of acquisition. The increase in revenues and operating income that resulted from the election are offset by pre-acquisition interests, net of tax.

(2) Includes a charge of $11.0 million associated with the investigation reserve (see Note 5).

(3) Fiscal 2005 amounts relate to environmental matters primarily associated with the Hylebos Waterway project.

(4) Includes a gain on disposition of joint ventures of $54.6 million.

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

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

	Class A Common Stock		Class B Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Capital	Earnings	Income/(Loss)	Total
Balance at August 31, 2004	22,022	$ 22,022	8,306	$ 8,306	$ 110,177	$ 278,374	$ 1	$ 418,880
Net income						146,867		146,867
Foreign currency translation adjustment							28	28
Comprehensive income								146,895
Class B common stock converted to Class A common stock	320	320	(320)	(320)				—
Class A common stock issued	148	148			1,511			1,659
Tax benefits from stock options exercised					14,157			14,157
Cash dividends paid - common ($0.068 per share)						(2,063)		(2,063)
Balance at August 31, 2005	22,490	22,490	7,986	7,986	125,845	423,178	29	579,528
Net income						41,530		41,530
Foreign currency translation adjustment							(60)	(60)
Comprehensive income								41,470

Stock-based compensation					494			494
Class A common stock issued	3	3			14			17
Cash dividends paid - common ($0.017 per share)						(519)		(519)
Balance at November, 2005	22,493	$ 22,493	7,986	$ 7,986	$ 126,353	$ 464,189	$ (31)	$ 620,990

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

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

	For The Three Months Ended November 30,	
	2005 (as restated)	2004 (as restated)
Cash flows from operating activities:		
Net income	$ 41,530	$ 42,936
Noncash items included in net income:		
Depreciation and amortization	6,241	5,050
Minority and pre-acquisition interests	320	1,021
Deferred income taxes	(10,206)	—
Distributed/(undistributed) equity in earnings of joint ventures	15,787	491
Stock based compensation expense	494	—
Gain on disposal of assets	(54,618)	(127)
Changes in assets and liabilities:		
Accounts receivable	21,321	13,972
Inventories	(7,753)	(12,587)
Prepaid expenses and other current assets	11,556	(108)
Other assets	1,630	53
Accounts payable	(12,684)	(1,162)
Accrued liabilities	21,409	(8,295)
Environmental liabilities	(2,959)	(3,156)
Other liabilities	(767)	159
Net cash provided by operating activities	31,301	38,247
Cash flows from investing activities:		
Capital expenditures	(15,823)	(7,531)
Acquisitions, net of cash acquired	(75,548)	—
Cash paid to joint ventures	(449)	(313)
Proceeds from sale of assets	12	398
Net cash used in investing activities	(91,808)	(7,446)
Cash flows from financing activities:		
Proceeds from line of credit	43,000	48,300
Repayment of line of credit	(33,000)	(30,800)
Proceeds from long-term debt	140,184	69,500
Repayment of long-term debt	(72,000)	(104,547)
Issuance of Class A common stock	17	1,182
Distributions to minority interests	(1,045)	(1,273)
Dividends declared and paid	(518)	(515)
Net cash provided by (used in) financing activities	76,638	(18,153)
Net increase in cash	16,131	12,648

Cash at beginning of period		20,645		11,307
Cash at end of period	$	36,776	$	23,955

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 CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED NOVEMBER 30, 2005 AND 2004

Note 1 - Restatement:

The condensed consolidated statements of operations for the three months ended November 30, 2005 have been restated due to the following:

The restatement corrects errors related to the interpretation and application of purchase accounting and the reporting of cash flows. During the three months ended November 30, 2005, as a result of a separation and termination agreement with Hugo Neu Corporation (“HNC”), the Company acquired the assets of Prolerized New England Company and Subsidiaries (“PNE”), Hugo Neu Schnitzer Global Trade-Baltic Operations (“HNSGT-Baltic”), and THS Recycling LLC, dba Hawaii Metal Recycling Company (“HMR”). Additionally, during the three months ending November 30, 2005, the Company acquired the assets of Regional Recycling, LLC (“Regional”) and purchased GreenLeaf Auto Recyclers, LLC (“GreenLeaf”). In the condensed consolidated statements of operations for the three months ended November 30, 2005, included in the Company’s Original Form 10-Q, the Company accounted for the operations of all of the acquired businesses on a consolidated basis, as of the beginning of the Company’s fiscal year 2006, with a corresponding deduction for the pre-acquisition operating results in arriving at net income.

It was determined that the acquired entities in which the Company did not have a previous interest, HMR, Regional and GreenLeaf, were accounted for incorrectly in the Company’s condensed consolidated statements of operations for the three months ended November 30, 2005 included in the Company’s Original Form 10-Q. ARB 51 allows the results of operations of entities acquired through a “step” acquisition to be consolidated as of the beginning of the fiscal year or as of the date of the acquisition. If the results of operations are consolidated as of the beginning of the fiscal year, there must be an offset for the pre-acquisition interests prior to arriving at net income. As the Company had prior joint venture interests in PNE and HNSGT-Baltic, the acquisitions of PNE and HNSGT-Baltic were each “step” acquisitions and the Company’s decision to consolidate their operations as of the beginning of fiscal year 2006 was appropriate. However, as the Company did not have a previous interest in HMR, Regional, and GreenLeaf, these acquisitions, under the provisions of SFAS 141, were not “step” acquisitions and their results of operations should have been consolidated as of the relevant dates of acquisition.

While the error did not impact net income or net income per share, it did result in the misstatement of a number of line items in the condensed consolidated statements of operations for the three months ended November 30, 2005, as presented. The error had no impact on the condensed consolidated balance sheets as of November 30, 2005 or the consolidated statements of cash flows for the three months ended November 30, 2005.

SCHNITZER STEEL INDUSTRIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED NOVEMBER 30, 2005 AND 2004

A summary of the restatements included in the condensed consolidated statements of operations in this amended filing are:

	As Previously Reported	Adjustment	As Restated
Statement of Operations for the three months ended November 30, 2005			
Revenue	$ 388,673	$ (47,442)	$ 341,231
Cost of goods sold	326,710	(41,604)	285,106
Selling, general and administrative	41,990	(1,646)	40,344
Interest expense	(981)	546	(435)
Other income, net	64,441	(8,907)	55,534
Income tax provision	(35,557)	4,422	(31,135)
Pre-acquisition interests, net of tax	(7,945)	8,131	186
Net income	41,530	—	41,530

Additionally, as a result of the error in purchase accounting, cash acquired from the Company's investments in Regional, HMR, Greenleaf, PNE and HNSGT-Baltic was classified as net cash provided by operations in error. This restatement corrects this error and reclassifies the cash acquired as a result of the acquisitions as net cash (used) provided by investments. The restatement of the consolidated statements of cash flows affects the minority interest, accrued liabilities, equity in income of joint ventures and other assets and liabilities line items in the consolidated statements of cash flows.

Finally, the consolidated statements of cash flows for the quarters ended November 30, 2005 and November 30, 2004 have been restated to correct an error in the classification of cash flows received from its interest in joint ventures. The Company had previously considered cash flows received from its joint ventures as returns of its investment and had therefore classified these cash flows as investing activities. However, the Company has now determined that the cash flows from its joint ventures should have been considered a return on its investment and classified as an operating activity as distributed/(undistributed) equity in earnings of joint ventures. The restatement does not affect net income or earnings per share and did not have an impact on the Company's consolidated statements of operations or consolidated statements of shareholders' equity for the quarters ended November 31, 2005 and November 31, 2004, nor did it have an impact on the consolidated balance sheets as of November 31, 2005 and November 31, 2004. Additionally, the Company has corrected its presentation of changes in other assets and changes in other liabilities within the cash flows from operating activities section and proceeds from line of credit, repayments of line of credit, proceeds from long-term debt, and repayments of long-term debt, within the cash flows from financing activities section of the consolidated statements of cash flows, to reflect these items gross rather than net.

SCHNITZER STEEL INDUSTRIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED NOVEMBER 30, 2005 AND 2004

Restated consolidated statements of cash flows for all affected periods reflecting the aforementioned adjustments are presented below (amounts in thousands):

	For The Three Months Ended November 30, 2005		
	As reported	Adjustment	As restated
Cash flows from operating activities:			
Net income	$ 41,530	$ —	$ 41,530
Noncash items included in net income:			
Depreciation and amortization	6,241	—	6,241
Minority and pre-acquisition interests	493	(173)	320
Deferred income taxes	(10,206)	—	(10,206)
Distributed/(undistributed) equity in earnings of joint ventures	(1,345)	17,132	15,787
Stock based compensation expense	494	—	494
Gain on disposal of assets	(54,617)	(1)	(54,618)
Changes in assets and liabilities:			
Accounts receivable	21,321	—	21,321
Inventories	(7,753)	—	(7,753)
Prepaid expenses and other current assets	11,556	—	11,556
Other assets	—	1,630	1,630
Accounts payable	(12,684)	—	(12,684)
Accrued liabilities	27,533	(6,124)	21,409
Environmental liabilities	(2,958)	(1)	(2,959)
Other liabilities	—	(767)	(767)
Other assets and liabilities	3,546	(3,546)	—
Net cash provided by operating activities	23,151	8,150	31,301
Cash flows from investing activities:			
Capital expenditures	(15,823)	—	(15,823)
Acquisitions, net of cash acquired	(85,641)	10,093	(75,548)
Cash received from joint ventures	17,957	(17,957)	—
Cash paid to joint ventures	(163)	(286)	(449)
Proceeds from sale of assets	12	—	12
Net cash used in investing activities	(83,658)	(8,150)	(91,808)
Cash flows from financing activities:			
Proceeds from line of credit	—	43,000	43,000
Repayment of line of credit	—	(33,000)	(33,000)
Proceeds from long-term debt	—	140,184	140,184
Repayment of long-term debt	—	(72,000)	(72,000)
Issuance of Class A common stock	17	—	17
Distributions to minority interests	(1,045)	—	(1,045)

Dividends declared and paid	(518)	—	(518)
Increase (decrease) in long-term debt	78,184	(78,184)	—
Net cash provided by financing activities	76,638	—	76,638
Net increase in cash	16,131	—	16,131
Cash at beginning of period	20,645	—	20,645
Cash at end of period	$ 36,776	$ —	$ 36,776

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SCHNITZER STEEL INDUSTRIES, INC.
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	For The Three Months Ended November 30, 2004		
	As reported	Adjustment	As restated
Cash flows from operating activities:			
Net income	$ 42,936	$ —	$ 42,936
Noncash items included in net income:			
Depreciation and amortization	5,050	—	5,050
Minority and pre-acquisition interests	1,021	—	1,021
Distributed/(undistributed) equity in earnings of joint ventures	(20,464)	20,955	491
Stock based compensation expense	—	—	—
Gain on disposal of assets	(127)	—	(127)
Changes in assets and liabilities:			
Accounts receivable	13,972	—	13,972
Inventories	(12,587)	—	(12,587)
Prepaid expenses and other current assets	(108)	—	(108)
	—		
Other assets	-	53	53
Accounts payable	(1,162)	—	(1,162)
Accrued liabilities	(8,295)	—	(8,295)
Environmental liabilities	(3,156)	—	(3,156)
Other liabilities	—	159	159
Other assets and liabilities	212	(212)	-
Net cash provided by operating activities	17,292	20,955	38,247
Cash flows from investing activities:			
Capital expenditures	(7,531)	—	(7,531)
Cash received from joint ventures	20,955	(20,955)	—
Cash paid to joint ventures	(313)	—	(313)
Proceeds from sale of assets	398	—	398
Net cash provided by investing activities	13,509	(20,955)	(7,446)
Cash flows from financing activities:			
Proceeds from line of credit	—	48,300	48,300
Repayment of line of credit	—	(30,800)	(30,800)
Proceeds from long-term debt	—	69,500	69,500
Repayment of long-term debt	—	(104,547)	(104,547)
Issuance of Class A common stock	1,182	—	1,182
Distributions to minority interests	(1,273)	—	(1,273)
Dividends declared and paid	(515)	—	(515)
Increase (decrease) in long-term debt	(17,547)	17,547	—
Net cash used in financing activities	(18,153)	—	(18,153)

Net increase in cash		12,648	—	12,648
Cash at beginning of period		11,307	—	11,307
Cash at end of period	$	23,955	$ —$	23,955

Note 2 - 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 and the rules and regulations of the Securities Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all adjustments, consisting only of normal, recurring adjustments considered necessary for a fair presentation, have been included. Although management believes that the disclosures made are adequate to ensure that the information presented is not misleading, management suggests that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's annual report for the fiscal

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year ended August 31, 2005. The results for the three months ended November 30, 2005 and 2004 are not necessarily indicative of the results of operations for the entire year.

Reclassifications
Certain prior year amounts have been reclassified to conform to the current year presentation. These changes had no impact on previously reported results of operations or shareholders' equity.

Cash and Cash Equivalents
Cash and cash equivalents include short-term securities that are not restricted by third parties and have an original maturity date of 90 days or less. Included in accounts payable are book overdrafts of $12.6 million and $11.5 million as of November 30, 2005 and August 31, 2005, respectively.

Earnings and Dividends per Share
Basic earnings per share (EPS) is computed based upon the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. All of the options issued through and outstanding as of November 30, 2005, except for 155,900 shares granted on November 29, 2005, are considered to be dilutive.

The following represents the reconciliation from basic EPS to diluted EPS (in thousands, except per share amounts):

	For the Three Months Ended November 30,	
	2005	2004
Net Income	$ 41,530	$ 42,936
Computation of shares:		
Average common shares outstanding	30,477	30,350
Stock options	560	793
Diluted average common shares outstanding	31,037	31,143
Basic EPS	$ 1.36	$ 1.41
Diluted EPS	$ 1.34	$ 1.38
Dividend per share	$ 0.017	$ 0.017

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Goodwill and Intangible Assets

The changes in the carrying amount of goodwill for the three months ended November 30, 2005 are as follows (in thousands):

	Metals Recycling Business	Auto Parts Business	Total
Balance as of August 31, 2005	$ 34,771	$ 116,583	$ 151,354
Acquisition of GreenLeaf Auto Recyclers, LLC (see Note 4)		14,001	14,001
Separation and termination of joint venture relationships with Hugo Neu Corporation (see Note 4)	61,557		61,557
Acquisition of Regional Recycling LLC assets (see Note 4)	39,915		39,915
Balance as of November 30, 2005	$ 136,243	$ 130,584	$ 266,827

The Company performs impairment tests annually during the second quarter of the fiscal year and whenever events and circumstances indicate that the value of goodwill and other indefinite-lived intangible assets might be impaired. Based on to the operating results of each of the businesses identified above and the Company's impairment testing completed in the second quarter of fiscal 2005, the Company determined that none of the above balances were considered impaired.

New Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS 151, "Inventory Costs". This statement clarifies the accounting for abnormal amounts of idle facility expense and freight and handling costs when those costs may be so abnormal as to require treatment as period charges. This statement is effective for fiscal years beginning after June 15, 2005. The Company adopted SFAS 151 on September 1, 2005 with no material impact on the consolidated financial statements.

In December 2004, the FASB issued SFAS 153, "Exchanges of Nonmonetary Assets." This statement explains that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. This statement is effective for fiscal years beginning after June 15, 2005. The Company adopted SFAS 153 on September 1, 2005 with no material impact on the consolidated financial statements.

In June 2005, the FASB issued SFAS 154, "Accounting Changes and Error Corrections." This statement revises the reporting requirements related to changes in accounting principles or adoption of new accounting pronouncements. This statement is effective for fiscal years beginning after December 15, 2005. The Company does not anticipate this pronouncement to have a material impact on the consolidated financial statements.

In December 2004, the FASB finalized SFAS No. 123(R) “Share-Based Payment“, which will be effective for the first interim reporting period of the first fiscal year beginning after June 15, 2005. The new standard requires the Company to expense stock options beginning in the first quarter of fiscal 2006. The Company adopted SFAS No. 123(R), effective September 1, 2005. SFAS 123(R) requires the recognition of the fair value of stock-based compensation in net income. The Company recognizes stock-based compensation expense over the requisite service period of the individual grants, which generally equals the vesting period. See Note 8 for further information regarding stock based compensation.

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Note 3 - Inventories:

Inventories consisted of the following (in thousands):

	November 30, 2005	August 31, 2005
Recycled metals	$ 124,702	$ 38,027
Work in process	8,084	17,124
Finished goods	62,984	36,304
Supplies	15,958	14,734
	$ 211,728	$ 106,189

Note 4 - Business Combinations

Hugo Neu Corporation Separation and Termination Agreement

On September 30, 2005, the Company, HNC and certain of their subsidiaries closed a transaction to separate and terminate their metals recycling joint venture relationships. The Company received the following as a result of the HNC joint venture separation and termination:

- The assets and related liabilities of Hugo Neu Schnitzer Global Trade related to a trading business in parts of Russia and the Baltic region, including Poland, Denmark, Finland, Norway and Sweden, and a non-compete agreement from HNC that bars it from buying scrap metal in certain areas in Russia and the Baltic region for a five-year period ending on June 8, 2010.
- The joint ventures' various interests in the New England operations that primarily operate in Massachusetts, New Hampshire, Rhode Island and Maine.
  - Full ownership in the Hawaii metals recycling business that was previously owned 100% by HNC.
- A payment of $36.6 million in cash, net of debt paid, subject to post-closing adjustments.

HNC received the following as result of the HNC joint venture separation and termination:

- The joint venture operations in New York, New Jersey and California, including the scrap processing facilities, marine terminals and related ancillary satellite sites, the interim New York City recycling contract, and other miscellaneous assets.
- The assets and related liabilities of Hugo Neu Schnitzer Global Trade that are not related to the Russian and Baltic region trading business.

The agreement provides for potential purchase price adjustments based on the closing date working capital of the acquired Hawaii business as well as the joint ventures' ending balances. The Company has not determined whether any purchase price adjustments will be necessary.

In accordance with SFAS 141, "Business Combinations," the purchase price of the acquired assets and liabilities assumed under the separation and termination agreement is the fair value of the joint venture interests given up as part of the exchange as well as

cash received, other liabilities assumed and acquisition costs, net of cash received. As a result, the purchase price is estimated to be $165.1 million, including acquisition costs of approximately $6.3 million. The $54.6 million gain resulting from the joint venture divesture represents the difference between the fair value of $160.1 million and the carrying value of $105.5 million of the joint ventures.

The purchase price was allocated to tangible and intangible identifiable assets acquired and liabilities assumed based on an estimate of the respective fair values. Final valuation reports are pending from a third party. The excess of the aggregate purchase price over the fair value of the identifiable net assets acquired of approximately $57.6 million was recognized as goodwill. Approximately $3.8 million of goodwill existed on the joint

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ventures' balance sheets prior to the separation and termination but was not shown separately in accordance with the equity method of accounting. Therefore, the total increase to goodwill related to the HNC Separation and Termination Agreement was $61.6 million.

The purchase price allocation has been prepared on a preliminary basis, and reasonable changes are expected as additional information, such as final valuation reports and any purchase price adjustments, becomes available. The following is a summary of the estimated fair values as November 30, 2005, for the assets acquired and liabilities assumed as of the date of the acquisition (in millions):

Cash, net of debt paid	$	36.6
Property, plant and equipment		26.1
Inventory		35.4
Other assets		30.8
Identified intangible assets		3.0
Liabilities		(24.4)
Goodwill		57.6
Total purchase price	$	165.1

GreenLeaf Acquisition
On September 30, 2005, the Company acquired GreenLeaf, five properties previously leased by GreenLeaf and certain GreenLeaf debt obligations. GreenLeaf is engaged in the business of auto dismantling and recycling and sells its products primarily to collision and mechanical repair shops. GreenLeaf currently operates in one wholesale sales office and 19 commercial locations throughout the United States. Total purchase price for the acquisition, including acquisition costs, was $44.7 million, subject to post-closing adjustments.

The purchase price of the GreenLeaf acquisition was allocated to tangible and intangible identifiable assets acquired and liabilities assumed based on an estimate of fair value. The machinery and equipment is being valued by the Company's management. The excess of the aggregate purchase price over the estimated fair value of the identifiable net assets acquired of $14.0 million was recognized as goodwill.

The purchase price allocation has been prepared on a preliminary basis, and reasonable changes are expected as additional information becomes available, such as final valuation reports and any post-closing adjustments. The following is a summary of the estimated fair values as of November 30, 2005, for the assets acquired and liabilities assumed on the date of the acquisition (in millions):

Property, plant and equipment	$	14.6
Inventory		20.8
Other assets		18.8
Liabilities		(23.5)
Goodwill		14.0

Total purchase price	$	44.7

Regional Recycling Acquisition

On October 31, 2005, the Company purchased substantially all of the assets of Regional for $65.5 million in cash and the assumption of certain liabilities, a working capital adjustment of $2.9 million and acquisition costs of approximately $0.5 million. Regional operates 10 metals recycling facilities located in the states of Georgia and Alabama which process ferrous and nonferrous scrap metals without the use of shredders.

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The purchase price of the Regional acquisition was allocated to tangible and intangible identifiable assets acquired and liabilities assumed based on an estimate of the respective fair values. Final valuation reports are pending from a third party. The excess of the aggregate purchase price over the estimated fair value of the identifiable net assets acquired of approximately $39.9 million was recognized as goodwill.

The purchase price allocation has been prepared on a preliminary basis, and reasonable changes are expected as additional information becomes available, such as final valuation reports. The following is a summary of the estimated fair values as November 30, 2005, for the assets acquired and liabilities assumed as of the date of the acquisition (in millions):

Property, plant and equipment	$	10.6
Accounts Receivable		27.7
Inventory		4.9
Other assets		1.1
Liabilities		(15.3)
Goodwill		39.9
Total purchase price	$	68.9

The total aggregate goodwill recognized from the recent acquisitions amounted to $115.5 million. In accordance with SFAS 142, goodwill is not amortized and will be tested for impairment at least annually. Goodwill recognized in connection with the HNC separation and termination and the Regional acquisition is deductible for tax, whereas that recognized in connection with GreenLeaf, an acquisition of equity interests, is not. Payment of the consideration for the recently acquired businesses was funded by the Company’s existing cash balances and credit facility.

During the first quarter of fiscal 2006, the Company recorded a gain of $54.6 million related to the disposition of assets pursuant to the HNC separation and termination. The transaction, which included selling certain assets previously owned through the joint venture, was recorded using the fair value of the assets with consideration of business valuations performed by a third party. The fair value of net assets received exceeded the carrying value of the assets sold, resulting in the gain recorded. Any change to the fair value in the final third party valuations would directly impact the gain recorded.

In connection with the HNC separation and termination, and the GreenLeaf and Regional acquisitions, the Company conducted environmental due diligence reviews of the acquired assets. Based upon the information obtained in the reviews in the first quarter of fiscal 2006, the Company accrued $24.8 million in environmental liabilities for probable and reasonably estimable future remediation costs at the acquired facilities. No environmental proceedings are pending with respect to any of these facilities.

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The following table is prepared on a pro forma basis, for the three month period ended November 30, 2005 and 2004, respectively, as though all of the businesses acquired through the HNC separation and termination agreement and the GreenLeaf and Regional acquisitions had occurred as of the beginning of the periods presented (in thousands, except per share amounts).

	For the Three Months Ended November 30,	
	2005 (pro forma)	2004 (pro forma)
Gross revenues	$ 388,673	$ 440,861
Net Income	$ 49,475	$ 48,679
Net Income per share:		
Basic	$ 1.62	$ 1.60
Diluted	$ 1.60	$ 1.56

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

Note 5 - Environmental Liabilities and Other Contingencies:

The Company considers various factors when estimating its environmental liabilities. Adjustments to the liabilities are made when additional information becomes available that affects the estimated costs to study or remediate any environmental issues. The factors which the Company considers in its recognition and measurement of environmental liabilities include the following:

- Current regulations, both at the time the reserve is established and during the course of the remediation, which specify standards for acceptable remediation;
- Information about the site that becomes available as the site is studied and remediated;
- The professional judgment of both senior-level internal staff and external consultants, who take into account similar, recent instances of environmental remediation issues, among other considerations;
- Available technologies that can be used for remediation; and
- The number and financial condition of other potentially responsible parties and the extent of their responsibility for the remediation.

Metals Recycling Business
In connection with acquisitions in the Metals Recycling Business in 1995 and 1996, the Company carried over to its financial statements reserves for environmental liabilities previously recorded by the acquired companies. These reserves are evaluated quarterly according to Company policy. On November 30, 2005, environmental reserves for the Metals Recycling Business aggregated $26.7 million.

Hylebos Waterway Remediation. General Metals of Tacoma (GMT), a subsidiary of the Company, owns and operates a metals recycling facility located in the State of Washington on the Hylebos Waterway, a part of Commencement Bay, which is the subject of an ongoing remediation project by the United States Environmental Protection Agency (EPA) under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). GMT and more than 60 other parties were named potentially responsible parties (PRPs) for the investigation and clean-up of contaminated sediment along the Hylebos Waterway. On March 25, 2002, EPA issued Unilateral Administrative Orders (UAOs) to GMT and another party (Other Party) to proceed with Remedial Design and Remedial Action (RD/RA) for the head of the Hylebos and to two other parties to proceed with the RD/RA for the balance of the waterway. The UAO for the head of the Hylebos Waterway was converted to a

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voluntary consent decree in 2004, pursuant to which GMT and the Other Party agreed to remediate the head of the Hylebos Waterway.

There are two phases to the remediation of the head of the Hylebos Waterway. The first phase was the intertidal and bank remediation, which was conducted in 2003 and early 2004. The second phase is dredging in the head of the Hylebos Waterway, which began on July 15, 2004. During fiscal 2005, the Company paid remediation costs of $15.9 million related to Hylebos dredging which resulted in a reduction of the recorded environmental liability. The Company's cost estimates were based on the assumption that dredge removal of contaminated sediments would be accomplished within one dredge season during July 2004 - February 2005. However, due to a variety of factors, including dredge contractor operational issues and other dredge related delays, the dredging was not completed during the first dredge season. As a result, the Company recorded environmental charges of $13.5 million in fiscal 2005 primarily to account for additional estimated costs to complete this work during a second dredging season, and the total reserve for this site was $10.6 million at August 31, 2005. In the first quarter of fiscal 2006, the Company incurred remediation costs of $3.9 million which were charged to the environmental reserves, and on November 30, 2005, environmental reserves for the Hylebos Waterway aggregated $6.7 million. The Company and the Other Party have filed a complaint in the United States District Court for the Western District of Washington against the dredge contractor to recover damages and a significant portion of the increased costs incurred in the second dredging season to complete the project.

GMT and the Other Party are pursuing settlement negotiations and legal actions against other non-settling, non-performing PRPs to recover additional amounts that may be applied against the head of the Hylebos remediation costs. During fiscal 2005, the Company recovered $0.7 million from four non-performing PRPs. This amount had previously been taken into account as a reduction in the Company's reserve for environmental liabilities. Uncertainties continue to exist regarding the total cost to remediate this site as well as the Company's share of those costs; nevertheless, the Company's estimate of its liabilities related to this site is based on information currently available.

The Natural Resource Damage Trustees (Trustees) for Commencement Bay have asserted claims against GMT and other PRPs within the Hylebos Waterway area for alleged damage to natural resources. In March 2002, the Trustees delivered a draft settlement proposal to GMT and others in which the Trustees suggested a methodology for resolving the dispute, but did not indicate any proposed damages or cost amounts. In June 2002, GMT responded to the Trustees' draft settlement proposal with various corrections and other comments, as did twenty other participants. In February 2004, GMT submitted a settlement proposal to the Trustees for a complete settlement of Natural Resource Damage liability for the GMT site. The proposal included three primary components: (1) an offer to perform a habitat restoration project; (2) reimbursement of Trustee past assessment costs; and (3) payment of Trustee oversight costs. The agreement would also address liability sub-allocation to other parties historically associated with the facility. In December 2005 the Trustees responded to

the GMT proposal. There remain significant differences between the parties and negotiations are continuing. It is unknown at this time whether, or to what extent, GMT will be liable for natural resource damages. The Company's previously recorded environmental liabilities include an estimate of the Company's potential liability for these claims.

Portland Harbor. In December 2000, the United States Environmental Protection Agency (EPA) named the Portland Harbor, a 5.5 mile stretch of the Willamette River in Portland, Oregon, as a Superfund site. The Company's metals recycling and deep water terminal facility in Portland, Oregon is located adjacent to the Portland Harbor. Crawford Street Corporation (CSC), a Company subsidiary, also owns property adjacent to the Portland Harbor. The EPA has identified 69 PRPs, including the Company and CSC, which own or operate sites adjacent to the Portland Harbor Superfund site. The precise nature and extent of any clean-up of the Portland Harbor, the parties to be involved, the process to be followed for such a clean-up, and the allocation of

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any costs for the clean-up among responsible parties have not yet been determined. It is unclear whether or to what extent the Company or CSC will be liable for environmental costs or damages associated with the Superfund site. It is also unclear whether or to what extent natural resource damage claims or third party contribution or damages claims will be asserted against the Company. While the Company and CSC participated in certain preliminary Portland Harbor study efforts, they are not parties to the consent order entered into by the EPA with other PRPs (Lower Willamette Group) for a Remedial Investigation/Feasibility Study (RI/FS); however, the Company and CSC could become liable for a share of the costs of this study at a later stage of the proceedings.

Separately, the Oregon Department of Environmental Quality (DEQ) has requested operating history and other information from numerous persons and entities which own or conduct operations on properties adjacent to or upland from the Portland Harbor, including the Company and CSC. The DEQ investigations at the Company and CSC sites are focused on controlling any current releases of contaminants into the Willamette River. The Company has agreed to a voluntary Remedial Investigation/Source Control effort with the DEQ regarding its Portland, Oregon deep water terminal facility and the site owned by CSC. DEQ identified these sites as potential sources of contaminants that could be released into the Willamette River. The Company believes that improvements in the operations at these sites, often referred to as Best Management Practices (BMPs), will provide effective source control and avoid the release of contaminants from these sites and has proposed to DEQ the implementation of BMPs as the resolution of this investigation.

The cost of the investigations associated with these properties and the cost of employment of source control BMPs are not expected to be material. No estimate is currently possible, and none has been made, as to the cost of remediation for the Portland Harbor or the Company's or CSC's adjacent properties.

Other Metals Recycling Business Sites. For a number of years prior to the Company's 1996 acquisition of Proler International Corp. (Proler), Proler operated an industrial waste landfill in Texas, which Proler utilized to dispose of auto shredder residue (ASR) from one of its operations. In August 2002, Proler entered the Texas Commission on Environmental Quality (TCEQ) Voluntary Cleanup Program (VCP) toward the pursuit of a VCP Certificate of Completion for the former landfill site. In fiscal 2005, TCEQ issued a Conditional Certificate of Completion, requiring the Company to perform on-going groundwater monitoring and annual inspections, maintenance and reporting. As a result of the resolution of this issue, the Company reduced its reserve related to this site by $1.6 million in fiscal 2005.

During the second quarter of fiscal 2005, in connection with the negotiation of the separation and termination agreement relating to the Company's metals recycling joint ventures with HNC (see Note 4), the Company conducted an environmental due diligence investigation of certain joint venture businesses it proposed to acquire. As a result of this investigation, the Company identified certain environmental risks and accrued $2.6 million for its share of the estimated costs to remediate these risks upon

completion of the separation. During the first quarter of fiscal 2006, an additional $12.8 million was recorded representing the remaining portion of the environmental liabilities associated with the separation and termination agreement as well as the Regional acquisition of which $0.3 million was expended in remediation efforts. No environmental proceedings are pending with respect to any of these sites.

The Washington State Department of Ecology named GMT, along with a number of other parties, as Potentially Liable Parties (PLPs) for a site referred to as Tacoma Metals. GMT operated on this site under a lease prior to 1982. The property owner and current operator have taken the lead role in performing a Remedial Investigation and Feasibility Study (RI/FS) for the site. The Company's previously recorded environmental liabilities include an estimate of the Company's potential liability at this site.

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A Company subsidiary is also a named PRP at another third-party site at which it allegedly disposed of automobile shredder residue. The site has not yet been subject to significant remedial investigation. In addition to the matters discussed above, the Company's environmental reserve includes amounts for potential future cleanup of other sites at which the Company or its acquired subsidiaries have conducted business or allegedly disposed of other materials.

Auto Parts Business

From fiscal 2003 through the first quarter of fiscal 2006, the Company completed four acquisitions of businesses in the Auto Parts Business segment. At the time of each acquisition, the Company conducted an environmental due diligence investigation related to locations involved in the acquisition. As a result of the environmental due diligence investigations, the Company recorded a reserve for the estimated cost to address certain environmental matters. The reserve is evaluated quarterly according to the Company policy. On November 30, 2005, environmental reserves for the Auto Parts Business aggregated $18.7 million, which includes an environmental reserve for the GreenLeaf acquisition. No environmental proceedings are pending with respect to any of these sites.

Other Contingencies

The Company had a past practice of making improper payments to the purchasing managers of customers in Asia in connection with export sales of recycled ferrous metals. The Company stopped this practice after it was advised in 2004 that it raised questions of possible violations of U.S. and foreign laws. Thereafter, the Audit Committee was advised and conducted a preliminary compliance review. On November 18, 2004, on the recommendation of the Audit Committee, the Board of Directors authorized the Audit Committee to engage independent counsel and conduct a thorough, independent investigation. The Board of Directors also authorized and directed that the existence and the results of the investigation be voluntarily reported to the U.S. Department of Justice (DOJ) and the SEC, and that the Company cooperate fully with those agencies. The Audit Committee notified the DOJ and the SEC of the independent investigation, engaged outside counsel to assist in the independent investigation and instructed outside counsel to fully cooperate with the DOJ and the SEC and to provide those agencies with the information obtained as a result of the independent investigation. On August 23, 2005, the Company received from the SEC a formal order of investigation related to the independent investigation. The Audit Committee is continuing its independent investigation. The Company, including the Audit Committee, continues to cooperate fully with the DOJ and the SEC. The investigations of the Audit committee, the DOJ and the SEC are not expected to affect the Company's previously reported financial results. However, the Company expects to enter into agreements with the DOJ and the SEC to resolve the above-referenced matters and believes that it is probable that the DOJ and SEC will impose penalties on, and require disgorgement of certain profits by, the Company as a result of their investigations. The Company estimates that the total amount of these penalties and disgorgement will be within a range of $11.0 million to $15.0 million. In the first quarter of 2006, the Company established a reserve totaling $11.0 million in connection with this estimate. The precise terms of any agreements to be entered into

with the DOJ and the SEC, however, remain under discussion with these two agencies. The Company, therefore, cannot predict with certainty the results of the aforementioned investigations or whether the Company or any of its employees will be subject to any additional remedial actions following completion of these investigations.

Note 6 - Long Term Debt

On November 8, 2005, the Company entered into an amended and restated unsecured committed bank credit agreement with Bank of America, N.A., as administrative agent, and the other lenders party thereto. The agreement provides for a five-year, $400.0 million revolving credit facility loan maturing in November 2010. The agreement prior to restatement provided for a $150.0 million revolving credit facility maturing in May 2006. Interest on outstanding indebtedness under the restated agreement is based, at the Company's option, on either LIBOR plus a spread of between 0.625% and 1.25%, with the amount of the spread based on a pricing grid tied to the Company's leverage ratio, or the greater of the prime rate or the federal funds rate plus 0.50%. In addition, annual commitment

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fees are payable on the unused portion of the credit facility at rates between 0.15% and 0.25% based on a pricing grid tied to the Company's leverage ratio. The restated agreement contains various representations and warranties, events of default and financial and other covenants, including covenants requiring maintenance of a minimum fixed charge coverage ratio and a maximum leverage ratio. The Company also has an additional unsecured credit line totaling $10.0 million, which is uncommitted. This additional debt agreement also has certain restrictive covenants. The fair value of long-term debt is deemed to be the same as that reflected in the condensed consolidated balance sheets given the variable interest rates. As of November 30, 2005, the Company had aggregate borrowings outstanding under its credit facilities of $86.0 million and was in compliance with the representations, warranties and covenants of its debt agreements.

Note 7 - Related Party Transactions

The Company leases its administrative offices under operating leases from Schnitzer Investment Corp. (SIC), a Schnitzer family controlled business engaged in real estate. The current leases expire in 2013, and annual rent was $0.4 million in fiscal 2005. Lease amendments have been executed under which, upon completion of tenant improvements, one lease will be terminated; the premises leased under the other lease will be increased; annual rent will accordingly increase to $0.5 million; and the lease term will be extended to 2015.

The Company and SIC are parties to a shared services agreement. Starting in fiscal 2005 and continuing into fiscal 2006, the Company has reduced or ceased the sharing of administrative services with SIC and other Schnitzer family companies in a number of areas as part of a process expected to eliminate substantially all the sharing of services between the Company and SIC in fiscal 2006. All transactions with the Schnitzer family (including Schnitzer family companies) require the approval of the Company's Audit Committee, and the Company is in compliance with this policy.

Thomas D. Klauer, Jr., President of the Company's Auto Parts Business, is the sole shareholder of a corporation that is the 25% minority partner in a partnership with the Company that operates four Pick-N-Pull stores in Northern California. Mr. Klauer's 25% share of the profits of this partnership totaled $0.4 million in the first fiscal quarter of 2006 and $1.6 million in fiscal 2005. Mr. Klauer also owns the property at one of these stores which is leased to the partnership under a lease providing for annual rent of $0.2 million, subject to annual adjustments based on the Consumer Price Index, and a term expiring in December 2010. The partnership has the option to renew the lease, upon its expiration, for a five-year period.

Note 8 - Stock Incentive Plan

The Company has adopted the 1993 Stock Incentive Plan (Plan) for its employees, consultants, and directors. Pursuant to the provisions of the Plan, as amended, the

Company is authorized to issue up to 7,200,000 shares of Class A Common Stock. Stock options are granted to employees at exercise prices equal to the fair market value of the Company's stock at the dates of grant. Generally, stock options granted to employees fully vest five years from the date of grant and have a contractual term of 10 years.

Adoption of SFAS 123(R). The Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment," effective September 1, 2005. SFAS 123(R) requires the recognition of the fair value of stock-based compensation in net income. The Company recognizes stock-based compensation expense over the requisite service period of the individual grants, which generally equals the vesting period.

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Prior to September 1, 2005, the Company accounted for the Plan under the intrinsic value method described in Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. The Company, applying the intrinsic value method, did not record stock-based compensation cost in net income because the exercise price of its stock options equaled the market price of the underlying stock on the date of grant. The Company has elected to utilize the modified prospective transition method for adopting SFAS 123(R). Under this method, the provisions of SFAS 123(R) apply to all awards granted or modified after the date of adoption. In addition, the unrecognized expense of awards unvested at the date of adoption, determined under the original provisions of SFAS 123, will be recognized in net income in the periods after the date of adoption.

The Company recognized stock-based compensation costs in the amount of $0.5 million for the three months ended November 30, 2005.

The fair value of each option grant under the Plan was estimated at the date of grant using the Black-Scholes Option Pricing Model, which utilizes assumptions related to volatility, the risk-free interest rate, the dividend yield, and employee exercise behavior. Expected volatilities utilized in the model are based primarily on the historical volatility of the Company's stock price and other factors. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the time of grant. The model incorporates exercise and post-vesting forfeiture assumptions based on an analysis of historical data. The expected lives of the grants are derived from historical data and other factors.

As of November 30, 2005, the total remaining unrecognized compensation cost related to non-vested stock options amounted to $5.8 million. The weighted average remaining requisite service period of the non-vested stock options was 27 months.

In accordance with the applicable provisions of SFAS 123(R) and FASB Staff Position (FSP) FAS 123(R)-3 issued on November 10, 2005, the Company elected to use the short-form method to calculate the Windfall tax pool (Windfall) as of September 1, 2005, against which any future deficiency in actual tax benefits from exercises of stock options as compared to tax benefits recorded under SFAS 123(R), defined as "Shortfall," will be offset.

Periods Prior to Adoption. SFAS 123(R) requires the Company to present pro forma information for periods prior to adoption as if the Company had accounted for all stock-based compensation under the fair value method of that statement. For purposes of pro forma disclosure, the estimated fair value of the options at the date of grant is amortized over the requisite service period, which generally equals the vesting period. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions to its stock-based employee compensation:

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FOR THE THREE MONTHS ENDED NOVEMBER 30, 2005 AND 2004

	For the Three Months Ended November 30, 2004
Reported net income	$ 42,936
Add: Stock based compensation costs included in reported net income, net of tax	225
Deduct: Total stock based employee compensation benefit (expense) under fair value based method for all awards, net of tax	(125)
Pro forma net income	$ 43,036
Reported basic income per share	$ 1.41
Pro forma basic income per share	$ 1.42
Reported diluted income per share	$ 1.38
Pro forma diluted income per share	$ 1.38

Note 9 - Employee Benefits

The Company has a number of retirement benefit plans that cover both union and non-union employees. The Company makes contributions following the provisions in each plan.

Primary actuarial assumptions are determined as follows:

- The expected long-term rate of return on plan assets is based on the Company's estimate of long-term returns for equities and fixed income securities weighted by the allocation of assets in the plans. The rate is affected by changes in general market conditions, but because it represents a long-term rate, it is not significantly affected by short-term market swings. Changes in the allocation of plan assets would also impact this rate.
- The assumed discount rate is used to discount future benefit obligations back to current dollars. The U.S. discount rate is as of the measurement date of August 31, 2005. This rate is sensitive to changes in interest rates. A decrease in the discount rate would increase the Company's obligation and expense.
- The expected rate of compensation increase is used to develop benefit obligations using projected pay at retirement. This rate represents average long-term salary increases and is influenced by the Company's compensation policies. An increase in this rate would increase the Company's obligation and expense.

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Defined Benefit Pension Plan

The Company maintains a defined benefit pension plan for certain nonunion employees. The components of net periodic pension benefit cost are (in thousands):

	For the Three Months Ended November 30,	
	2005	2004
Service cost	$ 294	$ 164
Interest cost	180	106
Expected return on plan assets	(220)	(121)
Amortization of past service cost	1	1
Recognized actuarial loss	51	30
Net periodic pension benefit cost	$ 306	$ 180

The Company expects to contribute $1.2 million to its defined benefit pension plan for the year ending August 31, 2006. During the quarter ended November 30, 2005, the Company made no contributions to the defined benefit pension plan. The Company typically makes annual contributions to the plan after it receives the annual actuarial valuation report. These payments are typically made in the Company's third and fourth fiscal quarters.

Defined Contribution Plans

The Company has several defined contribution plans covering nonunion employees. Company contributions to the defined contribution plans were as follows (in thousands):

	For the Three Months Ended November 30,	
	2005	2004
Plan costs	$ 521	$ 346

Multiemployer Pension Plans

In accordance with collective bargaining agreements, the Company contributes to multiemployer pension plans. Company contributions were as follows (in thousands):

	For the Three Months Ended November 30,	
	2005	2004
Plan contributions	$ 870	$ 738

The Company is not the sponsor or administrator of these multiemployer plans. Contributions were determined in accordance with provisions of negotiated labor contracts. The Company is unable to determine its relative portion of or estimate its future liability under the plans.

The Company learned during fiscal 2004 that one of the multiemployer plans for the Steel Manufacturing Business would not meet Employee Retirement Income Security Act of 1974 minimum funding standards for the plan year ended September 30, 2004. The trustees of that plan have applied to the Internal Revenue Service (IRS) for certain relief from this minimum funding standard. The IRS has tentatively responded, indicating a willingness to consider granting the relief provided the plan's contributing employers, including the Company, agree to increased contributions. The increased contributions are estimated to average 6% per year, compounded annually, until the plan reaches the funding status required by the IRS. These increases would be based on the Company's current contribution level to the plan of approximately $1.7 million per year. Based on commitments from the majority of employers participating in the plan to make the increased contributions, the plan trustees have proceeded with the relief request and are awaiting formal approval from the IRS.

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Absent relief by the IRS, the plan's contributing employers will be required to make additional contributions or pay an excise tax that may equal or exceed the full amount of the funding deficiency. The Company estimated its share of the required additional contribution for the 2004 plan year to be approximately $1.1 million and accrued for such amount in fiscal 2004. The Company did not accrue additional amounts for fiscal 2005 or the first quarter of fiscal 2006, based on the Company's belief that it is probable the IRS will grant relief.

Note 10 - Segment Information

The Company operates in three industry segments: metal processing and recycling (Metals Recycling Business), self-service and full-service used auto parts sales (Auto Parts Business) and mini-mill steel manufacturing (Steel Manufacturing Business). Additionally, the Company is a non-controlling partner in joint ventures that are suppliers of unprocessed metals and, prior to October 1, 2005, other joint ventures in the metals recycling business. In prior fiscal years, the Company considered these joint ventures to be separate segments because they were managed separately. These joint ventures are accounted for using the equity method. As such, the operating information related to the joint ventures is shown separately from consolidated information, except for the Company's equity in the net income of, investments in and advances to the joint ventures. Additionally, assets and capital expenditures are not shown for the joint ventures, as management does not use that information to allocate resources or assess performance. The Company does not allocate corporate interest income and expense, income taxes or other income and expenses related to corporate activity to its operating segments.

Revenues from external customers and from intersegment transactions for the Company's consolidated operations are as follows (in thousands):

	For the Three Months Ended November 30,	
	2005 (as restated)	2004
Metals Recycling Business	$ 241,430[(1)]	$ 144,532
Auto Parts Business	45,922	23,386
Steel Manufacturing Business	89,156	70,022
Intersegment revenues	(35,277)	(38,979)
Consolidated revenues	$ 341,231	$ 198,961

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SCHNITZER STEEL INDUSTRIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED NOVEMBER 30, 2005 AND 2004

The Company’s operating income is as follows (in thousands):

	For the Three Months Ended November 30,	
	2005 (as restated)	2004
Metals Recycling Business	$ 12,002 [1]	$ 33,788[2]
Auto Parts Business	7,737	7,048
Steel Manufacturing Business	16,070	12,760
Joint Ventures [3]	1,732	20,464
Total segment operating income	37,541	74,060
Corporate expense	(19,479)	(3,591)
Intercompany profit eliminations	(529)	(3,163)
Total operating income	$ 17,533	$ 67,306

[1] The Company elected to consolidate results of two of the businesses acquired through the HNC separation and termination agreement as though the transaction had occurred at the beginning of fiscal 2006, instead of the date of acquisition. The increase in revenues and operating income that resulted from the election is offset by pre-acquisition interests, net of tax. See Note 2 and Note 4 to the condensed consolidated financial statements.

[2] Includes $500 thousand of environmental expenses related to the Hylebos Waterway project.

[3] As a result of the HNC joint venture separation and termination agreement, the Joint Venture segment was eliminated and the results for the businesses acquired in this transaction that the Company is now managing, along with other smaller joint ventures, have been consolidated into the Metals Recycling Business beginning in fiscal 2006. Included in the Joint Venture segment for fiscal 2005 is estimated operating income for these two businesses of $9,465 for the three months ended November 30, 2005.

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SCHNITZER STEEL INDUSTRIES, INC.

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

Restatement

The Company has restated its condensed consolidated statement of operations for the quarter ended November 30, 2005 and its condensed consolidated statements of cash flows for the quarter ended November 30, 2005 and 2004. See Note 1 to the condensed consolidated financial statements for additional details. All amounts in the following discussion have been restated where necessary for the effect of the restatement.

General

Schnitzer Steel Industries, Inc. (the Company) operates in three vertically integrated business segments that include metal processing and recycling (Metals Recycling Business), self-service and full-service used auto parts sales (Auto Parts Business) and mini-mill steel manufacturing (Steel Manufacturing Business). The Metals Recycling Business collects, processes and recycles metals by operating one of the largest metals recycling businesses in the United States. The Auto Parts Business operates as Pick-N-Pull, which the Company believes is one of the country's leading self-service used auto parts networks, and GreenLeaf, the acquisition of which positions the Company in the full-service market. Additionally, Pick-N-Pull is a supplier of auto bodies to the Metals Recycling Business, which processes the auto bodies into sellable recycled metal. The Steel Manufacturing Business purchases recycled metals from the Metals Recycling Business and other sources and uses its mini-mill to process the recycled metals into finished steel products. As a result of the vertical integration the Company is able to transform auto bodies and other unprocessed metals into finished steel products.

Metals Recycling Business

The Company operates one of the largest metal recycling businesses in the United States. The Company buys, processes and sells ferrous metals to foreign and domestic steel producers, including its Steel Manufacturing Business and nonferrous metals to both the domestic and export markets. In addition, the Metals Recycling Business including Schnitzer Global Exchange engage in the metals trading business by purchasing processed metal from other recycled metals processors for shipment to either the Steel Manufacturing Business or third party customers without further processing.

On September 30, 2005, the Company and Hugo Neu Corporation (HNC) closed a transaction to separate and terminate their metals recycling joint venture relationships as discussed below under "acquisitions and transactions". As a result of the completion of this transaction, in addition to its previous recycling operations in Northern California, Washington and Oregon, the Company now has significant recycling operations in New England and Hawaii and operates, through its wholly owned subsidiary Schnitzer Global Exchange Corp. (Schnitzer Global Exchange), a metals trading business which purchases metals in parts of Russia and the Baltic region. In addition, as discussed below under "Acquisitions and Transactions", on October 31, 2005, the Company

purchased substantially all of the assets of Regional, which operates metals recycling facilities located in the southeastern United States and gives the Company a significant presence in this growing market. For a more detailed discussion of the HNC joint venture separation and termination and the Regional acquisition, see “Acquisitions and Transactions” and Note 4 to the condensed consolidated financial statements.

Auto Parts Business

The Auto Parts Business operates as Pick-N-Pull in the United States and Canada. The Company believes Pick-N-Pull is one of the country’s leading self-service used auto parts networks. The Auto Parts Business purchases salvaged vehicles, sells used parts from those vehicles through its retail stores and wholesale operations, and sells the remaining portion of the vehicles to metal recyclers, including the Company’s Metals Recycling Business. Until

September 30, 2005, the Auto Parts Business consisted of a network of retail locations operating exclusively as self-service used auto parts stores. These stores are self-service in that customers themselves remove used auto parts from vehicles in inventory.

During the first quarter of fiscal 2006, the Company acquired GreenLeaf, which is engaged in the business of full-service auto dismantling and recycling and sells its products primarily to collision and mechanical repair shops. This acquisition significantly increased Auto Parts Business presence in the Southern, Eastern and Midwestern United States and represents the Company's initial venture into the substantial full-service segment of the recycled auto parts market that services commercial customers. In full-service stores, professional staff members dismantle, test and inventory individual parts, which are then delivered to business or wholesale customers. Full-service stores also generally maintain newer cars in inventory. The Company is in the process of integrating GreenLeaf's operations into Pick-N-Pull. Management has identified several GreenLeaf stores to convert to self-service locations; others will combine both full-service and self-service and some will remain exclusively full service. For a more detailed discussion of the Greenleaf acquisition, see "Acquisitions and Transactions" and Note 4 to the condensed consolidated financial statements.

Steel Manufacturing Business
The Steel Manufacturing Business purchases recycled metals from the Metals Recycling Business as well as from third parties and uses its mini-mill to process the recycled metals into finished steel products, including steel reinforcing bar (rebar), wire rod, merchant bar, coiled rebar and other specialty products.

Acquisitions and Transactions

Metals Recycling Business. On September 30, 2005, the Company, HNC and certain of their subsidiaries closed a transaction to separate and terminate their metals recycling joint venture relationships. The Company received the following as a result of the HNC joint venture separation and termination:

- The assets and related liabilities of Hugo Neu Schnitzer Global Trade related to a trading business in parts of Russia and the Baltic region, including Poland, Denmark, Finland, Norway and Sweden, and a non-compete agreement from HNC that bars it from buying scrap metal in certain areas in Russia and the Baltic region for a five-year period ending on June 8, 2010.
- The joint ventures' various interests in the New England operations that primarily operate in Massachusetts, New Hampshire, Rhode Island and Maine.
    - Full ownership in the Hawaii metals recycling business that was previously owned 100% by HNC.
- A payment of $36.6 million in cash, net of debt paid, subject to post-closing adjustments.

HNC received the following as result of the HNC joint venture separation and termination:

- The joint venture operations in New York, New Jersey and California, including the scrap processing facilities, marine terminals and related ancillary satellite sites, the

interim New York City recycling contract, and other miscellaneous assets.

- The assets and related liabilities of Hugo Neu Schnitzer Global Trade that are not related to the Russian and Baltic region trading business.

As described above, the separation resulted in the exchange of the joint venture interests, as well as cash and other assets, to provide for an equitable division. The agreement provides for potential purchase price adjustments based on the closing date working capital of the acquired Hawaii business as well as the joint ventures' ending balances. The Company has not determined whether any purchase price adjustment will be necessary.

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On October 31, 2005, the Company purchased substantially all of the assets of Regional for $65.5 million in cash and the assumption of certain liabilities. Regional operates 10 metals recycling facilities located in the states of Georgia and Alabama which process ferrous and nonferrous scrap metals without the use of shredders.

Auto Parts Business. On September 30, 2005, the Company acquired GreenLeaf, five properties previously leased by GreenLeaf and certain GreenLeaf debt obligations. GreenLeaf currently operates its full-service auto dismantling business in one wholesale sales office and 19 commercial locations throughout the United States. Total purchase price for the acquisition was $44.7 million, subject to post-closing adjustments. This acquisition may have a modestly dilutive to neutral effect on earnings in fiscal 2006 as the conversion process is executed, but is expected to provide earnings growth in future years.

Management believes that the HNC joint venture separation and termination and the Regional and GreenLeaf acquisitions position the Company well as it continues to execute its growth strategy. Consideration for these recently acquired businesses was funded by the Company's cash balances on hand and borrowings under its bank credit facility. The Company has recorded estimated environmental liabilities as a result of due diligence performed in connection with these acquisitions. See Note 5 to the condensed consolidated financial statements for further information regarding contingencies.

SCHNITZER STEEL INDUSTRIES, INC.

Results of Operations

The Company's revenues and operating results by business segment are summarized below (in thousands):

	For the Three Months Ended November 30,	
	2005 (as restated)	2004
REVENUES:		
Metals Recycling Business:		
Ferrous	$ 208,227	$ 126,832
Nonferrous	31,526	15,654
Other	1,677	2,046
Total Metals Recycling Business	241,430[(1)]	144,532
Auto Parts Business	45,922	23,386
Steel Manufacturing Business	89,156	70,022
Intercompany revenue eliminations	(35,277)	(38,979)
Total revenues	$ 341,231	$ 198,961

	For the Three Months Ended November 30,	
	2005 (as restated)	2004
OPERATING INCOME:		
Metals Recycling Business	$ 12,002[(1)]	$ 33,788[(2)]
Auto Parts Business	7,737	7,048
Steel Manufacturing Business	16,070	12,760
Joint Ventures	1,732	20,464
Total segment operating income	37,541	74,060
Corporate expense	(19,479)	(3,591)
Intercompany profit eliminations	(529)	(3,163)
Total operating income	$ 17,533	$ 67,306
NET INCOME	$ 41,530	$ 42,936

(1) The Company elected to consolidate results of two of the businesses acquired through the HNC separation and termination agreement as though the transaction had occurred at the beginning of fiscal 2006. The increased revenues and operating income that resulted from the election was offset by pre-acquisition interests, net of tax. See Note 4 to the condensed consolidated financial statements.

[2] Includes $500 thousand of environmental expenses related to the Hylebos Waterway project.

SCHNITZER STEEL INDUSTRIES, INC.

The following table summarizes certain selected operating data for the Company:

	For the Three Months Ended November 30, 2005 (as restated)	2004
METALS RECYCLING BUSINESS:		
Average Ferrous Recycled Metal Sales Prices ($/LT)[1]		
Domestic	$ 207	$ 221
Export	$ 204	$ 245
Total Processing	$ 205	$ 236
Trading	$ 216	$ —
Ferrous Domestic Sales Volume (LT, in thousands)[2][3]		
Processed	181	134
Brokered	31	42
Total	212	176
Ferrous International Sales Volume (LT, in thousands)[3]		
Processed	337	295
Trading	307	—
Total	644	295
Total Ferrous Sales Volume (LT, in thousands)[2][3]	856	471
Ferrous Volumes Sold to Steel Manufacturing Business (LT, in thousands)	154	159
Nonferrous Sales Volumes (pounds, in thousands) [3]	50,000	29,400
STEEL MANUFACTURING BUSINESS:		
Average Sales Price ($/ton) [1]	$ 517	$ 534
Finished Steel Products Sold (tons, in thousands)	166	126
AUTO PARTS BUSINESS		
Number of Self-Service Locations at End of Quarter	30	26
Number of Full-Service Locations at End of Quarter[4]	19	—

(1) Price information is shown after a reduction for the cost of freight incurred to deliver the product to the customer.
(2) Includes sales to the Steel Manufacturing Business.
(3) The Company elected to consolidate results of two of the businesses acquired through the HNC separation and termination agreement as though the transaction had occurred at the beginning of fiscal 2006 instead of the date of acquisition. As a result, ferrous volume increased on a pro forma basis by 490,000 tons and nonferrous volume increased by 18,000 pounds. See Note 1 to the condensed consolidated financial statements.
(4) Reflects the addition of GreenLeaf to the Auto Parts Business in the first quarter of fiscal 2006.

First Quarter Fiscal 2006 Compared to First Quarter Fiscal 2005

General. The first quarter of fiscal 2006 marked the beginning of the Company's transformation. The Company completed the separation and termination of its joint ventures with HNC and closed two acquisitions, and as a result revenues increased 72% compared to the first quarter of fiscal 2005. The Company began the process of integrating the newly acquired businesses into its existing operations during the first quarter of fiscal 2006. The Company also continued on a major capital spending program to upgrade and replace infrastructure and equipment. The recent acquisitions and capital improvements are expected to provide long-term benefits, although management expects they will result in some short-term disruption to operations.

It was another strong quarter for the Steel Manufacturing Business and the Auto Parts Business. Compared to last year's first quarter, operating results for the Steel Manufacturing Business improved due to higher sales volumes primarily on rebar products. The Metals Recycling Business was impacted by a number of short term factors that reduced sales volumes and margins, and as a result, earnings did not reflect what the Company considers a normalized state of operations. Operating income declined for the Metals Recycling Business as margins for ferrous metals were compressed by lower selling prices, higher purchase costs for unprocessed metal and lower export volumes at the Company's previously owned West Coast operations. The entities acquired as part of the HNC separation and termination, which were reported for the first time in the Metals and Recycling Business segment, were impacted by low beginning inventories and a planned production shutdown. Additionally, operating income from Joint Ventures decreased by over 91% due to the elimination of the HNC joint ventures results from this segment. As a result of the HNC joint venture separation and termination, the Joint Venture segment will be eliminated and the results for the businesses acquired in this transaction, and other smaller joint ventures will be consolidated into the Metals Recycling Business in future periods. Finally, average segment margins are expected to decrease due to the Company's new trading business, has different characteristics and produces lower margins than the processing business.

The Company's results of operations depend in large part on demand and prices for recycled metals in world markets and steel products in the Western United States. Beginning in fiscal 2004, and continuing into the first half of fiscal 2005, strong worldwide demand combined with a tight supply of recycled metals created significant price volatility and drove the Metals Recycling Business' average selling prices to unprecedented highs. Average selling prices for recycled ferrous metals declined in the second half of fiscal 2005 due to the unsettled Asian markets, and continued to modestly decline in the first fiscal quarter of 2006. In particular, the fluctuations of prices for recycled ferrous metals have a significant impact on the results of operations for the Metals Recycling Business and to a lesser extent on the Auto Parts Business.

The Auto Parts Business purchases used and salvaged vehicles, sells parts from those vehicles through its retail facilities and wholesale operations, and sells the crushed auto bodies to metal recyclers. On September 30, 2005, the Auto Parts Business acquired GreenLeaf, which is a full-service supplier of recycled auto parts primarily to commercial customers. This acquisition expanded the Auto Parts Business' national

footprint, providing growth potential in both the self-service and full-service markets. The newly acquired locations are in Arizona, Florida, Georgia, Illinois, Massachusetts, Michigan, Nevada, North Carolina, Ohio, Virginia, and Texas. As the Company integrates these stores with its existing business, some of the sites will be converted to Pick-N-Pull's self-service model, while others will remain full-service or have combined operations. Two of the initial 22 acquired locations have been closed, and a third is a wholesale sales office. This acquisition is expected to have a modestly dilutive to neutral effect on earnings in fiscal 2006 as the conversion process is executed, but is anticipated to provide earnings growth in future years.

Prior to the GreenLeaf acquisition, the Auto Parts Business had existing operations in nine states and two Canadian provinces that achieved an annual pace of more than four million paid customer admissions per year. As a result of the Greenleaf acquisition and the acquisition of four self-service auto parts stores in January 2005, the Auto Parts Business has increased revenue by 128% for the first fiscal quarter of 2006 as compared to the same period last year. For both the full-service and self-service business, revenues for the wholesale product lines are principally affected by commodity metal prices. The Auto Parts Business also benefited from improved pricing for crushed auto bodies as compared to the fourth quarter of last year, which was partially offset by higher purchase prices for those vehicles. The self-service retail operations are somewhat seasonal and affected by weather conditions and promotional events. Since the stores are open to the natural elements, during periods of prolonged wet, cold or extreme heat, the retail business tends to slow due to the difficult working conditions for customers. As a result, the Company's first and third fiscal quarters tend to generate the greatest retail sales and the second and fourth fiscal quarters are slower for these operations.

Average net selling prices for the finished steel products of the Steel Manufacturing Business declined 3% compared to the first quarter of fiscal of 2005. Customer demand for steel products on the West Coast is good, and average prices remain strong by historical standards, increasing 5% from the fourth quarter of fiscal 2005. However, there has been an increase in the amount of imported wire rod which has lower selling prices than the Company's comparable products being delivered on the West Coast.

Revenues. Consolidated revenues for the quarter ended November 30, 2005 increased $142.3 million, or 72%, to $341.2 million from $199.0 million in the first quarter of fiscal 2005. Revenues in the first quarter of fiscal 2006 increased for all Company business segments. The Metals Recycling Business revenue increased primarily as a result of the businesses acquired in HNC separation and termination, and the acquisition of Regional. Although there continues to be a strong demand in the worldwide metals markets for scrap metals, the fourth fiscal quarter of 2005 was affected by the unsettled Asian market and this condition continued into the first fiscal quarter of 2006. The Auto Parts Business benefited from the acquisition of GreenLeaf in September 2005 and four newly acquired self-service stores in January 2005, increased prices for auto bodies and higher revenues from sales of cores. The Steel Manufacturing Business benefited from the strong West Coast demand, which led to higher selling prices for finished steel products and higher sales volumes.

The Metals Recycling Business generated revenues of $241.4 million for the quarter ended November 30, 2005, before intercompany eliminations, an increase of $96.9 million, or 67%, over the same period of the prior year. Ferrous revenues increased $81.4 million, or 64%, to $208.2 million. This increase was caused by higher sales volume provided by the newly acquired businesses, which added revenue of approximately $136.1 million, and was partially offset by an approximately $39.2 million decline in revenues from the Company's previously owned West Coast recycled metals facilities due to the timing of shipments and lower average net selling prices. Total ferrous sales volume increased 385,000 tons, or 82%, to 856,000 tons over the prior year first quarter, which was primarily due to the newly acquired businesses in the Southeast and Northeast as well as the addition of Schnitzer Global Exchange

trading volume. This increase in volume was offset by a 13% decrease in the average processing net sales price to $205 per ton. The freight that is included in revenue increased $1.9 million compared with the prior year first quarter, primarily due to the increased volumes. The entities acquired as part of the HNC separation and termination, which were reported for the first time in the Metals and Recycling Business segment, were impacted by low beginning inventories and a planned production shutdown. Sales to the Steel Manufacturing Business decreased 5,400 tons, or 3%, to 154,000 tons, while other domestic sales increased from 17,000 tons in the first fiscal quarter of 2005 to 58,000 tons in the same quarter of this year as a result of the Regional acquisition. Regional is situated in a growing recycled metals market in the Southeastern United States, which is home to many automobile and auto parts manufacturers. Regional sells its ferrous metal to domestic steel mills in its area, of which there are approximately 23.

Revenue from nonferrous metal sales increased $15.9 million, or 101%, over the prior year first quarter, which was the result of a $0.09, or 17%, increase in average net sales price to $0.62 per pound and 20.7 million pounds, or 70%, increase in pounds shipped. Total nonferrous shipped for the first fiscal quarter of 2006 was 50.0 million pounds. The increase in sales price per pound was a result of the additional value of the nonferrous product mix as a result of the Regional acquisition and increased Asian demand for nonferrous metals. The increase in pounds shipped was primarily due to the acquired businesses, which accounted for an additional 18.3 million pounds sold in the first quarter of fiscal 2006. Certain nonferrous metals are a byproduct of the shredding process, and quantities available for shipment are affected by the volume of materials processed in the Company's shredders.

The Auto Parts Business generated revenues of $45.9 million, before intercompany eliminations, for the quarter ended November 30, 2005, an increase of $22.5 million, or 96%, over the same period of the prior year. This increase in revenues was primarily due to the acquisition of GreenLeaf in September 2005. Revenues also increased as a result of higher wholesale revenues driven by higher average sales prices for scrapped auto bodies and higher revenues from sales of cores.

The Steel Manufacturing Business generated revenues of $89.2 million for the quarter ended November 30, 2005, an increase of $19.1 million, or 27%, over the prior year quarter. Sales volumes in the first fiscal quarter of 2006 increased 31% to 166,000 tons over the same period last year, increasing revenues by $21.4 million, partially due to strong demand for rebar products. Additionally, during the first quarter of fiscal 2005, customers reduced purchases of steel in an effort to reduce inventories on hand. By contrast, during the first quarter of fiscal 2006, customers were buying steel to replace inventories, and consumption of steel was strong. The average net selling price decreased $17 per ton, or 3%, to $517 per ton, which resulted in decreased revenue of $2.8 million as compared to record high prices in the first fiscal quarter of 2005. However, average selling prices during the first quarter of fiscal 2006 were 5% higher than the fourth quarter of fiscal 2005, reflecting several price increases announced earlier in the quarter. The decrease in average net selling prices compared to the first quarter of the prior year was due to a stabilization of the market after a number of price increases caused by increased steel consumption.

Cost of Goods Sold. Consolidated cost of goods sold increased $144.9 million, or 103%, for the quarter ended November 30, 2005, compared with the same period last year. Cost of goods sold increased as a percentage of revenues from 70% to 84%.

Cost of goods sold for the Metals Recycling Business increased $112.5 million, or 106%, to $219.0 million compared to the first fiscal quarter of 2005. As a percentage of revenues, cost of goods sold increased compared with the prior year quarter from 74% to 91%. The increase in cost of goods sold was primarily attributable to the recent HNC separation and termination and the Regional acquisition, as these businesses operate in different markets and are currently experiencing narrower margins than the Company's historical West Coast business. The margin variations for these businesses are due, in part, to differing markets for materials in the regions in which they operate, higher operating expenses due to the costs of integration and restructuring, higher freight costs to access certain foreign markets and the lower margins generally inherent in the

Global Exchange trading business. Additionally, in the first quarter of fiscal 2006, strong domestic demand for unprocessed metals caused purchase prices to rise at a time of declining export sales prices, resulting in narrowing margins. While Schnitzer Global Exchange, the Company's new trading business, provides increased revenues, the associated trading margins are lower than the historical Metals Recycling Business. Although the Company attempts to maintain and grow margins by responding to changing recycled metals selling prices through adjustments to its metals purchase prices, the Company's ability to do so in the trading business is particularly limited by competitive and other market factors. In addition, East Coast processing volumes were negatively impacted by a two-month shutdown of the Rhode Island shredder to install a new, more efficient, and environmentally friendly shredder motor as well as low beginning inventories at all the New England yards. The lower processing volumes contributed to higher processing costs, which caused the East Coast operations to record a small loss for the quarter.

Cost of goods sold for the Auto Parts Business increased $15.4 million, or 115%, compared to the fiscal 2005 first quarter. As a percentage of revenues, cost of goods sold increased compared with the prior year quarter from 57% to 63%. The higher cost of goods sold was primarily due to the acquisition of GreenLeaf in September 2005 and four self-service stores in January 2005, but also due to higher car purchase costs that resulted from higher unprocessed metal prices, as GreenLeaf typically purchases newer vehicles resulting in a higher purchase price and lower margins as compared to the older model vehicles that Pick-N-Pull purchases. During the quarter, the operations acquired in the GreenLeaf transaction recorded a slight loss as the Company began the process of integrating GreenLeaf's operations into the Auto Parts Business' operations.

Cost of goods sold for the Steel Manufacturing Business increased $15.9 million, or 28%, as compared to the fiscal 2005 first quarter. As a percentage of revenues, cost of goods sold increased slightly compared with the prior year quarter from 80% to 81%. Average cost of goods sold per ton decreased $10 per ton, or 2%, compared to the prior year quarter, which was primarily caused by lower raw material costs for recycled metal and alloys and improved productivity, which were offset by higher energy costs. The overall increase in cost of goods sold was primarily caused by a 31% increase in sales volume. The Steel Manufacturing Business continues to see the benefits from the new furnace installed at its mini-mill last year, production incentives recently negotiated with the steelworkers union and other improvements in business practices. As a result, the increased production volumes and lower cost per ton of producing steel more than offset a $17 per ton decrease in average selling prices.

Selling, General and Administrative Expense. Compared with the first quarter of fiscal 2005 selling, general and administrative expense for the same quarter this fiscal year increased $28.5 million, or 240%, to $40.3 million. As a percentage of revenues, selling, general and administrative expense increased by 6% percentage points, from 6% to 12%. A significant portion of the increase, $11.0 million, was attributed to the acquisitions that took place in the first quarter of fiscal 2006 that nearly doubled the Company's revenue. The increase in selling, general and administrative expense was also due, in part, to the charge associated with the reserve of $11.0 million related to the penalties that the Company estimates will be imposed by the DOJ and the SEC in connection with the past payment practices in Asia discussed in Note 5 to the condensed consolidated financial statements. Other significant increases included higher legal, accounting and professional fees of $2.2 million, which includes $1.5 million related to the Audit Committee's investigation of past payment practices in the Asia as discussed in Note 5 to the condensed consolidated financial statements, and the adoption of FAS 123(R) in fiscal 2006, which resulted in stock based compensation expense of $0.5 million.

Other Income (Expense). The Company recorded a gain of $54.6 million which arose from the HNC separation and termination. Based on the values determined by the valuations of the assets and liabilities acquired and assumed, the Company recorded a gain for the difference between the excess values of businesses acquired over the carrying value of the businesses sold. For a more detailed discussion of the HNC joint venture separation and termination agreement, see Notes 1 and 4 to the condensed consolidated financial statements.

Interest Expense. Interest expense for the first quarter of fiscal 2006 increased by $0.2 million, or 53%, to $0.4 million compared with the first quarter of fiscal 2005. The increase was a result of higher average debt balances and an increase in the loan rate during the fiscal 2006 first quarter compared with the fiscal 2005 first quarter. For more information, see Note 6 to the condensed consolidated financial statements.

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Income Tax Provision. The tax rate for the first quarter of fiscal 2006 was 42.9%, compared to a 34.8% rate for the same quarter last year. The rate was higher as a direct result of the $11.0 million charge associated with the investigation reserve recorded as a result of the DOJ and SEC investigation. At the end of the investigation, the Company will be able to determine the extent of the tax deductible portion if any, of the reserve, which currently is anticipated to be nondeductible. During the first quarter of fiscal 2006, the Company recorded a gain of $54.6 million which arose from the HNC separation and termination. Based on the values determined by the valuations of the assets and liabilities acquired and assumed, the Company recorded a gain for the difference between the excess values of businesses acquired over the carrying value of the businesses sold. The tax on the gain was recorded using a 38% effective tax rate.

Liquidity and Capital Resources

Certain items within the consolidated statements of cash flows have been restated. See Note 1 to the condensed consolidated financial statements for details of the restatements. Cash provided by operations for the three months ended November 30, 2005 was $31.3 million, compared with $38.2 million for the same period in the prior fiscal year. Cash provided by operating activities was primarily related to net income, accounts receivable, prepaid expenses and other current assets, accrued liabilities and the change in equity accounting for the joint ventures association with the HNC separation and termination agreement, which is offset by the gain on the disposition of the joint ventures, the change in deferred income taxes and increases in accounts payable.

Capital expenditures for the three months ended November 30, 2005 were $15.8 million compared with $7.5 million during the first three months of fiscal 2005. The increase was due to capital improvement projects at the Company's Portland, Oregon recycling facility related to dock repairs and preparation for the installation of a mega-shredder, as well as other operational improvements at the Oakland and Sacramento, California recycling facilities and a number of store remodels and equipment upgrades at the Auto Parts Business locations. The Company expects to spend approximately $75.0 million on capital improvement projects during the remainder of fiscal 2006. Additionally, the Company continues to explore other capital projects that will provide productivity improvements and add shareholder value.

As a result of the Regional and GreenLeaf acquisitions the Company entered into during the first fiscal quarter of 2006, the Company had higher borrowings under the credit facility of $78.2 million. In addition, these transactions resulted in investments in acquisitions, net of cash acquired of $85.6 million.

Accrued environmental liabilities as of November 30, 2005 were $45.4 million, which increased since August 31, 2005 by $21.9 million due to the acquisitions discussed in Note 4 and were partially offset by spending charged against the environmental reserve. During the next 12 months, the Company expects to pay approximately $6.9 million relating to previously accrued remediation projects, including the remediation on the Hylebos Waterway located in the State of Washington as discussed in Note 5 to the condensed consolidated financial statements. Additionally, the Company anticipates future cash outlays as it incurs the actual cost relating to the remediation of

identified environmental liabilities. The future cash outlays are anticipated to be within the amounts established as environmental liabilities.

On November 8, 2005, the Company entered into an amended and restated unsecured committed bank credit agreement with Bank of America, N.A., as administrative agent, and the other lenders party thereto. The new agreement provides for a five-year, $400.0 million revolving loan maturing in November 2010. The agreement prior to restatement provided for a $150.0 million revolving loan maturing in May 2006. Interest on outstanding indebtedness under the restated agreement is based, at the Company's option, on either LIBOR plus a spread of between 0.625% and 1.25%, with the amount of the spread based on a pricing grid tied to the Company's leverage ratio, or the greater of the prime rate or the federal funds rate plus 0.50%. In addition, annual commitment fees are payable on the unused portion of the credit facility at rates between 0.15% and 0.25% based on a pricing grid tied to the Company's leverage ratio. The restated agreement contains various representations and warranties, events of default and financial and other covenants, including covenants requiring maintenance of a minimum fixed charge

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coverage ratio and a maximum leverage ratio. The Company also has an additional unsecured credit line totaling $10.0 million, which is uncommitted. This additional debt agreement also has certain restrictive covenants. As of November 30, 2005, the Company had aggregate borrowings outstanding under its credit facilities of $86.0 million. As a result of the restatement, as discussed in Note 1 to the consolidated financial statements, the Company was not in compliance with their restrictive covenants. As such, a waiver was obtained from the lender, dated July 27, 2006, to waive any events of default provided the Company delivers it financial statements to the lender on or before September 8, 2006.

In July 2002, the Company's metals recycling joint ventures with HNC entered into a revolving credit facility (JV Credit Facility) with a group of banks for working capital and general corporate purposes. During February 2004, the facility was increased to $110.0 million.

Upon the closing of the agreement for the separation and termination of the Company's joint ventures with HNC on September 30, 2005, as described in Note 4 of the condensed consolidated financial statements, HNC paid the Company $52.3 million in cash. The Company also received approximately $1.4 million for previously undistributed earnings of the joint ventures net of the Company's share of outstanding borrowings under the JV Credit Facility as of that date. Following such earnings distributions, the Company and HNC each were obligated to repay the portion of the JV Credit Facility borrowed on behalf of the joint venture businesses it acquired in the transaction. The outstanding balance was paid off and the JV Credit Facility was terminated and repaid upon closing of the separation and termination agreement on September 30, 2005.

On September 30, 2005, the Company acquired GreenLeaf, five store properties leased by GreenLeaf and certain GreenLeaf debt obligations. Total consideration for the acquisition was $44.7 million, subject to post-closing adjustments.

On October 31, 2005, the Company acquired substantially all of the assets of Regional, a metal recycling business with ten facilities located in Georgia and Alabama. The purchase price was $65.5 million in cash and the assumption of certain liabilities.

The increase in borrowings outstanding since August 31, 2005 was primarily the result of the acquisitions that occurred in the first quarter of fiscal 2006.

The Company makes contributions to a defined benefit pension plan, several defined contribution plans and several multiemployer pension plans. Contributions vary depending on the plan and are based upon plan provisions, actuarial valuations and negotiated labor agreements. The Company anticipates making contributions of approximately $5.0 million to the various benefit plans in fiscal 2006.

Management evaluates long and short range forecasts as well as anticipated sources and uses of cash before determining the course of action that would best enhance shareholder value. During fiscal 2004 and 2005, the Company made significant investments in capital equipment and completed several acquisitions to both grow the business and enhance shareholder value. The Company is currently engaged in a

growth strategy to enhance shareholder value. Pursuant to a stock repurchase program approved in 1996, the Company is authorized to repurchase up to 3.0 million shares of its stock when the market price of the Company's stock is not reflective of management's opinion of an appropriate valuation of the stock. During the first three months of fiscal 2006, the Company made no share repurchases. As of November 30, 2005, the Company had repurchased a total of 1.3 million shares under this program.

The Company believes its current cash resources, internally generated funds, existing credit facilities and access to the capital markets will provide adequate financing for capital expenditures, working capital, stock repurchases, debt service requirements, post retirement obligations and future environmental obligations for the next twelve months. In the longer term, the Company may seek to finance business expansion with additional borrowing arrangements or additional equity financing.

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Outlook

The company said the factors that will affect its results in the second quarter of 2006 include:

Metals Recycling Business

Pricing: The uncertainty in the Asian export markets that was experienced beginning in the second half of last year and into the first quarter of 2006 is expected to continue through the second quarter. Domestic markets are expected to remain stronger than export markets. Sales orders completed in the early part of the second quarter would indicate an average price per ton of between $185 and $195.

The Company has seen recent evidence of declines in scrap acquisition costs which are greater than the declines in export sales prices, providing the potential for improved margins.

The Russian and Baltic region trading business generally purchases inventory in advance of making sales, has a lower overall margin on sales than the domestic metals processing business and thus can be impacted by small changes in price between the time of purchase and sale. During the second quarter, the trading business is expected to sell inventory that is valued higher than the current market price. As a result, margins related to these sales are expected to be negative, absent strengthening of the market.

Sales volumes: Ferrous scrap volumes in the domestic processing business are expected to rebound in the second quarter, primarily due to the timing of export orders. For the second quarter, volumes shipped from the Company’s domestic yards should increase from approximately 660,000 tons in the first quarter to between 800,000 and 850,000 tons.

Sales volumes in the Russian and Baltic region trading business are expected to decline approximately 40% from the first quarter to 175,000 tons. In addition to the impact of normal seasonable winter shipping conditions, lower market prices for scrap metal has significantly reduced the availability of processed metal available for purchase from Russia and the Baltic region.

For the year, the Company expects sales volumes to be approximately 3.5 million tons in the domestic processing business and 1.0 million tons in the Russian and Baltic region trading business.

Auto Parts Business

Retail demand in the self-service Auto Parts Business is affected by seasonal changes, with inclement winter weather in the second quarter expected to depress customer traffic and result in lower revenues when compared with the first quarter. For the second quarter, margins are expected to be affected by lower selling prices for scrapped cars and a high cost basis of cars sold from existing inventory compared to the second quarter of 2005.

The integration of GreenLeaf's operations is expected to result in the conversion of one full-service location to a self-service store toward the end of the second quarter. The GreenLeaf operation is expected to post a modest loss during the quarter.

Steel Manufacturing Business

Pricing: West Coast consumption of finished steel long products continues to remain strong, and the Company is seeing good demand for rebar and merchant bar. Based on current market conditions, the Company expects average prices for the second quarter to be slightly higher than both the first quarter of this year and the second quarter of last year. Higher prices on the West Coast relative to other markets could, however, result in an increase of foreign imports, putting downward pressure on pricing.

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Volumes: The Company typically sees a reduction in second quarter sales volumes due to the impact of winter weather on construction projects. However, this year customer inventories remain low and the Company expects demand to remain good through the quarter. As a result, second quarter sales volumes should be significantly higher than during the second quarter of 2005, but lower than the volumes in the first quarter of this year.

Factors That Could Affect Future Results

This Form 10-Q, including Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations", and including, particularly, the "Outlook" section, contains forward-looking statements, within the meaning of Section 21E of the Securities Exchange Act of 1934, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, statements regarding the Company's outlook for the business, and can be identified generally because they contain "expect," "believe," "anticipate," "estimate" and other words that convey a simila meaning. One can also identify these statements as statements that do not relate strictly to historical or current facts. Examples of factors affecting the Company that could cause actual results to differ materially from current expectations are the following: volatile supply and demand conditions affecting prices and volumes in the markets for both the Company's products and raw materials it purchases; world economic conditions; world political conditions; changes in federal and state income tax laws; impact of pending or new laws and regulations regarding imports and exports into the United States and other foreign countries; foreign currency fluctuations; competition; seasonality, including weather; energy supplies; freight rates; loss of key personnel; the inability to complete expected large scrap export shipments in the current quarter; consequences of the pending investigation by the Company's audit committee into past payment practices in Asia; business integration issues relating to acquisitions of businesses and the separation of the joint venture business described above; and business disruptions resulting from installation or replacement of major capital assets, as discussed in more detail under the heading "Factors That Could Affect Future Results" in the Company's most recent annual report on Form 10-K or quarterly report on Form 10-Q. One should understand that it is not possible to predict or identify all factors that could cause actual results to differ from the Company's forward-looking statements. Consequently, the reader should not consider any such list to be a complete statement of all potential risks or uncertainties. The Company does not assume any obligation to update any forward-looking statement.

Examples of factors affecting the Company that could cause actual results to differ materially are the following:

Cyclicality and General Market Considerations: Purchase and selling prices for recycled metals are highly cyclical in nature and subject to worldwide economic conditions. In addition, the cost and availability of recycled metals are subject to global supply and demand conditions which are volatile and beyond the Company's control, resulting in periodic fluctuations in recycled metals prices and working capital requirements. While the Company attempts to maintain and grow margins by responding to changing recycled metals selling prices through adjustments to its metals

purchase prices, the Company's ability to do so is limited by competitive and other market factors. Additionally, changing prices could potentially impact the volume of recycled metal available to the Company, the subsequent volume of processed metal sold by the Company, inventory levels and the timing of collections and levels relating to the Company's accounts receivable balances. Moreover, increases in recycled metals selling prices can adversely affect the operating results of the Company's Steel Manufacturing Business because increases in steel prices generally lag increases in ferrous recycled metals prices.

The steel industry is also highly cyclical in nature and sensitive to general economic conditions. Future economic downturns or a stagnant economy may adversely affect the performance of the Company.

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The Company expects to continue to experience seasonal fluctuations in its revenues and net income. Revenues can fluctuate significantly quarter to quarter due to factors such as the seasonal slowdown in the construction industry, which is an important buyer of the Company's finished steel products. Weather and economic conditions in the United States and abroad can also cause fluctuations in revenue and net income.

Another factor which may affect revenues relates to the seasonal reduction in demand from foreign customers who tend to reduce their finished steel production and corresponding scrap metal requirements, during the summer months to offset higher energy costs.

The Company makes a number of large ferrous recycled metals shipments to foreign steel producers each year. Customer requirements, shipping schedules and other factors limit the Company's control over the timing of these shipments. Variations in the number of foreign shipments from quarter to quarter will result in fluctuations in quarterly revenues and earnings. The Company's expectations regarding ferrous metal sales prices and volumes, as well as earnings, are based in part on a number of assumptions which are difficult to predict (for example, uncertainties relating to customer orders, metal availability, estimated freight rates, ship availability, cost and volume of unprocessed inventory and production output, etc.).

As a percentage of revenue, the Auto Parts Business' wholesale sales, including sales of auto bodies as well as cores, such as engines, transmissions, alternators and other nonferrous metals, have continued to grow in the past few years. Due to the nature of the wholesale business, which is more closely tied to the prices for recycled metals, the Auto Parts Business' results are increasingly subject to the volatility in the global recycled metals market more than they had been historically.

The Auto Parts Business experiences modest seasonal fluctuations in demand. The retail stores are open to the elements. During periods of extreme temperatures and precipitation, customers tend to delay their purchases and wait for milder conditions. As a result, retail sales are generally higher during the spring and fall of each calendar year and lower in the winter and summer months.

Additionally, the Auto Parts Business is subject to a number of other risks that could prevent it from maintaining or exceeding its current levels of profitability, such as volatile supply and demand conditions affecting prices and volumes in the markets for its products, services and raw materials; environmental issues; local and worldwide economic conditions; increasing competition; changes in automotive technology; the ultimate success of the Company's growth and acquisition plans; ability to build the infrastructure to support the Company's growth plans; and integration issues of the full-service business model.

Backlog: Historically, the Company has generally entered into export ferrous sales contract by selling forward 60 to 90 days. The backlog of sales contracts, coupled with knowledge of the price at which the processed material will be sold and the costs involved in processing the metals, allows the Company to take advantage of this differential in timing between purchases and sales and negotiate prices with suppliers that secure profitable sales transactions. As the difference in timing between the date

the sales contracts are executed and the date of shipment grows shorter, it reduces the ability to manage the purchase price of raw material against the future sales price. The timing of forward contracts may impact the Company's revenue on a quarter-to-quarter basis as well as profitability on export shipments of ferrous metals.

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Competition: The recycled metals industry is highly competitive, with the volume of purchases and sales subject to a number of competitive factors, principally price. The Company competes with both large and numerous smaller companies in its markets for the purchase of recyclable metals. The Company also competes with a number of domestic and foreign recycled metals processors and brokers for processed and unprocessed metal as well as for sales to domestic and foreign customers. For example, in 2001 and 2002, lower cost ferrous recycled metals supplies from certain foreign countries adversely affected market selling prices for ferrous recycled metals. Since then, many of these countries have imposed export restrictions which have significantly reduced their export volumes and lowered the worldwide supply of ferrous recycled metals. These restrictions are believed to have had a positive effect on the Company's selling prices. Given the intricacies in which the global markets operate, the Company cannot predict when or if foreign countries will change their trading policies and what effect, if any, such changes might have on the Company's operating results.

From time to time, both the United States and foreign governments impose regulations and restrictions on trade in the markets in which the Company operates. In the second quarter of fiscal 2005, the Company received a certificate from China that allows the Company to continue shipping recycled metals into China. The certificate is part of a process designed to ensure safe industrial and agricultural production in China. Also, it is not unusual for various constituencies to petition government entities to impose new restrictions or change current laws. If imposed, these restrictions could affect the Company's margins as well as its ability to ship goods to foreign customers. Alternatively, restrictions could also affect the global availability of ferrous recycled metals, thereby affecting the Company's volumes and margins. As a result, it is difficult to predict what, if any, impact pending or future trade restrictions will have on the operations of the Company.

For the Metals Recycling Business, some of the more significant domestic competitors include regional steel mills and their brokers who compete for recycled metal for the purpose of providing the mills with feedstock to produce finished steel. During periods when market supplies of metal are in short supply, these buyers may, at times, react by raising buying prices to levels that are not reasonable in relation to more normal market conditions. As a result, the Company may have to raise its buying prices to maintain its production levels which may result in compressed margins.

The Auto Parts Business competes with both full-service and self-service auto dismantlers as well as larger well financed more traditional retail auto parts chains for retail customers. Periodically, the Auto Parts Business increases prices, which may affect customer flow and buying patterns. Additionally, in markets where the Company has one or only a few stores it does not have the same pricing power it experiences in markets where it has multiple locations. As this segment expands, the Company may experience new competition from others attempting to replicate the Company's business model. The ultimate impact of these dynamics cannot be predicted. Also, the business competes for its automobile inventory with other dismantlers, used car dealers, auto auctions and metal recyclers. Inventory costs can fluctuate significantly depending on market conditions and prices for recycled metal.

The domestic steel industry also is highly competitive. Steel prices can be highly volatile and price is a significant competitive factor. The Company competes domestically with several steel producers in the Western United States for sales of its products. In recent years, the Company has experienced significant foreign competition, which is sometimes subsidized by large government agencies. There can be no assurance that such competition will not increase in the future. In the spring of 2002, the U.S. Government imposed anti-dumping and countervailing duties against wire rod products from eight foreign countries. However, there are other countries that import wire rod products where the imports are not subject to duties. These duties have assisted the Company in increasing sales of wire rod products; any expiration or termination of the duties could have a corresponding adverse effect. The Company has experienced increased competition for certain products by foreign importers during fiscal 2005 and 2006. The Company believes that the rise in import levels is attributable to the increase in selling prices in the West Coast market, which potentially allow the import sales to be more profitable to the foreign companies.

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The steel manufacturing industry has been consolidating over the last several years and as a result one West Coast manufacturing facility has been closed and remains idle. Any future start-up of operations of the currently idle facilities could negatively impact the Company's recycled metal and finished steel markets, prices, margins and potentially, cash flow.

In general, given the unprecedented profitability levels of the Company and other recycled metals and steel companies over the last two years, competitors may be attracted to the Company's markets, which may adversely affect the Company's ability to protect its profit margins.

Geographical Concentration: The Company competes in the scrap metal business through its Metals Recycling Business. Over the last few years, a significant portion of the revenues and operating profits earned by this business has been generated from sales to Asian countries, principally China and South Korea. In addition, the Company's sales in these countries are also concentrated with relatively few customers that vary depending on buying cycles and general market conditions. The Company's sales have expanded to a broader geographic area with recent business acquisitions. As always, a significant change in buying patterns, change in political events, change in regulatory requirements, tariffs and other export restrictions within the United States or these foreign countries, severe weather conditions or general changes in economic conditions could adversely affect the financial results of the Company.

Pending Investigation: As discussed in Part II, Item 1 "Legal Proceedings" and Note 5 to the consolidated financial statements, the Board of Directors authorized the Audit Committee to engage independent counsel and conduct a thorough, independent investigation of the Company's past practice of making improper payments to the purchasing managers of customers in Asia in connection with export sales of recycled ferrous metals. The Board of Directors also authorized and directed that the existence and the results of the investigation be voluntarily reported to the U.S. Department of Justice (DOJ) and the Securities and Exchange Commission (SEC), and that the Company cooperate fully with those agencies. The Audit Committee notified the DOJ and the SEC of the independent investigation, engaged outside counsel to assist in the independent investigation and instructed outside counsel to fully cooperate with the DOJ and the SEC and to provide those agencies with the information obtained as a result of the independent investigation. On August 23, 2005, the Company received from the SEC a formal order of investigation related to the independent investigation. The Audit Committee is continuing its independent investigation. The Company, including the Audit Committee, continues to cooperate fully with the DOJ and the SEC. The investigations of the Audit Committee, the DOJ and the SEC of the Company's past practice of making improper payments are not expected to affect the Company's previously reported financial results. However, the Company expects to enter into agreements with the DOJ and the SEC to resolve the above-referenced matters and believes that it is probable that DOJ and the SEC will impose penalties on, and require disgorgement of certain profits by, the Company as a result of their investigations. The Company estimates that the total amount of these penalties and disgorgement will be within a range of $11.0 million to $15.0 million. In the first fiscal quarter of 2006, the Company established a reserve totaling $11.0 million in connection with this estimate. The precise terms of any agreements to be entered into

with the DOJ and the SEC, however, remain under discussion with these two agencies. The Company, therefore, cannot predict with certainty the final outcome of the aforementioned investigations or whether the Company or any of its employees will be subject to any additional remedial actions following completion of these investigations. It is also possible that these investigations could lead to criminal charges, civil enforcement proceedings and civil lawsuits.

Union Contracts: The Company has a number of union contracts, several of which were recently re-negotiated, including the contract covering the Company's Steel Manufacturing Business. If the Company is unable to reach agreement on the terms of new contracts with any of its unions during future negotiations, the Company could be subject to work slowdowns or work stoppages.

Post Retirement Benefits: The Company has a number of post retirement benefit plans that include defined benefit, Supplemental Executive Retirement Benefit Plan (SERBP) and multiemployer plans. The Company's contributions to the defined benefit and SERBP plans are determined by actuarial calculations which are based on a number of estimates including the expected long-term rate of return on plan assets, allocation of plan assets between equity or fixed income investments, expected rate of compensation increases as well as other factors. Changes in these actual rates from year to year cause increases or decreases in the Company's annual contributions into the defined benefit plans and changes to the expenses recognized in a current fiscal year. Management and the actuary evaluate these rates annually and adjust if necessary.

The Company's union employees participate in a number of multiemployer pension plans. The Company is not the sponsor or administrator of these multiemployer plans. Contributions are determined in accordance with provisions of the negotiated labor contracts.

The Company learned during fiscal 2004 that one of the multiemployer plans of the Steel Manufacturing Business would not meet Employee Retirement Income Security Act of 1974 minimum funding standards for the plan year ending September 30, 2004. The trustees of that plan have applied to the Internal Revenue Service (IRS) for certain relief from this minimum funding standard. The IRS has tentatively responded, indicating a willingness to consider granting the relief, provided the plan's contributing employers, including the Company, agree to increased contributions. The increased contributions are estimated to average 6% per year, compounded annually, until the plan reaches the funding status required by the IRS. These increases would be based on the Company's current contribution level to the plan of approximately $1.7 million per year. Based on commitments from the majority of employers participating in the Plan to make the increased contributions, the Plan Trustees have proceeded with the relief request, and are awaiting formal approval from the IRS.

Absent relief by the IRS, the plan's contributing employers will be required to make additional contributions or pay excise tax that may equal or exceed the full amount of the funding deficiency. The Company estimated its share of the required additional contribution for the 2004 plan year to be approximately $1.1 million and accrued for such amount in fiscal 2004. Future funding deficiency assessments against the Company are possible until the multiemployer plan obtains a waiver from the IRS or the plan reaches the minimum funded status level required by the IRS.

Recently Acquired Businesses and Future Business Acquisitions: As discussed in Note 4 - Business Combinations, the Company recently completed transactions to separate and terminate its metals recycling joint venture relationships with HNC and to purchase Regional and GreenLeaf. With the separation of the joint ventures, the Company acquired direct ownership of metals recycling businesses in New England and Hawaii and a metals trading business in parts Russia and the Baltic region. The day-to-day operations of these businesses were overseen by HNC prior to the separation. The Company will depend on key employees of those businesses, particularly those involved in the metals trading operations, providing for the continuity of those businesses. As well, the Company will be hiring additional key employees to help manage those businesses. Loss of or failure to hire key personnel or

other transition issues could adversely affect the Company.

Additionally, given the significance of these recently acquired businesses relative to the size of the Company, integration of these businesses will be challenging. Any failure to adequately integrate these businesses may result in adverse impacts on the Company's profitability.

Throughout the Company's history, it has made a number of acquisitions as management attempts to improve the value of the Company for its shareholders. It is anticipated that the Company will continue to pursue additional expansion of the Metals Recycling Business and Auto Parts Business. Each acquisition comes with its own inherent risks that make it difficult to predict the ultimate success of the transaction. An acquisition may have a negative and/or unexpected impact on the Company's cash flow, operating income, net income, earnings per share and financial position.

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Trading Business Risks: Schnitzer Global Exchange (SGE), the Company's trading entity acquired in September 2005, has various risks associated with its business operations. SGE operates in foreign countries with varying degrees of political risk. It advances and occasionally loans money to suppliers for the delivery of materials at a later date. Credit is also periodically extended to foreign steel mills. Due to the nature of the business, profit margins are thinner than for the Company's processing business; thus, unsold inventory may be more susceptible to losses. In addition, inventory is generally purchased in advance of sale, and the Company has a lesser ability to manage the risk against adverse movements than in its domestic processing business. Also, the trading business has lower barriers to entry, making the Company potentially more susceptible to competition than in its processing business.

Replacement or Installation of Capital Equipment: The Company installs new equipment and constructs facilities or overhauls existing equipment and facilities (including export terminals) from time to time. Some of these projects take several months to complete, require the use of outside contractors and experts, require special permits and easements and have high degrees of risk. Examples of such major capital projects include the installation of a mega-shredder at a metal recycling yard, the overhaul of an export loading facility or the furnace replacement at the steel mill. Many times in the process of preparing the site for installation, the Company is required to temporarily halt or limit production for a period of time. If problems are encountered during the installation and construction process, the Company may lose the ability to process materials which may impact the amount of revenue it is able to earn or may increase operating expenses. Additionally, it may also result in the building of inventory levels. If market conditions then occur which result in lower selling prices, the Company's profit margins may be adversely impacted. In either case, the Company's ability to reasonably predict financial results may be hampered.

Reliance on Key Pieces of Equipment: The Company relies on key pieces of equipment in the various manufacturing processes. Key items include the shredders and ship loading facilities at the metals recycling locations and the transformer, furnace, melt shop and rolling mills at the Company's steel manufacturing business, including the electrical power and natural gas supply into all of the Company's locations. If one of these key pieces of equipment were to have a mechanical failure and the Company were unable to correct the failure, revenues and operating income may be adversely impacted. Where practical, the Company has taken steps to reduce these risks such as maintaining a supply of spare parts, performing a regular preventative maintenance program and maintaining a well trained maintenance team that is capable of making most of the Company's repairs.

Energy Supply: The Company utilizes various energy sources to operate its facilities. In particular, electricity and natural gas currently represent approximately 9% of the cost of steel manufactured for the Company's Steel Manufacturing Business. The Steel Manufacturing Business purchases electric power under a long-term contract from McMinnville Water & Light (McMinnville) which in turn relies on the Bonneville Power Administration (BPA). Historically, these contracts have had favorable prices and are long-term in nature. The Company's electrical power contract expires in September 2011. On October 1, 2001, the BPA increased its electricity rates due to increased demand on the West Coast and lower supplies. This increase was in the form

of a Cost Recovery Adjustment Clause (CRAC) added to BPA's contract with McMinnville. The CRAC is an additional monthly surcharge on selected power charges to recover costs associated with buying higher priced power during the West Coast power shortage. Because BPA can adjust the CRAC every six months, it is not possible to predict future rate changes.

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The Steel Manufacturing Business also has a contract for natural gas that expires on May 31, 2009 and obligates the business to purchase minimum amounts of gas at fixed rates, which adjust periodically. Effective November 1, 2005, the natural gas rate increased to $6.90 per MMBTU. This is a take or pay contract with a minimum average usage of 3,575 MMBTU per day. Gas not used is sold on the open market and gains or losses are recorded in cost of goods sold.

If the Company is unable to negotiate favorable terms of electricity, natural gas and other energy sources, this could adversely affect the performance of the Company.

Environmental Matters: The Company records accruals for estimated environmental remediation claims. A loss contingency is accrued when the Company's assessment indicates that it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. The Company's estimates are based upon currently available facts and presently enacted laws and regulations. These estimated liabilities are subject to revision in future periods based on actual costs, new information or changes in laws and regulations.

Tax Laws: The Company's tax rate the last three years has benefited from state income tax credits, from the federal Extraterritorial Income Exclusion (ETI) on export sales, and from the final releases of a valuation allowance previously offsetting the net operating losses and minimum tax credit carryforwards that had accompanied a 1996 business acquisition. The Company's future tax rates will benefit from the ETI, although the American Jobs Creation Act of 2004 (the Act) will gradually eliminate the ETI benefit. Compensating for the Company's loss of ETI benefit will be the new deduction under the Act for Qualified Production Activities Income, but the effect of this new deduction on the Company's effective tax rate will not be determinable until the newly issued final regulations explaining it are examined by the Company. The Company will also likely continue to benefit from trade tax credits.

Currency Fluctuations: Demand from the Company's foreign customers is partially driven by foreign currency fluctuations relative to the U.S. dollar. Strengthening of the U.S. dollar could adversely affect the competitiveness of the Company's products in the markets in which the Company competes. The Company has no control over such fluctuations and, as such, these dynamics could affect the Company's revenues and earnings. The Company conducts most transactions in U.S. dollars.

Shipping and Handling: Both the Metals Recycling Business and the Steel Manufacturing Business often rely on third parties to handle and transport their products to end users in a timely manner. The cost to transport the products can be affected by circumstances over which the Company has no control such as fuel prices, political events, governmental regulations on transportation and changes in market rates due to carrier availability. In estimating future operating results, the Company makes certain assumptions regarding shipping costs.

The Steel Manufacturing Business relies on the availability of rail cars to transport finished goods to customers and raw materials to the mill for use in the production process. Market demand for rail cars along the west coast has been very high which has reduced the number of rail cars available to the Steel Manufacturing Business to

transport finished goods. In addition, the Steel Manufacturing Business utilizes rail cars to provide an inexpensive form of transportation for delivering scrap metal to the mill for production. Although the Company expects to be able to maintain an adequate supply of scrap metal, a larger portion of those materials are anticipated to be delivered using trucks. The Company anticipates this change in delivery may lead to increased raw material costs.

The Metals Recycling Business relies on the availability of cargo ships to transport their ferrous and non ferrous bulk exports to Asian and other overseas markets. Demand for ocean going vessels has been strong, which has reduced the number of ships available to the Metals Recycling Business to transport product to markets. Although the Company anticipates that it will continue to find available vessels in a timely manner, the tight supply of ships could cause delays in meeting delivery schedules if vessels are not available.

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The Company’s Providence, Rhode Island facility, acquired in conjunction with the separation and termination of its metals recycling joint ventures with HNC, as discussed in Part I, Item II, “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Acquisitions and Transactions” and Note 4 to the condensed consolidated financial statements, is leased from the Port of Providence. A long-term lease of this facility expired several years ago. The parties are finalizing the terms for a long-term lease of the facility. If the new lease is not finalized and the Company fails to secure another similar facility, the Company’s ability to ship recycled metals cost-effectively from this region would be significantly impacted.

Insurance: The cost of the Company’s insurance is affected not only by its own loss experience but also by cycles in the insurance market. The Company cannot predict future events and circumstances which could cause rates to materially change such as war, terrorist activities or natural disasters.

It is not possible to predict or identify all factors that could cause actual results to differ from the Company’s forward-looking statements. Consequently, the reader should not consider any such list to be a complete statement of all potential risks or uncertainties. Further, the Company does not assume any obligation to update any forward-looking statement.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company periodically uses derivative financial instruments to limit exposure to changes in interest and foreign currency rates. Because such derivative instruments are used solely as hedges and not for speculative trading purposes, they do not represent incremental risk to the Company. For further discussion of derivative financial instruments, refer to “*Fair Value of Financial Instruments”* in the consolidated Financial Statements included in Item 8 of Form 10-K for the fiscal year ended August 31, 2005.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company’s 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 the Company’s 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”)). Based on this evaluation, the Company’s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the fiscal period covered by the Original Form 10-Q, the Company’s disclosure controls and procedures were not effective to ensure that information required to be disclosed by the Company in reports that it files or submits 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.

In making this determination the Company's Chief Executive Officer and Chief Financial Officer considered, among other things, that:

The Company determined that it did not timely file with the SEC financial statements of the businesses it acquired through the termination and separation of its joint ventures with HNC on September 30,

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2005, as required under Rule 3-05 and Article 11 of Regulation S-X. The Company filed the required financial statements with the SEC on July 10, 2006.

Further, the Company determined that the following material weaknesses existed as of November 30, 2005. A material weakness is a control deficiency or combination of control deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

1. As of November 30, 2005, the Company did not maintain effective controls over the accurate preparation and review of our consolidated statements of cash flows. Specifically, the Company did not maintain effective controls to ensure that (i) certain cash flows received from joint ventures as returns on investment were accurately classified as net cash provided by operations and (ii) debt proceeds and repayments and changes in other assets and liabilities were accurately presented on a gross basis, as required by generally accepted accounting principles. This control deficiency resulted in the restatement of the Company's consolidated financial statements for the fiscal years ended August 31, 2005, 2004, and 2003, each of the quarters in fiscal 2005, the first two quarters of fiscal 2006 and adjustments to the third quarter of 2006. Additionally, this control deficiency could result in a misstatement of operating and investing cash flows in the consolidated statements of cash flows that would result in a material misstatement of the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has concluded that this control deficiency constitutes a material weakness.

2. As of November 30, 2005, the Company did not maintain effective controls over its application and review of the completeness and accuracy of purchase accounting. Specifically, the Company did not maintain effective controls to ensure that purchase business combinations were accurately recorded as of the acquisition date in accordance with generally accepted accounting principles. This control deficiency resulted in the restatement of revenue, cost of goods sold, selling, general and administrative expense, interest expense, other income, net, income tax provision, pre-acquisition interests, net of tax, and operating and investing cash flows in the condensed consolidated financial statements for the three months ended November 30, 2005 and the six months ended February 28, 2006. Additionally, this control deficiency could result in the misstatement of the aforementioned accounts and disclosures that would result in a material misstatement of the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has concluded that this control deficiency constitutes a material weakness.

Remediation Plan

As of the date of the filing of this amendment on Form 10-Q/A, the Company has taken or will take the following steps to remediate the material weaknesses:

· The Company has created new accounting and financing positions, hired additional accounting and finance personnel and replaced accounting and finance personnel

hired earlier in fiscal year 2006.

- The Company has engaged outside consultants to review the Company's accounting position where the accounting treatment is considered by the Company to be particularly complex or, under certain circumstances, to involve subjective decision making.
- The Company reassembled its Technical Accounting Team, which includes the divisional CFO of the Auto Parts Business, the divisional Director of Finance of the Metals Recycling Business, the divisional Controllers of all the Company's business segments, the corporate Controller, the corporate Assistant Controller, the Finance Manager and the corporate Senior Accounting Manager. The Technical Accounting Team holds bi-monthly meetings to address accounting issues relevant to the Company.
- The Company has taken a thorough review of the classification requirements of each component line item and the individual elements that comprise each line item of the Consolidated Statements of Cash Flows in accordance with FAS 95**.**

- The SEC reporting manager will now utilize a detailed checklist to review appropriate classification of cash flows in accordance with FAS 95.
- The Company has contracted with a public accounting firm (other than its independent auditors) to perform a thorough review of the detailed checklist to ensure that the cash flows have been prepared in accordance with FAS 95.

Changes in Internal Control Over Financial Reporting

Other than the material weakness identified related to the application and review of the completeness and accuracy of purchase accounting discussed above, there were no changes in the Company's internal control over financial reporting during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

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PART II

ITEM 1. LEGAL PROCEEDINGS

The Company had a past practice of making improper payments to the purchasing managers of customers in Asia in connection with export sales of recycled ferrous metals. The Company stopped this practice after it was advised in 2004 that it raised questions of possible violations of U.S. and foreign laws. Thereafter, the Audit Committee was advised and conducted a preliminary compliance review. On November 18, 2004, on the recommendation of the Audit Committee, the Board of Directors authorized the Audit Committee to engage independent counsel and conduct a thorough, independent investigation. The Board of Directors also authorized and directed that the existence and the results of the investigation be voluntarily reported to the U.S. Department of Justice (DOJ) and the Securities and Exchange Commission (SEC), and that the Company cooperate fully with those agencies. The Audit Committee notified the DOJ and the SEC of the independent investigation, engaged outside counsel to assist in the independent investigation and instructed outside counsel to fully cooperate with the DOJ and the SEC and to provide those agencies with the information obtained as a result of the independent investigation. On August 23, 2005, the Company received from the SEC a formal order of investigation related to the independent investigation. The Audit Committee is continuing its independent investigation. The Company, including the Audit Committee, continues to cooperate fully with the DOJ and the SEC. The investigations of the Audit Committee, the DOJ and the SEC are not expected to affect the Company's previously reported financial results. However, the Company expects to enter into agreements with the DOJ and the SEC to resolve the above-referenced matters and believes that it is probable that the SEC and DOJ will impose penalties on, and require disgorgement of certain profits by, the Company as a result of their investigations. The Company estimates that the total amount of these penalties and disgorgement will be within a range of $11.0 million to $15.0 million. In the first fiscal quarter of 2006, the Company established a reserve totaling $11.0 million in connection with the penalties this estimate. The precise terms of any agreements to be entered into with the DOJ and the SEC, however, remain under discussion with these two agencies. The Company, therefore, cannot predict with certainty the final outcome of the aforementioned investigations or whether the Company or any of its employees will be subject to any additional remedial actions following completion of these investigations.

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ITEM 6. EXHIBITS

3.1 1993 Restated Articles of Incorporation f the Registrant. (incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form S-1. Registration No. 33.69352 (the Form S-1).

3.2 Restated Bylaws of the Registrant. (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form 10-Q for the quarter ended May 31, 2005).

10.1 Amendment No. 1 to Lease, 3200 Yeon (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form 10-Q filed January 9, 2006).

10.2 Amendment No. 2 to Yeon Business Center Lease Agreement, 3200 Yeon (incorporated by reference to Exhibit 10.0 to the Registrant's Registration Statement on Form 10-Q filed January 9, 2006).

10.3 Amendment No. 1 to Lease, 3330 Yeon (incorporated by reference to Exhibit10.3 to the Registrant's Registration Statement on Form 10-Q filed January 9, 2006).

10.4 Amendment to Yeon Business Center Lease Agreement, 3330 Yeon (incorporated by reference to Exhibit 10.4 to the Registrant's Registration Statement on Form 10-Q filed January 9, 2006).

10.5 Non-Employee Director Compensation Summary (incorporated by reference to Exhibit 10.5 to the Registrant's Registration Statement on Form 10-Q filed January 9, 2006).

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.

SCHNITZER STEEL INDUSTRIES, INC.

SIGNATURE

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:	August 30, 2006	By:	/s/ John D. Carter
			John D. Carter Chief Executive Officer
Date:	August 30, 2006	By:	/s/ Gregory J. Witherspoon
			Gregory J. Witherspoon Chief Financial Officer