

SCHNITZER STEEL INDUSTRIES INC

Form 10-Q

April 07, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934  
For the Quarterly Period Ended February 28, 2015

Or

Transition Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934  
For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 0-22496

SCHNITZER STEEL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

OREGON

(State or other jurisdiction of  
incorporation or organization)

93-0341923

(I.R.S. Employer  
Identification No.)

299 SW Clay St., Suite 350

Portland, OR

(Address of principal executive offices)

(503) 224-9900

(Registrant's telephone number, including area code)

97201

(Zip Code)

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

Yes  No

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

Yes  No

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

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

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

Yes  No

The Registrant had 26,480,095 shares of Class A common stock, par value of \$1.00 per share, and 305,900 shares of Class B common stock, par value of \$1.00 per share, outstanding as of April 2, 2015.

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

|   | February 28,<br>2015 | August 31, 2014 |
|---|----------------------|-----------------|
| Assets  |                      |                 |
| Current assets:   |                      |                 |
| Cash and cash equivalents   | \$7,601              | \$25,672        |
| Accounts receivable, net of allowance for doubtful accounts of \$2,668 and \$2,720                                | 112,202              | 189,359         |
| Inventories   | 255,931              | 216,172         |
| Deferred income taxes   | 5,724                | 6,865           |
| Refundable income taxes   | 13,005               | 1,756           |
| Prepaid expenses and other current assets   | 18,747               | 24,108          |
| Total current assets  | 413,210              | 463,932         |
| Property, plant and equipment, net of accumulated depreciation of \$668,653 and \$659,872                         | 440,874              | 523,433         |
| Investments in joint venture partnerships   | 15,409               | 14,624          |
| Goodwill  | 176,732              | 325,903         |
| Intangibles, net of accumulated amortization of \$6,820 and \$15,612  | 7,211                | 9,835           |
| Other assets  | 17,170               | 17,483          |
| Total assets  | \$1,070,606          | \$1,355,210     |
| Liabilities and Equity  |                      |                 |
| Current liabilities:  |                      |                 |
| Short-term borrowings   | \$618                | \$523           |
| Accounts payable  | 74,139               | 103,453         |
| Accrued payroll and related liabilities   | 19,343               | 32,127          |
| Environmental liabilities   | 191                  | 1,062           |
| Accrued income taxes  | 353                  | 3,202           |
| Other accrued liabilities   | 35,922               | 36,903          |
| Total current liabilities   | 130,566              | 177,270         |
| Deferred income taxes   | 20,150               | 22,746          |
| Long-term debt, net of current maturities   | 312,902              | 318,842         |
| Environmental liabilities, net of current portion   | 47,354               | 47,287          |
| Other long-term liabilities   | 14,295               | 13,088          |
| Total liabilities   | 525,267              | 579,233         |
| Commitments and contingencies (Note 6)  |                      |                 |
| Schnitzer Steel Industries, Inc. ("SSI") shareholders' equity:  |                      |                 |
| Preferred stock – 20,000 shares \$1.00 par value authorized, none issued  | —                    | —               |
| Class A common stock – 75,000 shares \$1.00 par value authorized, 26,480 and 26,384 shares issued and outstanding | 26,480               | 26,384          |
| Class B common stock – 25,000 shares \$1.00 par value authorized, 306 and 306 shares issued and outstanding       | 306                  | 306             |
| Additional paid-in capital  | 21,304               | 19,164          |
| Retained earnings   | 529,158              | 737,571         |
| Accumulated other comprehensive loss  | (36,148)             | (12,641)        |
| Total SSI shareholders' equity  | 541,100              | 770,784         |
| Noncontrolling interests  | 4,239                | 5,193           |

|                              |             |             |
|------------------------------|-------------|-------------|
| Total equity                 | 545,339     | 775,977     |
| Total liabilities and equity | \$1,070,606 | \$1,355,210 |

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

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

|  | Three Months Ended February 28, |           | Six Months Ended February 28, |             |
|--|---------------------------------|-----------|-------------------------------|-------------|
|  | 2015                            | 2014      | 2015                          | 2014        |
| Revenues   | \$439,232                       | \$626,147 | \$994,822                     | \$1,213,891 |
| Operating expense:   |                                 |           |                               |             |
| Cost of goods sold   | 408,783                         | 571,140   | 918,805                       | 1,113,558   |
| Selling, general and administrative                        | 42,737                          | 45,856    | 88,103                        | 93,406      |
| Income from joint ventures                                 | (609)                           | (367)     | (1,109)                       | (777)       |
| Goodwill impairment charge                                 | 141,021                         | —         | 141,021                       | —           |
| Other asset impairment charges                             | 43,838                          | 928       | 43,838                        | 928         |
| Restructuring charges and other exit-related costs         | 8,371                           | 2,006     | 8,994                         | 3,819       |
| Operating income (loss)                                    | (204,909)                       | 6,584     | (204,830)                     | 2,957       |
| Interest expense   | (2,345)                         | (2,816)   | (4,769)                       | (5,517)     |
| Other income (expense), net                                | 1,620                           | (142)     | 2,372                         | 33          |
| Income (loss) before income taxes                          | (205,634)                       | 3,626     | (207,227)                     | (2,527)     |
| Income tax (expense) benefit                               | 9,752                           | (986)     | 9,743                         | (201)       |
| Net income (loss)  | (195,882)                       | 2,640     | (197,484)                     | (2,728)     |
| Net (income) loss attributable to noncontrolling interests | 240                             | (851)     | (631)                         | (1,712)     |
| Net income (loss) attributable to SSI                      | \$(195,642)                     | \$1,789   | \$(198,115)                   | \$(4,440)   |
| Net income (loss) per share attributable to SSI:           |                                 |           |                               |             |
| Basic  | \$(7.24)                        | \$0.07    | \$(7.34)                      | \$(0.17)    |
| Diluted  | \$(7.24)                        | \$0.07    | \$(7.34)                      | \$(0.17)    |
| Weighted average number of common shares:                  |                                 |           |                               |             |
| Basic  | 27,020                          | 26,825    | 26,982                        | 26,790      |
| Diluted  | 27,020                          | 26,947    | 26,982                        | 26,790      |
| Dividends declared per common share                        | \$0.1875                        | \$0.1875  | \$0.3750                      | \$0.3750    |

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

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

|   | Three Months Ended February 28, |             | Six Months Ended February 28, |              |   |
|---|---------------------------------|-------------|-------------------------------|--------------|---|
|   | 2015                            | 2014        | 2015                          | 2014         |   |
| Net income (loss)   | \$ (195,882                     | ) \$ 2,640  | \$ (197,484                   | ) \$ (2,728  | ) |
| Other comprehensive income (loss), net of tax:                  |                                 |             |                               |              |   |
| Foreign currency translation adjustments                        | (12,601                         | ) (5,688    | ) (19,873                     | ) (6,579     | ) |
| Cash flow hedges, net   | (2,785                          | ) (229      | ) (3,693                      | ) (108       | ) |
| Pension obligations, net  | 23                              | 45          | 59                            | 89           |   |
| Total other comprehensive loss, net of tax                      | (15,363                         | ) (5,872    | ) (23,507                     | ) (6,598     | ) |
| Comprehensive loss  | (211,245                        | ) (3,232    | ) (220,991                    | ) (9,326     | ) |
| Less net (income) loss attributable to noncontrolling interests | 240                             | (851        | ) (631                        | ) (1,712     | ) |
| Comprehensive loss attributable to SSI                          | \$ (211,005                     | ) \$ (4,083 | ) \$ (221,622                 | ) \$ (11,038 | ) |

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

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

|  | Six Months Ended February 28, |            |
|--|-------------------------------|------------|
|  | 2015                          | 2014       |
| Cash flows from operating activities:  |                               |            |
| Net loss   | \$(197,484                    | ) \$(2,728 |
| Adjustments to reconcile net loss to cash provided by operating activities:    |                               |            |
| Goodwill impairment charge   | 141,021                       | —          |
| Other asset impairment charges   | 43,838                        | 928        |
| Other exit-related asset impairments and accelerated depreciation              | 6,352                         | 566        |
| Depreciation and amortization  | 36,871                        | 41,047     |
| Inventory write-down   | 3,031                         | —          |
| Deferred income taxes  | (858                          | ) 1,803    |
| Undistributed equity in earnings of joint ventures                             | (1,109                        | ) (777     |
| Share-based compensation expense   | 4,300                         | 7,180      |
| Excess tax benefit from share-based payment arrangements                       | (94                           | ) (54      |
| Gain on disposal of assets   | (1,032                        | ) (66      |
| Unrealized foreign exchange gain (loss), net                                   | (1,610                        | ) 808      |
| Bad debt (recoveries) expense, net   | (67                           | ) 400      |
| Changes in assets and liabilities, net of acquisitions:                        |                               |            |
| Accounts receivable  | 69,434                        | 5,342      |
| Inventories  | (38,404                       | ) (7,581   |
| Income taxes   | (15,325                       | ) (3,284   |
| Prepaid expenses and other current assets                                      | 5,143                         | 1,464      |
| Intangibles and other long-term assets   | 33                            | 273        |
| Accounts payable   | (22,195                       | ) 1,758    |
| Accrued payroll and related liabilities  | (12,525                       | ) (1,771   |
| Other accrued liabilities  | (4,382                        | ) (115     |
| Environmental liabilities  | (52                           | ) (337     |
| Other long-term liabilities  | 638                           | (198       |
| Distributed equity in earnings of joint ventures                               | 325                           | 1,040      |
| Net cash provided by operating activities                                      | 15,849                        | 45,698     |
| Cash flows from investing activities:  |                               |            |
| Capital expenditures   | (16,828                       | ) (21,064  |
| Joint venture payments, net  | (1                            | ) (1,468   |
| Proceeds from sale of assets   | 1,358                         | 635        |
| Acquisitions, net of cash acquired   | (150                          | ) (2,160   |
| Net cash used in investing activities  | (15,621                       | ) (24,057  |
| Cash flows from financing activities:  |                               |            |
| Proceeds from line of credit   | 145,000                       | 257,500    |
| Repayment of line of credit  | (145,000                      | ) (266,000 |
| Borrowings from long-term debt   | 109,694                       | 185,027    |
| Repayment of long-term debt  | (114,965                      | ) (180,477 |
| Taxes paid related to net share settlement of share-based payment arrangements | (1,360                        | ) (676     |
| Excess tax benefit from share-based payment arrangements                       | 94                            | 54         |
| Stock options exercised  | —                             | 240        |
| Distributions to noncontrolling interest                                       | (1,585                        | ) (1,072   |
| Contingent consideration paid relating to business acquisitions                | (759                          | ) —        |

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|  |         |           |   |
|--|---------|-----------|---|
| Dividends paid                                       | (10,087 | ) (9,983  | ) |
| Net cash used in financing activities                | (18,968 | ) (15,387 | ) |
| Effect of exchange rate changes on cash              | 669     | 668       |   |
| Net (decrease) increase in cash and cash equivalents | (18,071 | ) 6,922   |   |
| Cash and cash equivalents as of beginning of period  | 25,672  | 13,481    |   |
| Cash and cash equivalents as of end of period        | \$7,601 | \$20,403  |   |

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



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SCHNITZER STEEL INDUSTRIES, INC.  
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Unaudited Condensed Consolidated Financial Statements of Schnitzer Steel Industries, Inc. (the “Company”) have been prepared pursuant to generally accepted accounting principles in the United States of America (“U.S. GAAP”) for interim financial information and the rules and regulations of the United States Securities and Exchange Commission (the “SEC”) for Form 10-Q, including Article 10 of Regulation S-X. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to the rules and regulations of the SEC. In the opinion of management, all normal, recurring adjustments considered necessary for a fair statement have been included. Management suggests that these Unaudited Condensed Consolidated Financial Statements be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended August 31, 2014. The results for the three and six months ended February 28, 2015 and 2014 are not necessarily indicative of the results of operations for the entire fiscal year.

Accounting Changes

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

Cash and Cash Equivalents

Cash and cash equivalents include short-term securities that are not restricted by third parties and have an original maturity date of 90 days or less. Included in accounts payable are book overdrafts representing outstanding checks in excess of funds on deposit of \$22 million and \$35 million as of February 28, 2015 and August 31, 2014, respectively.

Other Assets

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

As of February 28, 2015 and August 31, 2014, the Company reported \$3 million of assets held for sale within prepaid expenses and other current assets in the Unaudited Condensed Consolidated Balance Sheets. During the second quarter of fiscal 2015 and 2014, the Company recorded impairment charges for the initial and subsequent write-down of certain equipment held for sale to its fair value less cost to sell of \$2 million and \$1 million, respectively, which are reported within other asset impairment charges in the Unaudited Condensed Consolidated Statements of Operations. The Company determined fair value using Level 3 inputs under the fair value hierarchy consisting of information provided by brokers and other external sources along with management’s own assumptions. See Note 10 - Fair Value Measurements for further detail.

#### Long-Lived Assets

The Company tests long-lived tangible and intangible assets for impairment at the asset group level, which is determined based on the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. The Company tests its asset groups for impairment when certain triggering events or changes in circumstances indicate that the carrying value of the asset group may be impaired. If the carrying value of the asset group is not recoverable because it exceeds the Company's estimate of future undiscounted cash flows from the use and eventual disposition of the asset group, an impairment loss is recognized by the amount the carrying value exceeds its fair value, if any. The impairment loss is

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

allocated to the long-lived assets of the group on a pro rata basis using the relative carrying amounts of those assets, except that the loss allocated to an individual long-lived asset of the group shall not reduce the carrying amount of that asset below its fair value. Fair value is determined primarily using the cost and market approaches.

During the second quarter of fiscal 2015, the Company recorded impairment charges on long-lived tangible and intangible assets associated with certain regional metals recycling operations and used auto parts store locations.

These charges are reported within other asset impairment charges or, if related to a site closure, restructuring charges and other exit-related costs in the Unaudited Condensed Consolidated Statements of Operations for the three and six months ended February 28, 2015 and 2014 (in thousands):

|   | 2015     | 2014 |
|---|----------|------|
| Other asset impairment charges:                     |          |      |
| MRB   | \$41,544 | \$—  |
| Restructuring charges and other exit-related costs: |          |      |
| APB   | 2,666    | —    |
| Total long-lived asset impairment charges           | \$44,210 | \$—  |

**Goodwill and Other Intangible Assets**

Goodwill represents the excess of the purchase price over the net amount of identifiable assets acquired and liabilities assumed in a business combination measured at fair value. The Company evaluates goodwill for impairment annually during the fourth fiscal quarter and upon the occurrence of certain triggering events or substantive changes in circumstances that indicate that the fair value of goodwill may be impaired. Impairment of goodwill is tested at the reporting unit level. A reporting unit is an operating segment or one level below an operating segment (referred to as a component). The Company has determined that its reporting units for which goodwill has been allocated are equivalent to the Company's operating segments, as all of the components of each operating segment meet the criteria for aggregation.

When testing goodwill for impairment, the Company has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the estimated fair value of a reporting unit is less than its carrying amount. If the Company elects to perform a qualitative assessment and determines that an impairment is more likely than not, the Company is then required to perform the two-step quantitative impairment test, otherwise no further analysis is required. The Company also may elect not to perform the qualitative assessment and, instead, proceed directly to the two-step quantitative impairment test. In the first step of the two-step quantitative impairment test, the fair value of a reporting unit is compared to its carrying value. If the carrying value of a reporting unit exceeds its fair value, the second step of the impairment test is performed for purposes of measuring the impairment. In the second step, the fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit to determine an implied goodwill value. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of goodwill, an impairment loss will be recognized in an amount equal to that excess.

The Company estimates the fair value of its reporting units using an income approach based on the present value of expected future cash flows, including terminal value, utilizing a market-based weighted average cost of capital ("WACC") determined separately for each reporting unit. The determination of fair value involves the use of significant estimates and assumptions, including revenue growth rates driven by future commodity prices and volume expectations, operating margins, capital expenditures, working capital requirements, tax rates, terminal growth rates, discount rates, benefits associated with a taxable transaction and synergistic benefits available to market participants. In addition, to corroborate the reporting units' valuation, the Company uses a market approach based on earnings multiple data and a reconciliation of the Company's estimate of the aggregate fair value of the reporting units to the Company's market capitalization, including consideration of a control premium. See Note 4 - Goodwill for further detail including the recognition of a goodwill impairment charge of \$141 million during the second quarter of fiscal 2015.

The Company tests indefinite-lived intangible assets for impairment by first assessing qualitative factors to determine whether it is necessary to perform a quantitative impairment test. If the Company believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of the indefinite-lived intangible asset is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The Company did not record any impairment charges on indefinite-lived intangible assets in any of the periods presented.

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## Other Asset Impairment Charges

The following impairment charges were recorded within other asset impairment charges in the Unaudited Condensed Consolidated Statements of Operations for the three and six months ended February 28, 2015 and 2014 (in thousands):

|                      | 2015     | 2014  |
|----------------------|----------|-------|
| Long-lived assets    | \$41,544 | \$—   |
| Assets held for sale | 1,549    | 928   |
| Other                | 745      | —     |
| Total                | \$43,838 | \$928 |

All of the other asset impairment charges presented in the table above were recorded during the second quarter of each fiscal year.

## Derivative Financial Instruments

The Company records derivative instruments in prepaid expenses and other current assets or other accrued liabilities in the Unaudited Condensed Consolidated Balance Sheets at fair value, and changes in the fair value are either recognized in other comprehensive income (loss) in the Unaudited Condensed Consolidated Statements of Comprehensive Loss or net income (loss) in the Unaudited Condensed Consolidated Statements of Operations, as applicable, depending on the nature of the underlying exposure, whether the derivative has been designated as a hedge and, if designated as a hedge, the extent to which the hedge is effective. Amounts included in accumulated other comprehensive loss are reclassified to earnings in the period in which earnings are impacted by the hedged items, in the period that the hedged transaction is deemed no longer likely to occur, or in the period that the derivative is terminated. For cash flow hedges, a formal assessment is made, both at the hedge's inception and on an ongoing basis, to determine whether the derivatives that are designated as hedging instruments have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. To the extent the hedge is determined to be ineffective, the ineffective portion is immediately recognized in earnings. When available, quoted market prices or prices obtained through external sources are used to measure a derivative instrument's fair value. The fair value of these instruments is a function of underlying forward commodity prices or foreign currency exchange rates, related volatility, counterparty creditworthiness and duration of the contracts. Cash flows from derivatives are recognized in the Unaudited Condensed Consolidated Statements of Cash Flows in a manner consistent with the underlying transactions. See Note 11 - Derivative Financial Instruments for further detail.

## Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents, accounts receivable, notes and other contractual receivables and derivative financial instruments. The majority of cash and cash equivalents are maintained with two major financial institutions (Bank of America and Wells Fargo Bank, N.A.). Balances with these institutions exceeded the Federal Deposit Insurance Corporation insured amount of \$250,000 as of February 28, 2015. Concentration of credit risk with respect to accounts receivable is limited because a large number of geographically diverse customers make up the Company's customer base. The Company controls credit risk through credit approvals, credit limits, credit insurance, letters of credit or other collateral, cash deposits and monitoring procedures. The Company is exposed to a residual credit risk with respect to open letters of credit by virtue of the possibility of the failure of a bank providing a letter of credit. The Company had \$24 million and \$74 million of open letters of credit relating to accounts receivable as of February 28, 2015 and August 31, 2014, respectively. The counterparties to the Company's derivative financial instruments are major financial institutions.

## Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, debt and derivative contracts. The Company uses the market approach to value its financial assets and liabilities, determined using available market information. The net carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term nature of these instruments. For

long-term debt, which is primarily at variable interest rates, fair value is estimated using observable inputs (Level 2) and approximates its carrying value. Derivative contracts are reported at fair value. See Note 11 - Derivative Financial Instruments for further detail.

#### Fair Value Measurements

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

Level 1 – Unadjusted quoted prices in active markets for identical assets and liabilities.

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SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the determination of the fair value of the asset or liability, either directly or indirectly.

Level 3 – Unobservable inputs that are significant to the determination of the fair value of the asset or liability.

When developing the fair value measurements, the Company uses quoted market prices whenever available or seeks to maximize the use of observable inputs and minimize the use of unobservable inputs when quoted market prices are not available.

**Restructuring Charges**

Restructuring charges consist of severance, contract termination and other restructuring-related costs. A liability for severance costs is typically recognized when the plan of termination has been communicated to the affected employees and is measured at its fair value at the communication date. Contract termination costs consist primarily of costs that will continue to be incurred under operating leases for their remaining terms without economic benefit to the Company. A liability for contract termination costs is recognized at the date the Company ceases using the rights conveyed by the lease contract and is measured at its fair value, which is determined based on the remaining contractual lease rentals reduced by estimated sublease rentals. A liability for other restructuring-related costs is measured at its fair value in the period in which the liability is incurred. See Note 7 - Restructuring Charges and Other Exit-Related Costs for further detail.

**Note 2 - Recent Accounting Pronouncements**

In April 2014, an accounting standard update was issued that amends the requirements for reporting discontinued operations, which may include a component of an entity or a group of components of an entity. The amendments limit discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have, or will have, a major effect on an entity's operations and financial results. The amendments require expanded disclosure about the assets, liabilities, revenues and expenses of discontinued operations. Further, the amendments require an entity to disclose the pretax profit or loss of an individually significant component that is being disposed of that does not qualify for discontinued operations reporting. The standard is applicable to the Company and is to be applied prospectively to all disposals or classifications as held for sale of components that occur beginning in the first quarter of fiscal 2016, and interim periods within that fiscal year, and all businesses that, on acquisition, are classified as held for sale that occur beginning in the first quarter of fiscal 2016, and interim periods within that fiscal year. Upon adoption, the standard will impact how the Company assesses and reports discontinued operations.

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

**Note 3 - Inventories**

Inventories consisted of the following (in thousands):

|                                       | February 28, 2015 | August 31, 2014 |
|---------------------------------------|-------------------|-----------------|
| Processed and unprocessed scrap metal | \$ 143,993        | \$ 106,877      |
| Semi-finished goods (billets)         | 7,764             | 12,920          |
| Finished goods                        | 65,123            | 59,039          |
| Supplies                              | 39,051            | 37,336          |
| Inventories                           | \$ 255,931        | \$ 216,172      |





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## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## Note 4 - Goodwill

The Company tests the goodwill of each of its reporting units annually on July 1 and upon the occurrence of certain triggering events or substantive changes in circumstances that indicate that the fair value of goodwill may be impaired. In the second quarter of fiscal 2015, management identified the combination of a significant further weakening in market conditions, continued constrained supply of raw materials due to the lower price environment which negatively impacted volumes, the planned idling or closure of certain production facilities and retail stores, the Company's recent financial performance and a decline in the Company's market capitalization during the first half of fiscal 2015 as a triggering event requiring an interim impairment test of goodwill allocated to its reporting units. In connection with the interim impairment test performed in the second quarter of fiscal 2015, the Company used a measurement date of February 1, 2015.

For the MRB reporting unit with goodwill of \$141 million as of February 1, 2015, the first step of the impairment test showed that the fair value of the MRB reporting unit was less than its carrying amount, indicating a potential impairment. Based on the second step of the impairment test, the Company concluded that no implied fair value of goodwill remained for the MRB reporting unit, resulting in an impairment of the entire carrying amount of MRB's goodwill totaling \$141 million.

For the APB reporting unit with goodwill of \$176 million as of February 1, 2015, the estimated fair value of the reporting unit exceeded its carrying value by approximately 20%. The projections used in the income approach for APB took into consideration the impact of current market conditions for ferrous and nonferrous commodities, the cost of obtaining adequate supply flows of end-of-life vehicles and recent trends of self-serve parts sales. The projections assumed a recovery of operating margins from current depressed levels over a multi-year period, including the benefits from recently initiated productivity improvements and cost-saving measures, but remaining significantly below the level of operating margins experienced in fiscal years 2010 and 2011. The market-based WACC used in the income approach for APB was 10.37%. The terminal growth rate used in the discounted cash flow model was 1%. Assuming all other components of the fair value estimate were held constant, an increase in the WACC of 1.5% or more or weaker than anticipated improvements in operating margins could result in a failure of the step one quantitative impairment test for the APB reporting unit.

The Company also used a market approach based on earnings multiple data and the Company's market capitalization to corroborate the reporting units' valuations. The Company reconciled its market capitalization to the aggregated estimated fair value of its reporting units, including consideration of a control premium representing the estimated amount a market participant would pay to obtain a controlling interest. The implied control premium resulting from the difference between the Company's market capitalization (based on the average trading price of our Class A common stock for the two-week period ended February 1, 2015) and the higher aggregated estimated fair value of its reporting units was within the historical range of average and mean premiums observed on historical transactions within the steel-making, scrap processing and metals industries. The Company identified specific reconciling items, including market participant synergies, which supported the implied control premium as of February 1, 2015.

The determination of fair value of the reporting units used to perform the first step of the impairment test requires judgment and involves significant estimates and assumptions about the expected future cash flows and the impact of market conditions on those assumptions. Due to the inherent uncertainty associated with forming these estimates, actual results could differ from those estimates. Future events and changing market conditions may impact the Company's assumptions as to future revenue growth rates, pace and extent of operating margin and volume recovery, market-based WACC and other factors that may result in changes in the estimates of the Company's reporting units' fair value. Although management believes the assumptions used in testing the Company's reporting units' goodwill for impairment are reasonable, it is possible that market and economic conditions could deteriorate further or not improve

as expected. Additional declines in or a lack of recovery of market conditions from current levels, a trend of weaker than anticipated financial performance including the pace and extent of operating margin recovery for the APB reporting unit, a further deterioration in the Company's share price from current levels for a sustained period of time, or an increase in the market-based WACC, among other factors, could significantly impact the impairment analysis and may result in future goodwill impairment charges that, if incurred, could have a material adverse effect on the Company's financial condition and results of operations.

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## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The gross changes in the carrying amount of goodwill by reporting segment for the six months ended February 28, 2015 were as follows (in thousands):

|   | Metals Recycling<br>Business | Auto Parts<br>Business | Total     |   |
|---|------------------------------|------------------------|-----------|---|
| Balance as of August 31, 2014           | \$146,108                    | \$179,795              | \$325,903 |   |
| Acquisitions                            | —                            | 201                    | 201       |   |
| Foreign currency translation adjustment | (5,087                       | ) (3,264               | ) (8,351  | ) |
| Goodwill impairment charge              | (141,021                     | ) —                    | (141,021  | ) |
| Balance as of February 28, 2015         | \$—                          | \$176,732              | \$176,732 |   |

Accumulated goodwill impairment charges were \$462 million and \$321 million as of February 28, 2015 and August 31, 2014.

## Note 5 - Short-Term Borrowings

The Company has an unsecured, uncommitted \$25 million credit line with Wells Fargo Bank, N.A. As of March 1, 2015, the term of this credit facility was renewed and extended to April 1, 2016. Interest rates are set by the bank at the time of borrowing. The Company had no borrowings outstanding under this credit line as of February 28, 2015 and August 31, 2014. The credit agreement contains various representations and warranties, events of default and financial and other covenants, including covenants regarding maintenance of a minimum fixed charge ratio and a maximum leverage ratio.

## Note 6 - Commitments and Contingencies

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

Changes in the Company's environmental liabilities for the six months ended February 28, 2015 were as follows (in thousands):

| Reporting Segment         | Balance as of<br>August 31,<br>2014 | Liabilities<br>Established<br>(Released), Net | Payments<br>and Other | Balance as of<br>February 28, 2015 | Short-Term | Long-Term |
|---------------------------|-------------------------------------|---|-----------------------|------------------------------------|------------|-----------|
| Metals Recycling Business | \$30,139                            | \$178   | \$(994 )              | \$29,323                           | \$160      | \$29,163  |
| Auto Parts Business       | 17,822                              | 200   | (131 )                | 17,891                             | —          | 17,891    |
| Corporate                 | 388                                 | —   | (57 )                 | 331                                | 31         | 300       |
| Total                     | \$48,349                            | \$378   | \$(1,182 )            | \$47,545                           | \$191      | \$47,354  |

## Metals Recycling Business ("MRB")

As of February 28, 2015, MRB had environmental liabilities of \$29 million for the potential remediation of locations where it has conducted business and has environmental liabilities from historical or recent activities.

## Portland Harbor

In December 2000, the Company was notified by the United States Environmental Protection Agency ("EPA") under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") that it is one of the potentially responsible parties ("PRPs") that own or operate or formerly owned or operated sites which are part of or adjacent to the Portland Harbor Superfund site (the "Site"). The precise nature and extent of any cleanup of the Site, the parties to be involved, the process to be followed for any cleanup and the allocation of the costs for any cleanup among responsible

parties have not yet been determined, but the process of identifying additional PRPs and beginning allocation of costs is underway. It is unclear to what extent the Company will be liable for environmental costs or natural resource damage claims or third party contribution or damage claims with respect to the Site. While the Company participated in certain preliminary Site study efforts, it is not party to the consent order entered into by the EPA with certain other PRPs, referred to as the "Lower Willamette Group" ("LWG"), for a remedial investigation/feasibility study ("RI/FS").

During fiscal 2007, the Company and certain other parties agreed to an interim settlement with the LWG under which the Company made a cash contribution to the LWG RI/FS. The Company has also joined with more than 80 other PRPs, including the LWG, in

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a voluntary process to establish an allocation of costs at the Site. These parties have selected an allocation team and have entered into an allocation process design agreement. The LWG has also commenced federal court litigation, which has been stayed, seeking to bring additional parties into the allocation process.

In January 2008, the Natural Resource Damages Trustee Council (“Trustees”) for Portland Harbor invited the Company and other PRPs to participate in funding and implementing the Natural Resource Injury Assessment for the Site. Following meetings among the Trustees and the PRPs, a funding and participation agreement was negotiated under which the participating PRPs agreed to fund the first phase of the natural resource damage assessment. The Company joined in that Phase I agreement and paid a portion of those costs. The Company did not participate in funding the second phase of the natural resource damage assessment.

On March 30, 2012, the LWG submitted to the EPA and made available on its website a draft feasibility study (“draft FS”) for the Site based on approximately ten years of work and \$100 million in costs classified by the LWG as investigation related. The draft FS identifies ten possible remedial alternatives which range in estimated cost from approximately \$170 million to \$250 million (net present value) for the least costly alternative to approximately \$1.08 billion to \$1.76 billion (net present value) for the most costly and estimates a range of two to 28 years to implement the remedial work, depending on the selected alternative. The draft FS does not determine who is responsible for remediation costs, define the precise cleanup boundaries or select remedies. The draft FS is being revised by the EPA and the revisions may be significant and could materially impact the scope or cost of remediation. While the draft FS is an important step in the EPA’s development of a proposed plan for addressing the Site, a final decision on the nature and extent of the required remediation will occur only after the EPA has prepared a proposed plan for public review and issued a record of decision (“ROD”). Currently available information indicates that the EPA does not expect to issue its final ROD selecting a remedy for the Site until at least 2017 or commence remediation activities until 2024. Responsibility for implementing and funding the EPA’s selected remedy will be determined in a separate allocation process, which is currently underway.

Because there has not been a determination of the total cost of the investigations, the remediation that will be required, the amount of natural resource damages or how the costs of the ongoing investigations and any remedy and natural resource damages will be allocated among the PRPs, the Company believes it is not possible to reasonably estimate the amount or range of costs which it is likely or reasonably possible that the Company may incur in connection with the Site, although such costs could be material to the Company’s financial position, results of operations, cash flows and liquidity. Among the facts currently not known or available are detailed information on the history of ownership of and the nature of the uses of and activities and operations performed on each property within the Site, which are factors that will play a substantial role in determining the allocation of investigation and remedy costs among the PRPs. The Company has insurance policies that it believes will provide reimbursement for costs it incurs for defense and remediation in connection with the Site, although there is no assurance that those policies will cover all of the costs which the Company may incur. Further, the Company has a cost sharing arrangement under which a third party is paying 50% of costs, net of insurance recoveries. The Company previously recorded a liability for its estimated share of the costs of the investigation of \$1 million.

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

Other MRB Sites

As of February 28, 2015, the Company had environmental liabilities related to various MRB sites other than Portland Harbor of \$28 million. The liabilities relate to the potential future remediation of soil contamination, groundwater contamination and storm water runoff issues and were not individually material at any site.

Auto Parts Business (“APB”)

As of February 28, 2015, the Company had environmental liabilities related to various APB sites of \$18 million. The liabilities relate to the potential future remediation of soil contamination, groundwater contamination and storm water runoff issues and were not individually material at any site.

Steel Manufacturing Business (“SMB”)

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

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SMB has an operating permit issued under Title V of the Clean Air Act Amendments of 1990, which governs certain air quality standards. The permit is based on an annual production capacity of 950 thousand tons. The permit was first issued in 1998 and has since been renewed through February 1, 2018.

SMB had no environmental liabilities as of February 28, 2015.

Other than the Portland Harbor Superfund site, which is discussed above, management currently believes that adequate provision has been made for the potential impact of these issues and that the ultimate outcomes will not have a material adverse effect on the Unaudited Condensed Consolidated Financial Statements of the Company as a whole. Historically, the amounts the Company has ultimately paid for such remediation activities have not been material in any given period.

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

Note 7 - Restructuring Charges and Other Exit-Related Costs

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

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

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

At the end of the second quarter of fiscal 2015, the Company initiated additional restructuring and exit-related initiatives by undertaking strategic actions consisting of idling underutilized assets at MRB and initiating the closure of seven APB stores to more closely align the Company's business to the prevalent market conditions. The Company expanded these initiatives in April 2015 by announcing measures aimed at further reducing the Company's annual operating expenses, primarily selling, general and administrative expenses, at Corporate, MRB and APB through headcount reductions, reducing organizational layers, consolidating shared service functions and other non-headcount measures. Collectively, these initiatives are referred to as the "Q2'15 Plan."

The vast majority of the restructuring charges require the Company to make cash payments.

In addition to the restructuring charges recorded related to these initiatives, the Company incurred other exit-related costs consisting of asset impairments and accelerated depreciation due to shortened useful lives in connection with site closures.





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## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Restructuring charges and other exit-related costs were comprised of the following (in thousands):

|  | Three Months Ended February 28, 2015 |            |               |               | Three Months Ended February 28, 2014 |            |               |
|--|--------------------------------------|------------|---------------|---------------|--------------------------------------|------------|---------------|
|  | Q1'14 Plan                           | Q1'15 Plan | Q2'15 Plan    | Total Charges | Q4'12 Plan                           | Q1'14 Plan | Total Charges |
| Restructuring charges:                                   |                                      |            |               |               |                                      |            |               |
| Severance costs  | \$(57 )                              | \$428      | \$540         | \$911         | \$(39 )                              | \$1,182    | \$1,143       |
| Contract termination costs                               | 56                                   | —          | 79            | 135           | 106                                  | (9 )       | 97            |
| Other restructuring costs                                | —                                    | 880        | 93            | 973           | —                                    | 200        | 200           |
| Total restructuring charges                              | (1 )                                 | 1,308      | 712           | 2,019         | 67                                   | 1,373      | 1,440         |
| Other exit-related costs:                                |                                      |            |               |               |                                      |            |               |
| Asset impairments and accelerated depreciation           | —                                    | —          | 6,352         | 6,352         | —                                    | 566        | 566           |
| Total other exit-related costs                           | —                                    | —          | 6,352         | 6,352         | —                                    | 566        | 566           |
| Total restructuring charges and other exit-related costs | \$(1 )                               | \$1,308    | \$7,064       | \$8,371       | \$67                                 | \$1,939    | \$2,006       |
|  |                                      |            |               |               |                                      |            |               |
|  | Six Months Ended February 28, 2015   |            |               |               | Six Months Ended February 28, 2014   |            |               |
|  | Q1'14 Plan                           | Q1'15 Plan | Q2'15 Plan    | Total Charges | Q4'12 Plan                           | Q1'14 Plan | Total Charges |
| Restructuring charges:                                   |                                      |            |               |               |                                      |            |               |
| Severance costs  | \$(30 )                              | \$428      | \$540         | \$938         | \$(13 )                              | \$2,259    | \$2,246       |
| Contract termination costs                               | 309                                  | —          | 79            | 388           | 568                                  | 29         | 597           |
| Other restructuring costs                                | —                                    | 1,223      | 93            | 1,316         | —                                    | 410        | 410           |
| Total restructuring charges                              | 279                                  | 1,651      | 712           | 2,642         | 555                                  | 2,698      | 3,253         |
| Other exit-related costs:                                |                                      |            |               |               |                                      |            |               |
| Asset impairments and accelerated depreciation           | —                                    | —          | 6,352         | 6,352         | —                                    | 566        | 566           |
| Total other exit-related costs                           | —                                    | —          | 6,352         | 6,352         | —                                    | 566        | 566           |
| Total restructuring charges and other exit-related costs | \$279                                | \$1,651    | \$7,064       | \$8,994       | \$555                                | \$3,264    | \$3,819       |
|  |                                      |            |               |               |                                      |            |               |
|  |                                      |            | Total Charges |               |                                      |            |               |
| Total restructuring charges to date                      |                                      |            | Q4'12 Plan    | Q1'14 Plan    | Q1'15 Plan                           | Q2'15 Plan | Total         |
| Total expected restructuring charges                     |                                      |            | \$13,549      | \$6,049       | \$1,651                              | \$712      | \$21,961      |
|  |                                      |            | \$13,549      | \$6,100       | \$1,651                              | \$9,900    | \$31,200      |

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The following illustrates the reconciliation of the restructuring liability by major type of costs for the six months ended February 28, 2015 (in thousands):

|                               | All Other Plans      |         |                          | Q2'15 Plan           |                      |         |                          | All Plans            |                             |                              |
|-------------------------------|----------------------|---------|--------------------------|----------------------|----------------------|---------|--------------------------|----------------------|-----------------------------|------------------------------|
|                               | Balance<br>8/31/2014 | Charges | Payments<br>and<br>Other | Balance<br>2/28/2015 | Balance<br>8/31/2014 | Charges | Payments<br>and<br>Other | Balance<br>2/28/2015 | Total<br>Charges<br>to Date | Total<br>Expected<br>Charges |
| Severance costs               | \$669                | \$398   | \$(1,033)                | \$34                 | \$—                  | \$540   | \$(31)                   | \$509                | \$10,729                    | \$15,800                     |
| Contract<br>termination costs | 1,489                | 309     | (813)                    | 985                  | —                    | 79      | —                        | 79                   | 5,441                       | 8,000                        |
| Other<br>restructuring costs  | —                    | 1,223   | (772)                    | 451                  | —                    | 93      | —                        | 93                   | 5,791                       | 7,400                        |
| Total                         | \$2,158              | \$1,930 | \$(2,618)                | \$1,470              | \$—                  | \$712   | \$(31)                   | \$681                | \$21,961                    | \$31,200                     |

Due to the immateriality of the activity and liability balances for each of the Q4'12 Plan, Q1'14 Plan and Q1'15 Plan, the reconciliation of the restructuring liability is provided in aggregate.

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

|   | Three Months Ended<br>February 28,<br>2015 |         | Six Months Ended<br>February 28,<br>2015 |         | Total<br>Charges<br>to Date | Total<br>Expected<br>Charges |
|---|--|---------|--|---------|-----------------------------|------------------------------|
|   | 2015                                       | 2014    | 2015                                     | 2014    |                             |                              |
| Restructuring charges:                                      |  |         |  |         |                             |                              |
| Metals Recycling Business                                   | \$322                                      | \$860   | \$577                                    | \$2,152 | \$9,256                     | \$11,300                     |
| Auto Parts Business   | 1,634                                      | 435     | 2,008                                    | 496     | 3,537                       | 8,500                        |
| Unallocated (Corporate)                                     | 63   | 145     | 57                                       | 605     | 9,168                       | 11,400                       |
| Total restructuring charges                                 | 2,019                                      | 1,440   | 2,642                                    | 3,253   | 21,961                      | 31,200                       |
| Other exit-related costs:                                   |  |         |  |         |                             |                              |
| Metals Recycling Business                                   | 3,235                                      | 566     | 3,235                                    | 566     | 3,801                       |                              |
| Auto Parts Business   | 3,117                                      | —       | 3,117                                    | —       | 3,117                       |                              |
| Total other exit-related costs                              | 6,352                                      | 566     | 6,352                                    | 566     | 6,918                       |                              |
| Total restructuring charges and other<br>exit-related costs | \$8,371                                    | \$2,006 | \$8,994                                  | \$3,819 | \$28,879                    |                              |

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

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## Note 8 - Changes in Equity

The following is a summary of the changes in equity for the six months ended February 28, 2015 and 2014 (in thousands):

|  | Fiscal 2015            |                          |              | Fiscal 2014            |                          |              |
|--|------------------------|--------------------------|--------------|------------------------|--------------------------|--------------|
|  | SSI Shareholder Equity | Noncontrolling Interests | Total Equity | SSI Shareholder Equity | Noncontrolling Interests | Total Equity |
| Balance - September 1 (Beginning of period)  | \$ 770,784             | \$ 5,193                 | \$ 775,977   | \$ 776,558             | \$ 4,641                 | \$ 781,199   |
| Net income (loss)  | (198,115 )             | 631                      | (197,484 )   | (4,440 )               | 1,712                    | (2,728 )     |
| Other comprehensive loss, net of tax   | (23,507 )              | —                        | (23,507 )    | (6,598 )               | —                        | (6,598 )     |
| Distributions to noncontrolling interests  | —                      | (1,585 )                 | (1,585 )     | —                      | (1,072 )                 | (1,072 )     |
| Restricted stock withheld for taxes  | (1,360 )               | —                        | (1,360 )     | (676 )                 | —                        | (676 )       |
| Stock options exercised  | —                      | —                        | —            | 240                    | —                        | 240          |
| Share-based compensation   | 4,300                  | —                        | 4,300        | 7,180                  | —                        | 7,180        |
| Excess tax deficiency from stock options exercised and restricted stock units vested | (704 )                 | —                        | (704 )       | (674 )                 | —                        | (674 )       |
| Dividends  | (10,298 )              | —                        | (10,298 )    | (10,094 )              | —                        | (10,094 )    |
| Balance - February 28 (End of period)  | \$ 541,100             | \$ 4,239                 | \$ 545,339   | \$ 761,496             | \$ 5,281                 | \$ 766,777   |

## Note 9 - Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss, net of tax, were comprised of the following (in thousands):

|   | Three Months Ended February 28, 2015     |                          |  |             | Three Months Ended February 28, 2014     |                          |  |             |
|---|--|--------------------------|--|-------------|--|--------------------------|--|-------------|
|   | Foreign Currency Translation Adjustments | Pension Obligations, net | Net Unrealized Gain (Loss) on Cash Flow Hedges | Total       | Foreign Currency Translation Adjustments | Pension Obligations, net | Net Unrealized Gain (Loss) on Cash Flow Hedges | Total       |
| Balances - December 1 (Beginning of period)                   | \$(17,935 )                              | \$(2,000 )               | \$(850 )                                       | \$(20,785 ) | \$(7,314 )                               | \$(2,773 )               | \$—  | \$(10,087 ) |
| Other comprehensive loss before reclassifications             | (12,601 )                                | —                        | (3,424 )                                       | (16,025 )   | (5,688 )                                 | —                        | (305 )   | (5,993 )    |
| Income tax benefit  | —  | —                        | —  | —           | —  | —                        | 76   | 76          |
| Other comprehensive loss before reclassifications, net of tax | (12,601 )                                | —                        | (3,424 )                                       | (16,025 )   | (5,688 )                                 | —                        | (229 )   | (5,917 )    |
| Amounts reclassified from accumulated                         | —  | 38                       | 853  | 891         | —  | 71                       | —  | 71          |

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|  |              |             |             |              |              |             |           |              |
|--|--------------|-------------|-------------|--------------|--------------|-------------|-----------|--------------|
| other comprehensive loss   |              |             |             |              |              |             |           |              |
| Income tax benefit   | —            | (15 )       | (214 )      | (229 )       | —            | (26 )       | —         | (26 )        |
| Amounts reclassified from accumulated other comprehensive loss, net of tax | —            | 23          | 639         | 662          | —            | 45          | —         | 45           |
| Net periodic other comprehensive income (loss)                             | (12,601 )    | 23          | (2,785 )    | (15,363 )    | (5,688 )     | 45          | (229 )    | (5,872 )     |
| Balances - February 28 (End of period)                                     | \$ (30,536 ) | \$ (1,977 ) | \$ (3,635 ) | \$ (36,148 ) | \$ (13,002 ) | \$ (2,728 ) | \$ (229 ) | \$ (15,959 ) |

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

|   | Six Months Ended February 28, 2015                |                                |   |            | Six Months Ended February 28, 2014                |                                |  |            |
|---|---|--------------------------------|---|------------|---|--------------------------------|--|------------|
|   | Foreign<br>Currency<br>Translation<br>Adjustments | Pension<br>Obligations,<br>net | Net<br>Unrealized<br>Gain<br>(Loss) on<br>Cash Flow<br>Hedges | Total      | Foreign<br>Currency<br>Translation<br>Adjustments | Pension<br>Obligations,<br>net | Net<br>Unrealized<br>Gain<br>(Loss) on<br>Cash<br>Flow<br>Hedges | Total      |
| Balances - September 1<br>(Beginning of period)                                     | \$(10,663 )                                       | \$ (2,036 )                    | \$58  | \$(12,641) | \$(6,423 )  | \$ (2,817 )                    | \$(121 )   | \$(9,361 ) |
| Other comprehensive<br>loss before<br>reclassifications                             | (19,873 )   | —                              | (5,136 )  | (25,009 )  | (6,579 )  | —                              | (305 )   | (6,884 )   |
| Income tax benefit  | —   | —                              | 428   | 428        | —   | —                              | 76   | 76         |
| Other comprehensive<br>loss before<br>reclassifications, net of<br>tax              | (19,873 )   | —                              | (4,708 )  | (24,581 )  | (6,579 )  | —                              | (229 )   | (6,808 )   |
| Amounts reclassified<br>from accumulated<br>other comprehensive<br>loss             | —   | 87                             | 1,354   | 1,441      | —   | 140                            | 98   | 238        |
| Income tax (benefit)<br>expense   | —   | (28 )                          | (339 )  | (367 )     | —   | (51 )                          | 23   | (28 )      |
| Amounts reclassified<br>from accumulated<br>other comprehensive<br>loss, net of tax | —   | 59                             | 1,015   | 1,074      | —   | 89                             | 121  | 210        |
| Net periodic other<br>comprehensive income<br>(loss)                                | (19,873 )   | 59                             | (3,693 )  | (23,507 )  | (6,579 )  | 89                             | (108 )   | (6,598 )   |
| Balances - February 28<br>(End of period)   | \$(30,536 )                                       | \$ (1,977 )                    | \$(3,635 )  | \$(36,148) | \$(13,002 )                                       | \$ (2,728 )                    | \$(229 )   | \$(15,959) |

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

## Note 10 - Fair Value Measurements

The following table presents information about the Company's assets and liabilities measured at fair value as of February 28, 2015 and August 31, 2014, and indicates the fair value hierarchy of the valuation techniques utilized by the Company and the type of measurement.

| (in thousands) | Assets (Liabilities) at Fair Value |                 | Fair Value<br>Measurement<br>Level | Type of<br>Measurement | Balance Sheet<br>Classification |
|----------------|------------------------------------|-----------------|------------------------------------|------------------------|---------------------------------|
|                | February 28,<br>2015               | August 31, 2014 |                                    |                        |                                 |
|                |                                    |                 |                                    |                        |                                 |

## Assets:

|   |          |         |           |               |   |
|---|----------|---------|-----------|---------------|---|
| Assets held for sale                        | \$2,839  | \$—     | Level 3   | Non-recurring | Prepaid expenses and other current assets |
| Foreign currency exchange forward contracts | 12       | 202     | Level 2   | Recurring     | Prepaid expenses and other current assets |
| Total assets                                | \$2,851  | \$202   |           |               |   |
| Liabilities:                                |          |         |           |               |   |
| Foreign currency exchange forward contracts | \$(3,653 | ) \$(46 | ) Level 2 | Recurring     | Other accrued liabilities                 |
| Total liabilities                           | \$(3,653 | ) \$(46 | )         |               |   |

## Note 11 - Derivative Financial Instruments

The Company entered into a series of foreign currency exchange forward contracts to sell U.S. dollars in order to hedge a portion of its exposure to fluctuating rates of exchange on anticipated U.S. dollar-denominated sales by its Canadian subsidiary with a functional currency of the Canadian dollar. The Company utilized intercompany foreign currency derivatives and offsetting derivatives with external counterparties in order to designate the intercompany derivatives as hedging instruments. Once the U.S. dollar-denominated sales have been recognized and the corresponding receivables collected, the Company utilized foreign currency

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## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

exchange forward contracts to sell Canadian dollars, achieving a result similar to net settling the contracts to sell U.S. dollars. The foreign currency exchange forward contracts to sell Canadian dollars are not designated as hedging instruments.

As of February 28, 2015, the Company had foreign currency exchange forward contracts with external counterparties to buy Canadian Dollars for a total notional amount of \$35 million, which have various settlement dates through September 30, 2015, and foreign currency exchange forward contracts with external counterparties to sell Canadian Dollars for a total notional amount of \$4 million, all of which have a settlement date of March 31, 2015. The contracts with external counterparties are reported at fair value in the Unaudited Condensed Consolidated Balance Sheets measured using quoted foreign currency exchange rates.

The fair value of derivative instruments in the Unaudited Condensed Consolidated Balance Sheets is as follows (in thousands):

|   | Asset (Liability) Derivatives             |                   |                 |
|---|---|-------------------|-----------------|
|   | Balance Sheet Location                    | February 28, 2015 | August 31, 2014 |
| Foreign currency exchange forward contracts | Prepaid expenses and other current assets | \$ 12             | \$ 202          |
| Foreign currency exchange forward contracts | Other accrued liabilities                 | \$(3,653          | ) \$(46         |

The results of foreign currency exchange derivatives are comprised of the following (in thousands):

|  | Derivative Gain (Loss) Recognized    |                              |                             |                                      |                              |                             |
|--|--------------------------------------|------------------------------|-----------------------------|--------------------------------------|------------------------------|-----------------------------|
|  | Three Months Ended February 28, 2015 |                              |                             | Three Months Ended February 28, 2014 |                              |                             |
|  | Other Comprehensive Income (Loss)    | Revenues - Effective Portion | Other Income (Expense), net | Other Comprehensive Income (Loss)    | Revenues - Effective Portion | Other Income (Expense), net |
| Foreign currency exchange forward contracts - designated as cash flow hedges     | \$(3,424                             | ) \$(853                     | ) \$ 121                    | \$(229                               | ) \$—                        | \$—                         |
| Foreign currency exchange forward contracts - not designated as cash flow hedges | \$—                                  | \$—                          | \$(117                      | ) \$—                                | \$—                          | \$—                         |

|  | Derivative Gain (Loss) Recognized  |                              |                             |                                    |                              |                             |
|--|------------------------------------|------------------------------|-----------------------------|------------------------------------|------------------------------|-----------------------------|
|  | Six Months Ended February 28, 2015 |                              |                             | Six Months Ended February 28, 2014 |                              |                             |
|  | Other Comprehensive Income (Loss)  | Revenues - Effective Portion | Other Income (Expense), net | Other Comprehensive Income (Loss)  | Revenues - Effective Portion | Other Income (Expense), net |
| Foreign currency exchange forward contracts - designated as cash flow hedges     | \$(5,136                           | ) \$(1,354                   | ) \$ 175                    | \$(229                             | ) \$—                        | \$—                         |
| Foreign currency exchange forward contracts - not designated as cash flow hedges | \$—                                | \$—                          | \$(122                      | ) \$—                              | \$—                          | \$—                         |

There was no hedge ineffectiveness with respect to the forward currency exchange cash flow hedges for the three and six months ended February 28, 2015 and 2014.

Note 12 - Share-Based Compensation

In the first quarter of fiscal 2015, as part of the annual awards under the Company's Long-Term Incentive Plan, the Compensation Committee of the Company's Board of Directors granted 268,988 restricted stock units ("RSUs") and 268,988 performance share awards to the Company's key employees and officers under the Company's 1993 Amended and Restated Stock Incentive Plan.

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



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

In the second quarter of fiscal 2015, the Company granted deferred stock units ("DSU") to each of its non-employee directors under the Company's 1993 Stock Incentive Plan. John Carter, the Company's Chairman, and Tamara Lundgren, President and Chief Executive Officer, receive compensation pursuant to their employment agreements and do not receive DSUs. Each DSU gives the director the right to receive one share of Class A common stock at a future date. The grant included an aggregate of 43,347 shares that will vest on the day before the Company's 2016 annual meeting, subject to continued Board service. The total value of these awards is not material.

## Note 13 - Income Taxes

The effective tax rate for the Company's operations for each of the three and six months ended February 28, 2015 was a benefit of 4.7%, compared to an expense of 27.2% and 8.0%, respectively, for the three and six months ended February 28, 2014.

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

|  | Three Months Ended February 28,<br>2015 <sup>(1)</sup> |   | 2014 |   | Six Months Ended February 28,<br>2015 <sup>(1)</sup> |   | 2014 <sup>(1)</sup> |    |
|--|--|---|------|---|--|---|---------------------|----|
|  |  | % |      | % |  | % |                     | %  |
| Federal statutory rate                     | 35.0   |   | 35.0 |   | 35.0   |   | 35.0                |    |
| State taxes, net of credits                | 1.1  |   | 0.5  |   | 1.1  |   | 5.5                 |    |
| Foreign income taxed at different rates    | (7.4   | ) | 1.7  |   | (7.5   | ) | (18.2               | )  |
| Section 199 deduction                      | —  |   | (1.9 | ) | —  |   | 0.3                 |    |
| Non-deductible officers' compensation      | (0.1   | ) | 0.7  |   | (0.1   | ) | (0.3                | )  |
| Noncontrolling interests                   | 0.5  |   | (2.3 | ) | 0.5  |   | 1.1                 |    |
| Research and development credits           | 0.1  |   | (0.3 | ) | 0.1  |   | 0.3                 |    |
| Valuation allowance on deferred tax assets | (20.6  | ) | (8.5 | ) | (20.5  | ) | (29.3               | )  |
| Non-deductible goodwill                    | (2.8   | ) | —    |   | (2.7   | ) | —                   |    |
| Unrecognized tax benefits                  | (0.5   | ) | 1.4  |   | (0.5   | ) | (2.0                | )  |
| Other                                      | (0.6   | ) | 0.9  |   | (0.7   | ) | (0.4                | )  |
| Effective tax rate                         | 4.7  | % | 27.2 | % | 4.7  | % | (8.0                | )% |

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

The effective tax rate for the second quarter and first six months of fiscal 2015 was impacted primarily by the recognition of valuation allowances of \$42 million on current period benefits in multiple taxing jurisdictions and the impact of the lower financial performance of foreign operations, which are taxed at more favorable rates. The deferred tax assets for which a valuation allowance was recorded were related primarily to deductible temporary differences created in the second quarter by the impairment charges to goodwill and other assets.

The Company recorded a valuation allowance on substantially all of its deferred tax assets as of February 28, 2015. The valuation allowance was recognized as a result of negative evidence, including recent losses, outweighing the more subjective positive evidence, indicating that it is more likely than not that the associated tax benefit will not be

realized. Realization of deferred tax assets is dependent upon the Company generating a consistent trend of profitability to objectively forecast sufficient taxable income in multiple tax jurisdictions in future years to obtain benefit from the reversal of net deductible temporary differences and from utilization of net operating losses. The effective tax rate for the first six months of fiscal 2014 was impacted primarily by the recognition of a full valuation allowance on the current period benefit associated with foreign operations losses and the impact of the lower financial performance of foreign operations, which are tax at more favorable rates. The effective tax rate for the second quarter of fiscal 2014 benefited primarily

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

from the partial realization of previously reserved tax benefits in the foreign jurisdiction as a result of taxable income generated during the period.

The Company files federal and state income tax returns in the U.S. and foreign tax returns in Puerto Rico and Canada. For U.S. federal income tax returns, fiscal years 2011 to 2014 remain subject to examination. At this time, the Company is not under examination in any of its taxing jurisdictions.

## Note 14 - Net Income (Loss) Per Share

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

|   | Three Months Ended February 28, |         | Six Months Ended February 28, |            |
|---|---------------------------------|---------|-------------------------------|------------|
|   | 2015                            | 2014    | 2015                          | 2014       |
| Net income (loss)   | \$(195,882 )                    | \$2,640 | \$(197,484 )                  | \$(2,728 ) |
| Net (income) loss attributable to noncontrolling interests  | 240                             | (851 )  | (631 )                        | (1,712 )   |
| Net income (loss) attributable to SSI   | \$(195,642 )                    | \$1,789 | \$(198,115 )                  | \$(4,440 ) |
| Computation of shares:  |                                 |         |                               |            |
| Weighted average common shares outstanding, basic   | 27,020                          | 26,825  | 26,982                        | 26,790     |
| Incremental common shares attributable to dilutive stock options, performance share awards, DSUs and RSUs | —                               | 122     | —                             | —          |
| Weighted average common shares outstanding, diluted   | 27,020                          | 26,947  | 26,982                        | 26,790     |

Common stock equivalent shares of 1,365,274 were considered antidilutive and were excluded from the calculation of diluted net loss per share for each of the three and six months ended February 28, 2015, compared to the 591,662 and 1,175,976 common stock equivalent shares for the three and six ended February 28, 2014.

## Note 15 - Related Party Transactions

The Company purchases recycled metal from its joint venture operations at prices that approximate fair market value. These purchases totaled \$6 million and \$7 million for the three months ended February 28, 2015 and 2014, respectively, and \$13 million and \$14 million for the six months ended February 28, 2015 and 2014, respectively. Amounts receivable from joint venture partners were zero and \$1 million as of February 28, 2015 and August 31, 2014, respectively.

Thomas D. Klauer, Jr., who had been President of the Company's Auto Parts Business prior to his retirement on January 5, 2015, is the sole shareholder of a corporation that is the 25% minority partner in a partnership in which the Company is the 75% partner and which operates five self-service stores in Northern California. Mr. Klauer's 25% share of the profits, through the date of his retirement, of this partnership totaled less than \$1 million and \$1 million for the three and six months ended February 28, 2015, respectively, and less than \$1 million and \$1 million for the three and six months ended February 28, 2014, respectively. The partnership leases properties from entities in which Mr. Klauer has ownership interests under agreements that expire in March 2016 with options to renew the leases, upon expiration, for multiple periods. The rent paid by the partnership, through the date of his retirement, to the entities in which Mr. Klauer has ownership interests was less than \$1 million for each of the three and six months ended February 28, 2015, and less than \$1 million for each of the three and six months ended February 28, 2014.

Note 16 - Segment Information

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

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

and selling (MRB), used auto parts (APB) and mini-mill steel manufacturing (SMB). Additionally, the Company is a noncontrolling partner in joint ventures, which are either in the metals recycling business or are suppliers of unprocessed metal.

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

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

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

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

The information provided below is obtained from internal information that is provided to the Company's chief operating decision maker for the purpose of corporate management. The Company uses operating income to measure segment performance. The Company does not allocate corporate interest income and expense, income taxes, other income and expenses related to corporate activity or corporate expense for management and administrative services that benefit all three segments. In addition, the Company does not allocate restructuring charges and other exit-related costs to the segment operating income because management does not include this information in its measurement of the performance of the operating segments. Because of this unallocated income and expense, the operating income of each reporting segment does not reflect the operating income the reporting segment would report as a stand-alone business.

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

|                                | Three Months Ended February 28, |           | Six Months Ended February 28, |             |
|--------------------------------|---------------------------------|-----------|-------------------------------|-------------|
|                                | 2015                            | 2014      | 2015                          | 2014        |
| Revenues:                      |                                 |           |                               |             |
| Metals Recycling Business:     |                                 |           |                               |             |
| Revenues                       | \$340,543                       | \$535,690 | \$796,820                     | \$1,025,999 |
| Less: Intersegment revenues    | (44,728)                        | (45,140)  | (100,009)                     | (94,893)    |
| MRB external customer revenues | 295,815                         | 490,550   | 696,811                       | 931,106     |
| Auto Parts Business:           |                                 |           |                               |             |
| Revenues                       | 69,135                          | 76,360    | 150,056                       | 155,995     |
| Less: Intersegment revenues    | (18,844)                        | (22,219)  | (40,389)                      | (42,790)    |
| APB external customer revenues | 50,291                          | 54,141    | 109,667                       | 113,205     |
| Steel Manufacturing Business:  |                                 |           |                               |             |
| Revenues                       | 93,126                          | 81,456    | 188,344                       | 169,580     |
| Total revenues                 | \$439,232                       | \$626,147 | \$994,822                     | \$1,213,891 |

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## SCHNITZER STEEL INDUSTRIES, INC.

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

|  | Three Months Ended February 28, |            | Six Months Ended February 28, |            |
|--|---------------------------------|------------|-------------------------------|------------|
|  | 2015                            | 2014       | 2015                          | 2014       |
| Metals Recycling Business                          | \$(186,679                      | ) \$10,605 | \$(184,757                    | ) \$11,195 |
| Auto Parts Business                                | (2,891                          | ) 4,575    | (930                          | ) 10,184   |
| Steel Manufacturing Business                       | 3,799                           | 3,573      | 10,006                        | 5,318      |
| Segment operating income (loss)                    | (185,771                        | ) 18,753   | (175,681                      | ) 26,697   |
| Restructuring charges and other exit-related costs | (8,371                          | ) (2,006   | ) (8,994                      | ) (3,819   |
| Corporate and eliminations                         | (10,767                         | ) (10,163  | ) (20,155                     | ) (19,921  |
| Operating income (loss)                            | (204,909                        | ) 6,584    | (204,830                      | ) 2,957    |
| Interest expense                                   | (2,345                          | ) (2,816   | ) (4,769                      | ) (5,517   |
| Other income (expense), net                        | 1,620                           | (142       | ) 2,372                       | 33         |
| Income (loss) before income taxes                  | \$(205,634                      | ) \$3,626  | \$(207,227                    | ) \$(2,527 |

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

|  | February 28, 2015 | August 31, 2014 |
|--|-------------------|-----------------|
| Metals Recycling Business <sup>(1)</sup> | \$1,132,825       | \$1,343,771     |
| Auto Parts Business                      | 346,985           | 361,411         |
| Steel Manufacturing Business             | 361,232           | 350,344         |
| Total segment assets                     | 1,841,042         | 2,055,526       |
| Corporate and eliminations               | (770,436          | ) (700,316      |
| Total assets                             | \$1,070,606       | \$1,355,210     |

(1) MRB total assets include \$15 million as of February 28, 2015 and August 31, 2014, for investments in joint venture partnerships.

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

This section includes a discussion of our operations for the three and six months ended February 28, 2015 and 2014. The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of our results of operations and financial condition. The discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended August 31, 2014 and the Unaudited Condensed Consolidated Financial Statements and the related Notes thereto included in Part I, Item 1 of this report.

### Forward-Looking Statements

Statements and information included in this Quarterly Report on Form 10-Q by Schnitzer Steel Industries, Inc. (the "Company") that are not purely historical are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Except as noted herein or as the context may otherwise require, all references to "we," "our," "us" and "SSI" refer to the Company and its consolidated subsidiaries.

Forward-looking statements in this Quarterly Report on Form 10-Q include statements regarding our expectations, intentions, beliefs and strategies regarding the future, which may include statements regarding trends, cyclicity and changes in the markets we sell into; strategic direction or initiatives; changes to manufacturing and production processes; the cost of and the status of any agreements or actions related to our compliance with environmental and other laws; expected tax rates, deductions and credits; the realization of deferred tax assets; the anticipated value of goodwill or other intangible assets; planned capital expenditures; liquidity positions; ability to generate cash from continuing operations; the potential impact of adopting new accounting pronouncements; expected results, including pricing, sales volumes and profitability; obligations under our retirement plans; benefits, savings or additional costs from business realignment, cost containment and productivity improvement programs; and the adequacy of accruals. When used in this report, the words "believes," "expects," "anticipates," "intends," "assumes," "estimates," "evaluates," "may," "opinions," "forecasts," "future," "forward," "potential," "probable," and similar expressions are intended to identify forward-looking statements.

We may make other forward-looking statements from time to time, including in reports filed with the Securities and Exchange Commission, press releases and public conference calls. All forward-looking statements we make are based on information available to us at the time the statements are made, and we assume no obligation to update any forward-looking statements, except as may be required by law. Our business is subject to the effects of changes in domestic and global economic conditions and a number of other risks and uncertainties that could cause actual results to differ materially from those included in, or implied by, such forward-looking statements. Some of these risks and uncertainties are discussed in "Item 1A. Risk Factors" of Part I of our most recent annual report on Form 10-K. Examples of these risks include: potential environmental cleanup costs related to the Portland Harbor Superfund site; the impact of general economic conditions; volatile supply and demand conditions affecting prices and volumes in the markets for both our products and raw materials we purchase; difficulties associated with acquisitions and integration of acquired businesses; the impact of goodwill impairment charges; the impact of long-lived asset impairment charges; the realization of expected cost reductions related to restructuring initiatives; the benefit of business realignment, cost containment and productivity improvement programs and strategic initiatives; the inability of customers to fulfill their contractual obligations; the impact of foreign currency fluctuations; potential limitations on our ability to access capital resources and existing credit facilities; restrictions on our business and financial covenants under our bank credit agreement; the impact of the consolidation in the steel industry; the impact of imports of foreign steel into the U.S.; inability to realize expected benefits from investments in technology; freight rates and availability of transportation; impact of equipment upgrades and failures on production; product liability claims; the impact of impairment of our deferred tax assets; the impact of a cybersecurity incident; costs associated with compliance with environmental regulations; the adverse impact of climate change; inability to obtain or renew business licenses and permits; compliance with greenhouse gas emission regulations; reliance on employees subject to collective bargaining agreements; and the impact of the underfunded status of multiemployer plans in which we participate.





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## SCHNITZER STEEL INDUSTRIES, INC.

## General

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

We operate in three reporting segments: the Metals Recycling Business (“MRB”) and the Auto Parts Business (“APB”), which collectively provide an end-of-life cycle solution for a variety of metal products and materials, and the Steel Manufacturing Business (“SMB”), which through our integrated business platform processes recycled metals into finished steel products. We use operating income to measure our segments’ performance. Restructuring charges and other exit-related costs are not allocated to segment operating income because we do not include this information in our measurement of the segments’ performance. Corporate expense consists primarily of unallocated expense for management and administrative services that benefit all three reporting segments. As a result of this unallocated expense, the operating income of each reporting segment does not reflect the operating income the reporting segment would report as a stand-alone business. For further information regarding our reporting segments, see Note 16 - Segment Information in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report.

On April 7, 2015 we announced our intention to combine the MRB and APB businesses into a single operating segment. This change in organizational structure is intended to further optimize the efficiencies in our operating platform, enable additional synergies to be captured throughout our supply chain and global sales channel and more effectively leverage our shared services platform. This change is expected to take place starting in the fourth quarter of fiscal 2015.

Our results of operations depend in large part on the demand and prices for recycled metal in foreign and domestic markets and on the supply of raw materials, including end-of-life vehicles, available to be processed at our facilities. Our deep water port facilities on both the East and West Coasts of the U.S. (in Everett, Massachusetts; Providence, Rhode Island; Oakland, California; Portland, Oregon; and Tacoma, Washington) and access to public deep water port facilities (in Kapolei, Hawaii; and Salinas, Puerto Rico) allow us to efficiently meet the global demand for recycled ferrous metal by shipping bulk cargoes to steel manufacturers located in Asia, Europe, Africa, the Middle East (“EAME”), and Central and South America. Our exports of nonferrous recycled metal are shipped in containers through various public docks to specialty steelmakers, foundries, aluminum sheet and ingot manufacturers, copper refineries and smelters, brass and bronze ingot manufacturers and wire and cable producers globally. We also transport both ferrous and nonferrous metals by truck, rail and barge in order to transfer scrap metal between our facilities for further processing, to load shipments at our export facilities and to meet regional domestic demand.

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

We generated consolidated revenues of \$439 million in the second quarter of fiscal 2015, a decrease of 30% from the \$626 million of consolidated revenues in the second quarter of fiscal 2014. Overall consolidated revenues decreased primarily due to significantly lower average net selling prices for ferrous metal and reduced sales volumes of export ferrous and nonferrous metals. Continuing the trend of sharp declines in export net selling prices seen in the first quarter of fiscal 2015, during which export prices decreased by approximately \$80 per ton, or 20%, compared to the end of the fourth quarter of fiscal 2014, export net selling prices for shipments of recycled ferrous metal in the second quarter of fiscal 2015 declined further by approximately \$80 per ton, or 26%, compared to the end of the first quarter of fiscal 2015 driven by softer global steel markets due to overproduction, a further strengthening of the U.S. currency during the period, the impact of lower iron ore prices on market conditions for recycled metals and weaker demand in the end-markets to which we sell. Domestic net selling prices for ferrous metal also decreased sharply during the quarter. These impacts were only partially offset by higher sales volumes for our finished steel products compared to the prior year period.

Consolidated operating loss was \$205 million in the second quarter of fiscal 2015, compared to consolidated operating income of \$7 million in the second quarter of fiscal 2014. Adjusted consolidated operating loss in the second quarter of fiscal 2015, which excludes the impact of a goodwill impairment charge, other asset impairment charges,

restructuring charges and other exit-related costs, and the impact of reselling or modifying the terms of certain previously contracted bulk ferrous shipments, was \$10 million, compared to adjusted consolidated operating income of \$10 million in the second quarter of fiscal 2014 (see the reconciliation of adjusted consolidated operating income (loss) in Non-GAAP Financial Measures at the end of Item 2). In an environment of sharply declining commodity selling prices, average inventory costs did not decrease as quickly as purchase costs for raw materials, resulting in a significant adverse effect on cost of goods sold and compression of operating margins at MRB and APB. The lower price environment and, to a lesser extent, unusually severe weather conditions during the quarter also adversely impacted the supply of scrap metal, which led to lower processed volumes further compressing operating margins. The effects of these adverse conditions on operating results were partially offset by a decrease in consolidated selling, general and administrative ("SG&A") expense by \$3 million, or 7%, compared to the prior year period primarily as a result of the benefits from the cost-saving and productivity initiatives implemented in fiscal 2014 and 2015.

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## SCHNITZER STEEL INDUSTRIES, INC.

In the second quarter of fiscal 2015, we identified the combination of a significant further weakening in market conditions, continued constrained supply of raw materials due to the lower price environment which adversely impacted volumes, the planned idling or closure of certain production facilities and retail stores, our recent financial performance and the decline in our market capitalization during the first half of fiscal 2015 as a triggering event requiring an interim impairment test of goodwill allocated to our reporting units. The impairment test resulted in a non-cash goodwill impairment charge of \$141 million at the MRB reporting unit. We also undertook a series of strategic actions to improve our operating performance as part of the Q2'15 Plan described below. At MRB, we reduced shredding capacity on both the east and west coasts in order to increase operating efficiency while lowering costs. At APB, we initiated plans to close certain stores in Massachusetts, Oregon and Western Canada. As a result of these actions, we tested the recoverability of certain assets and recorded a non-cash long-lived asset impairment charge of \$44 million, of which \$42 million is recorded in other asset impairment charges and \$2 million is recorded in restructuring charges and other exit-related costs in the Unaudited Condensed Consolidated Statements of Operations. In addition, during the second quarter of fiscal 2015, we recorded non-cash impairment charges of \$2 million on other assets, consisting primarily of assets held for sale at MRB, which are reported within other asset impairment charges.

In fiscal 2014, we implemented restructuring and productivity initiatives (the "Q1'14 Plan") to reduce our annual operating expenses by approximately \$40 million, with the full annual benefit expected to be achieved in fiscal 2015. In the second quarter of fiscal 2015, we achieved a benefit of approximately \$10 million from these initiatives, compared to a benefit of approximately \$6 million in the prior year period. The reduction in expenses was from a combination of headcount reductions, implementation of operational efficiencies, reduced lease costs and other productivity improvements.

In the first quarter of fiscal 2015, we initiated and implemented incremental cost reduction and productivity initiatives at APB (the "Q1'15 Plan") to improve performance through a combination of revenue drivers and production and SG&A cost reduction initiatives, with a targeted annual improvement of \$7 million, which was subsequently increased to an aggregate annual improvement of \$14 million, with approximately one-third of that amount expected to benefit fiscal 2015, primarily in the second half, and the full annual run rate expected to be achieved in fiscal 2016.

At the end of the second quarter of fiscal 2015, we initiated additional restructuring and exit-related initiatives by undertaking strategic actions consisting of idling shredding equipment at MRB and initiating the closure of seven APB stores to more closely align the Company's business to the prevalent market conditions. We expanded these initiatives in April 2015 by announcing measures aimed at further reducing our annual operating expenses, primarily SG&A, at Corporate, MRB and APB through headcount reductions, reducing organizational layers, consolidating shared service functions and other non-headcount measures. Collectively, these initiatives are referred to as the "Q2'15 Plan" and are further described in Part II, Item 5 - Other Information of this Report. These restructuring initiatives target an improvement in annual performance of approximately \$46 million. The strategic actions consisting of idling of assets and closure of stores are expected to contribute approximately \$18 million of this amount, of which approximately one-third is from reduced depreciation expense, starting in the remainder of fiscal 2015 with the full annual run rate expected to be achieved in fiscal 2016. The SG&A cost-saving measures are expected to contribute \$28 million of this amount, with approximately one-quarter expected to benefit fiscal 2015 and the substantial majority of the remaining benefit expected to be recognized by fiscal 2016. Charges incurred in connection with the foregoing initiatives are discussed in Results of Operations, Operating Income (Loss) in this Item 2.

Net loss attributable to SSI in the second quarter of fiscal 2015 was \$196 million, or \$(7.24) per diluted share, compared to net income attributable to SSI of \$2 million, or \$0.07 per diluted share, in the prior year period. Adjusted net loss attributable to SSI, which excludes the impact of a goodwill impairment charge, other asset impairment charges, restructuring charges and other exit-related costs and the impact of reselling or modifying the terms of certain previously contracted bulk ferrous shipments, was \$9 million, or \$(0.33) per diluted share, in the second quarter of

fiscal 2015, compared to adjusted net income attributable to SSI of \$3 million, or \$0.13 per diluted share, in the prior year period (see the reconciliation of adjusted net income (loss) attributable to SSI in Non-GAAP Financial Measures at the end of Item 2).

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

• Revenues of \$439 million, compared to \$626 million in the second quarter of fiscal 2014;

• Consolidated operating loss of \$205 million, compared to consolidated operating income of \$7 million in the second quarter of fiscal 2014;

• Adjusted consolidated operating loss of \$10 million, compared to adjusted consolidated operating income of \$10 million in the second quarter of fiscal 2014 (see reconciliation of adjusted consolidated operating income (loss) in Non-GAAP Financial Measures at the end of Item 2);

• Net loss attributable to SSI of \$196 million, or \$(7.24) per diluted share, compared to net income attributable to SSI of \$2 million, or \$0.07 per diluted share, in the second quarter of fiscal 2014;

• Adjusted net loss attributable to SSI of \$9 million, or \$(0.33) per diluted share, compared to adjusted net income attributable

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to SSI of \$3 million, or \$0.13 per diluted share, in the second quarter of fiscal 2014 (see the reconciliation of adjusted net income (loss) and adjusted diluted earnings per share in Non-GAAP Financial Measures at the end of Item 2); For the first six months of fiscal 2015, net cash provided by operating activities of \$16 million, compared to \$46 million in the prior year period; and Debt, net of cash, of \$306 million as of February 28, 2015, compared to \$294 million as of August 31, 2014 (see the reconciliation of debt, net of cash in Non-GAAP Financial Measures at the end of Item 2).

The following items highlight the financial results for our reporting segments for the second quarter of fiscal 2015: MRB revenues and operating loss of \$341 million and \$187 million, respectively, compared to revenues and operating income of \$536 million and \$11 million, respectively, in the second quarter of fiscal 2014. MRB adjusted operating loss of \$1 million compared to adjusted operating income of \$12 million in the second quarter of fiscal 2014 (see reconciliation of adjusted MRB operating income (loss) in Non-GAAP Financial Measures at the end of Item 2); APB revenues and operating loss of \$69 million and \$3 million, respectively, compared to revenues and operating income of \$76 million and \$5 million, respectively, in the second quarter of fiscal 2014; and SMB revenues and operating income of \$93 million and \$4 million, respectively, compared to \$81 million and \$4 million, respectively, in the second quarter of fiscal 2014.

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## SCHNITZER STEEL INDUSTRIES, INC.

## Results of Operations

| (\$ in thousands)   | Three Months Ended February 28, |            |          | Six Months Ended February 28, |              |          |
|---|---------------------------------|------------|----------|-------------------------------|--------------|----------|
|   | 2015                            | 2014       | % Change | 2015                          | 2014         | % Change |
| Revenues:   |                                 |            |          |                               |              |          |
| Metals Recycling Business   | \$ 340,543                      | \$ 535,690 | (36 )%   | \$ 796,820                    | \$ 1,025,999 | (22 )%   |
| Auto Parts Business   | 69,135                          | 76,360     | (9 )%    | 150,056                       | 155,995      | (4 )%    |
| Steel Manufacturing Business                                      | 93,126                          | 81,456     | 14 %     | 188,344                       | 169,580      | 11 %     |
| Intercompany revenue eliminations <sup>(1)</sup>                  | (63,572 )                       | (67,359 )  | (6 )%    | (140,398 )                    | (137,683 )   | 2 %      |
| Total revenues  | 439,232                         | 626,147    | (30 )%   | 994,822                       | 1,213,891    | (18 )%   |
| Cost of goods sold:   |                                 |            |          |                               |              |          |
| Metals Recycling Business   | 323,493                         | 503,524    | (36 )%   | 757,372                       | 972,124      | (22 )%   |
| Auto Parts Business   | 59,286                          | 58,119     | 2 %      | 124,584                       | 117,501      | 6 %      |
| Steel Manufacturing Business                                      | 87,998                          | 76,689     | 15 %     | 175,301                       | 160,370      | 9 %      |
| Intercompany cost of goods sold eliminations <sup>(1)</sup>       | (61,994 )                       | (67,192 )  | (8 )%    | (138,452 )                    | (136,437 )   | 1 %      |
| Total cost of goods sold  | 408,783                         | 571,140    | (28 )%   | 918,805                       | 1,113,558    | (17 )%   |
| Selling, general and administrative expense:                      |                                 |            |          |                               |              |          |
| Metals Recycling Business   | 20,180                          | 21,020     | (4 )%    | 41,184                        | 42,504       | (3 )%    |
| Auto Parts Business   | 12,740                          | 13,666     | (7 )%    | 26,402                        | 28,310       | (7 )%    |
| Steel Manufacturing Business                                      | 1,329                           | 1,194      | 11 %     | 3,037                         | 3,892        | (22 )%   |
| Corporate <sup>(2)</sup>  | 8,488                           | 9,976      | (15 )%   | 17,480                        | 18,700       | (7 )%    |
| Total selling, general and administrative expense                 | 42,737                          | 45,856     | (7 )%    | 88,103                        | 93,406       | (6 )%    |
| Income loss from joint ventures:                                  |                                 |            |          |                               |              |          |
| Metals Recycling Business   | (565 )                          | (387 )     | 46 %     | (1,093 )                      | (752 )       | 45 %     |
| Change in intercompany profit elimination <sup>(3)</sup>          | (44 )                           | 20         | NM       | (16 )                         | (25 )        | (36 )%   |
| Total income from joint ventures                                  | (609 )                          | (367 )     | 66 %     | (1,109 )                      | (777 )       | 43 %     |
| Goodwill impairment charge:                                       |                                 |            |          |                               |              |          |
| Metals Recycling Business   | 141,021                         | —          | NM       | 141,021                       | —            | NM       |
| Other asset impairment charges:                                   |                                 |            |          |                               |              |          |
| Metals Recycling Business   | 43,093                          | 928        | NM       | 43,093                        | 928          | NM       |
| Corporate <sup>(2)</sup>  | 745                             | —          | NM       | 745                           | —            | NM       |
| Total other asset impairment charges                              | 43,838                          | 928        | NM       | 43,838                        | 928          | NM       |
| Operating income (loss):  |                                 |            |          |                               |              |          |
| Metals Recycling Business   | (186,679 )                      | 10,605     | NM       | (184,757 )                    | 11,195       | NM       |
| Auto Parts Business   | (2,891 )                        | 4,575      | NM       | (930 )                        | 10,184       | NM       |
| Steel Manufacturing Business                                      | 3,799                           | 3,573      | 6 %      | 10,006                        | 5,318        | 88 %     |
| Segment operating income (loss)                                   | (185,771 )                      | 18,753     | NM       | (175,681 )                    | 26,697       | NM       |
| Restructuring charges and other exit-related costs <sup>(4)</sup> | (8,371 )                        | (2,006 )   | 317 %    | (8,994 )                      | (3,819 )     | 136 %    |
| Corporate expense <sup>(2)</sup>                                  | (9,233 )                        | (9,976 )   | (7 )%    | (18,225 )                     | (18,700 )    | (3 )%    |
| Change in intercompany profit elimination <sup>(5)</sup>          | (1,534 )                        | (187 )     | 720 %    | (1,930 )                      | (1,221 )     | 58 %     |
| Total operating income (loss)                                     | \$(204,909 )                    | \$ 6,584   | NM       | \$(204,830 )                  | \$ 2,957     | NM       |

(1) MRB sells ferrous recycled metal to SMB at rates per ton that approximate U.S. West Coast market prices. In addition, APB sells ferrous and nonferrous material to MRB at prices that approximate local market rates. These

intercompany revenues and cost of goods sold are eliminated in consolidation.

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## SCHNITZER STEEL INDUSTRIES, INC.

Corporate expense consists primarily of unallocated expenses for services that benefit all three reporting segments. (2) As a consequence of this unallocated expense, the operating income of each segment does not reflect the operating income the segment would have as a stand-alone business.

The joint ventures sell recycled metal to MRB and to SMB at prices that approximate local market rates, which (3) produces intercompany profit. This intercompany profit is eliminated while the products remain in inventory and is not recognized until the finished products are sold to third parties.

Restructuring charges consist of expense for severance, contract termination and other restructuring costs that (4) management does not include in its measurement of the performance of the operating segments. Other exit-related costs consist of asset impairments and accelerated depreciation related to site closures.

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

## Revenues

Consolidated revenues in the second quarter and first six months of fiscal 2015 were \$439 million and \$995 million, respectively, decreases of 30% and 18% compared to the same periods in the prior year. The decreases were primarily due to significantly lower average net selling prices for ferrous metal and reduced sales volumes of export ferrous and nonferrous metals. Continuing the trend of sharp declines in export net selling prices seen in the first quarter of fiscal 2015, during which export prices decreased by approximately \$80 per ton, or 20%, compared to the end of the fourth quarter of fiscal 2014, export net selling prices for shipments of recycled ferrous metal in the second quarter of fiscal 2015 declined further by approximately \$80 per ton, or 26%, compared to the end of the first quarter of fiscal 2015 driven by softer global steel markets due to overproduction, a further strengthening of the U.S. currency during the period, the impact of lower iron ore prices on market conditions for recycled metals and weaker demand in the end-markets to which we sell. Domestic net selling prices for ferrous metal also decreased during the first six months of fiscal 2015 driven by a sharp decline during the second quarter. These impacts were only partially offset by higher sales volumes for our finished steel products compared to the prior year periods.

## Operating Income (Loss)

Consolidated operating loss in each of the second quarter and first six months of fiscal 2015 was \$205 million compared to consolidated operating income of \$7 million and \$3 million, respectively, in the same periods in the prior year. Adjusted consolidated operating loss in the second quarter and first six months of fiscal 2015, which excludes the impact of a goodwill impairment charge, other asset impairment charges, restructuring and other exit-related costs and reselling or modifying the terms of certain previously contracted bulk ferrous shipments, was \$10 million and \$4 million, respectively, compared to adjusted consolidated operating income of \$10 million and \$8 million, respectively, in the same periods in the prior year (see reconciliation of adjusted consolidated operating income (loss) in Non-GAAP Financial Measures at the end of Item 2). In an environment of declining commodity selling prices, average inventory costs did not decrease as quickly as purchase costs for raw materials, resulting in an adverse effect on cost of goods sold and compression of operating margins at MRB and APB. The lower price environment and, to a lesser extent, unusually severe weather conditions in the second quarter of fiscal 2015 also adversely impacted the supply of scrap metal, which led to lower processed volumes further compressing operating margins. The effects of these adverse conditions on operating results were partially offset by decreases in consolidated SG&A expense for the second quarter and first six months of fiscal 2015 by \$3 million and \$5 million, respectively, compared to the prior year periods, primarily as a result of the benefits from the cost-saving and productivity initiatives implemented in fiscal 2014 and 2015.

In the second quarter of fiscal 2015, we identified the combination of a significant further weakening in market conditions, continued constrained supply of raw materials due to the lower price environment which adversely impacted volumes, the planned idling or closure of certain production facilities and retail stores, our recent financial performance and the decline in our market capitalization during the first half of fiscal 2015 as a triggering event requiring an interim impairment test of goodwill allocated to our reporting units. The impairment test resulted in a non-cash goodwill impairment charge of \$141 million at the MRB reporting unit. As described above, in the second quarter of fiscal 2015, we also undertook a series of strategic actions to improve our operating performance in



connection with the Q2'15 Plan. At MRB, we reduced shredding capacity on both the east and west coasts in order to increase operating efficiency while lowering costs. At APB, we initiated plans to close certain stores in Massachusetts, Oregon and Western Canada. As a result of these actions, we tested the recoverability of certain assets and recorded a non-cash long-lived asset impairment charge of \$44 million, of which \$42 million is recorded in other asset impairment charges and \$2 million is recorded in restructuring charges and other exit-related costs in the Unaudited Condensed Consolidated Statements of Operations. In addition, during the second quarter of fiscal 2015, we also recorded non-cash impairment charges of \$2 million on other assets, consisting primarily of assets held for sale at MRB, which are reported within other asset impairment charges.

Consolidated operating results in the second quarter and first six months of fiscal 2015 also included restructuring charges and other exit-related costs of \$8 million and \$9 million, respectively, compared to charges of \$2 million and \$4 million, respectively, in the prior year periods. Restructuring charges consisted of severance, contract termination and other restructuring costs. Other exit-related costs of \$6 million in the second quarter and first six months of fiscal 2015 consisted of asset impairments and accelerated depreciation of assets in connection with the closure of certain operations. These charges relate to restructuring initiatives

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## SCHNITZER STEEL INDUSTRIES, INC.

under four separate plans: the plans announced in the fourth quarter of fiscal 2012 (the "Q4'12 Plan"), the "Q1'14 Plan," the "Q1'15 Plan" and the "Q2'15 Plan".

In the first quarter of fiscal 2014, we initiated the Q1'14 Plan and began implementing restructuring and productivity initiatives to further reduce our annual operating expenses by approximately \$30 million, which was subsequently increased to \$40 million later in the fiscal year. We achieved approximately \$29 million of benefit in fiscal 2014, with the full annual benefit expected to be achieved in fiscal 2015. In the second quarter and first six months of fiscal 2015, we achieved a benefit of approximately \$10 million and \$20 million, respectively, compared to a benefit of approximately \$6 million and \$10 million in the prior year periods. The majority of the reduction in operating expenses occurred at MRB and resulted from a combination of headcount reductions, implementation of operational efficiencies, reduced lease costs and other productivity improvements.

In the first quarter of fiscal 2015, we initiated the Q1'15 Plan and started implementing additional productivity initiatives at APB to improve profitability through a combination of revenue drivers and cost reduction initiatives. In addition to the measures announced in October 2014 with a targeted annual improvement of \$7 million, we identified incremental cost reduction and productivity initiatives aimed at reducing SG&A expense in connection with the Q1'15 Plan and increased the overall targeted annual improvement at APB to \$14 million, with approximately one-third of that amount expected to benefit fiscal 2015, primarily in the second half, and the full annual run rate expected to be achieved in fiscal 2016.

At the end of the second quarter of fiscal 2015, we initiated the Q2'15 Plan, consisting of additional restructuring and exit-related initiatives by undertaking strategic actions consisting of idling shredding equipment at MRB and initiating the closure of seven APB stores to more closely align the Company's business to the prevalent market conditions. We expanded these initiatives in April 2015 by announcing measures aimed at further reducing our annual operating expenses, primarily SG&A, at Corporate, MRB and APB through headcount reductions, reducing organizational layers, consolidating shared service functions and other non-headcount measures. These restructuring initiatives target an improvement in annual performance of approximately \$46 million. The strategic actions consisting of idling of assets and closure of stores are expected to contribute approximately \$18 million of this amount, of which approximately one-third is from reduced depreciation expense, starting in the remainder of fiscal 2015 with the full annual run rate expected to be achieved in fiscal 2016. The SG&A cost-saving measures are expected to contribute \$28 million of this amount, with approximately one-quarter expected to benefit fiscal 2015 and the substantial majority of the remaining benefit expected to be recognized by fiscal 2016. We expect to incur restructuring charges of approximately \$10 million in connection with the Q2'15 Plan, consisting of employee termination benefits of \$6 million, contract termination costs of \$3 million and other restructuring costs of \$1 million. We recognized \$1 million of these restructuring charges in the second quarter of fiscal 2015 and expect the substantial majority of the remaining restructuring charges to be recognized by the end of fiscal 2015, all of which require the Company to make cash payments. As discussed above, we incurred other exit-related costs of \$6 million in the second quarter of fiscal 2015 consisting of asset impairments and accelerated depreciation of assets in connection with the idling of assets and closure of certain operations.

Restructuring charges and other exit-related costs were comprised of the following (in thousands):

|                             | Three Months Ended February 28, 2015 |            |            |               | Three Months Ended February 28, 2014 |            |               |
|-----------------------------|--------------------------------------|------------|------------|---------------|--------------------------------------|------------|---------------|
|                             | Q1'14 Plan                           | Q1'15 Plan | Q2'15 Plan | Total Charges | Q4'12 Plan                           | Q1'14 Plan | Total Charges |
| Restructuring charges:      |                                      |            |            |               |                                      |            |               |
| Severance costs             | \$(57 )                              | \$428      | \$540      | \$911         | \$(39 )                              | \$1,182    | \$1,143       |
| Contract termination costs  | 56                                   | —          | 79         | 135           | 106                                  | (9 )       | 97            |
| Other restructuring costs   | —                                    | 880        | 93         | 973           | —                                    | 200        | 200           |
| Total restructuring charges | (1 )                                 | 1,308      | 712        | 2,019         | 67                                   | 1,373      | 1,440         |
| Other exit-related costs:   |                                      |            |            |               |                                      |            |               |
| Asset impairments           | —                                    | —          | 6,352      | 6,352         | —                                    | 566        | 566           |

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|  |      |           |         |         |      |         |         |
|--|------|-----------|---------|---------|------|---------|---------|
| Total other exit-related costs                           | —    | —         | 6,352   | 6,352   | —    | 566     | 566     |
| Total restructuring charges and other exit-related costs | \$(1 | ) \$1,308 | \$7,064 | \$8,371 | \$67 | \$1,939 | \$2,006 |

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## SCHNITZER STEEL INDUSTRIES, INC.

|  | Six Months Ended February 28, 2015 |            |            |               | Six Months Ended February 28, 2014 |            |               |
|--|------------------------------------|------------|------------|---------------|------------------------------------|------------|---------------|
|  | Q1'14 Plan                         | Q1'15 Plan | Q2'15 Plan | Total Charges | Q4'12 Plan                         | Q1'14 Plan | Total Charges |
| Restructuring charges:                                   |                                    |            |            |               |                                    |            |               |
| Severance costs  | \$(30 )                            | \$428      | \$540      | \$938         | \$(13 )                            | \$2,259    | \$2,246       |
| Contract termination costs                               | 309                                | —          | 79         | 388           | 568                                | 29         | 597           |
| Other restructuring costs                                | —                                  | 1,223      | 93         | 1,316         | —                                  | 410        | 410           |
| Total restructuring charges                              | 279                                | 1,651      | 712        | 2,642         | 555                                | 2,698      | 3,253         |
| Other exit-related costs:                                |                                    |            |            |               |                                    |            |               |
| Asset impairments  | —                                  | —          | 6,352      | 6,352         | —                                  | 566        | 566           |
| Total other exit-related costs                           | —                                  | —          | 6,352      | 6,352         | —                                  | 566        | 566           |
| Total restructuring charges and other exit-related costs | \$279                              | \$1,651    | \$7,064    | \$8,994       | \$555                              | \$3,264    | \$3,819       |

See Note 7 - Restructuring Charges and Other Exit-Related Costs in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report for additional details on restructuring charges.

**Income Tax Expense**

Our effective tax rate for each of the second quarter and first six months of fiscal 2015 was a benefit of 4.7%, compared to an expense of 27.2% and 8.0%, respectively, for the same periods in the prior year.

The effective tax rate for the second quarter and first six months of fiscal 2015 was impacted primarily by the recognition of a valuation allowance of \$42 million on current period benefits in multiple tax jurisdictions and the impact of the lower financial performance of foreign operations, which are taxed at more favorable rates. The deferred tax assets for which a valuation allowance was recorded were related primarily to deductible temporary differences created in the second quarter by the impairment charges to goodwill and other assets.

We recorded a valuation allowance on substantially all of our deferred tax assets as of February 28, 2015. The valuation allowance was recognized as a result of negative evidence, including recent losses, outweighing the more subjective positive evidence, indicating that it is more likely than not that the associated tax benefit will not be realized. Realization of deferred tax assets is dependent upon the Company generating a consistent trend of profitability to objectively forecast sufficient taxable income in multiple tax jurisdictions in future years to obtain benefit from the reversal of net deductible temporary differences and from utilization of net operating losses. The effective tax rate for the first six months of fiscal 2014 was impacted primarily by the recognition of a full valuation allowance on the current period benefit associated with foreign operations losses and the impact of the lower financial performance of foreign operations, which are taxed at more favorable rates. The effective tax rate for the second quarter of fiscal 2014 benefited primarily from the partial realization of previously reserved tax benefits in the foreign jurisdiction as a result of taxable income generated during the period.

The effective tax rate for fiscal 2015 is expected to be approximately 5%, subject to financial performance for the remainder of the year.

**Financial Results by Segment**

We operate our business across three reporting segments: MRB, APB and SMB. Additional financial information relating to these reporting segments is contained in Note 16 - Segment Information in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report.



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## SCHNITZER STEEL INDUSTRIES, INC.

## Metals Recycling Business

| (\$ in thousands, except for prices)                                | Three Months Ended February 28, |           |          | Six Months Ended February 28, |           |          |
|---|---------------------------------|-----------|----------|-------------------------------|-----------|----------|
|   | 2015                            | 2014      | % Change | 2015                          | 2014      | % Change |
| Ferrous revenues  | \$243,999                       | \$409,106 | (40)%    | \$581,578                     | \$778,661 | (25)%    |
| Nonferrous revenues   | 91,055                          | 120,833   | (25)%    | 203,647                       | 233,987   | (13)%    |
| Other   | 5,489                           | 5,751     | (5)%     | 11,595                        | 13,351    | (13)%    |
| Total segment revenues  | 340,543                         | 535,690   | (36)%    | 796,820                       | 1,025,999 | (22)%    |
| Cost of goods sold  | 323,493                         | 503,524   | (36)%    | 757,372                       | 972,124   | (22)%    |
| Selling, general and administrative expense                         | 20,180                          | 21,020    | (4)%     | 41,184                        | 42,504    | (3)%     |
| Income from joint ventures  | (565)                           | (387)     | 46%      | (1,093)                       | (752)     | 45%      |
| Goodwill impairment charge  | 141,021                         | —         | NM       | 141,021                       | —         | NM       |
| Other asset impairment charges                                      | 43,093                          | 928       | NM       | 43,093                        | 928       | NM       |
| Segment operating income (loss)                                     | \$(186,679)                     | \$10,605  | NM       | \$(184,757)                   | \$11,195  | NM       |
| Average ferrous recycled metal sales prices (\$/LT): <sup>(1)</sup> |                                 |           |          |                               |           |          |
| Domestic  | \$305                           | \$374     | (18)%    | \$325                         | \$365     | (11)%    |
| Foreign   | \$286                           | \$361     | (21)%    | \$306                         | \$353     | (13)%    |
| Average   | \$295                           | \$365     | (19)%    | \$313                         | \$357     | (12)%    |
| Ferrous sales volume (LT, in thousands):                            |                                 |           |          |                               |           |          |
| Domestic  | 334                             | 328       | 2%       | 668                           | 651       | 3%       |
| Foreign   | 416                             | 701       | (41)%    | 1,020                         | 1,356     | (25)%    |
| Total ferrous sales volume (LT, in thousands)                       | 750                             | 1,029     | (27)%    | 1,688                         | 2,007     | (16)%    |
| Average nonferrous sales price (\$/pound) <sup>(1)</sup>            | \$0.81                          | \$0.86    | (6)%     | \$0.83                        | \$0.87    | (5)%     |
| Nonferrous sales volumes (pounds, in thousands)                     | 108,126                         | 135,935   | (20)%    | 235,599                       | 259,876   | (9)%     |
| Outbound freight included in cost of goods sold                     | \$26,384                        | \$37,223  | (29)%    | \$60,873                      | \$69,806  | (13)%    |

LT = Long Ton, which is 2,240 pounds

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

## Revenues

Revenues in the second quarter and first six months of fiscal 2015 decreased by 36% and 22%, respectively, compared to the prior year periods primarily due to significantly lower average net selling prices for ferrous metal and reduced sales volumes of export ferrous and nonferrous metals. Continuing the trend of sharp declines in export net selling prices seen in the first quarter of fiscal 2015, during which export prices decreased by approximately \$80 per ton, or 20%, compared to the end of the fourth quarter of fiscal 2014, export net selling prices for shipments of recycled ferrous metal in the second quarter of fiscal 2015 declined further by approximately \$80 per ton, or 26%, compared to the end of the first quarter of fiscal 2015 driven by softer global steel markets due to overproduction, a further strengthening of the U.S. currency during the period, the impact of lower iron ore prices on market conditions for recycled metals and weaker demand in the end-markets to which we sell. Domestic net selling prices for ferrous metal also decreased during the first six months of fiscal 2015 driven by a sharp decline during the second quarter.

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## SCHNITZER STEEL INDUSTRIES, INC.

## Segment Operating Income (Loss)

Operating loss for the second quarter and first six months of fiscal 2015 was \$187 million and \$185 million, respectively, compared to operating income of \$11 million in the each of the prior year periods. Adjusted operating loss for the second quarter fiscal 2015 was \$1 million, and adjusted operating income for the first six months of fiscal 2015 was \$6 million, which excludes a goodwill impairment charge, other asset impairment charges and the impact of reselling or modifying the terms of certain previously contracted bulk ferrous shipments. These compare to adjusted operating income of \$12 million in each of the prior year periods, which exclude other asset impairment charges (see reconciliation of adjusted MRB operating income (loss) in Non-GAAP Financial Measures at the end of Item 2). In an environment of declining commodity selling prices, average inventory costs did not decrease as quickly as purchase costs for raw materials, resulting in an adverse effect on cost of goods sold and compression of operating margins. The lower price environment also adversely impacted the supply of scrap metal, which led to lower processed volumes further compressing operating margins. The lower price environment, and to a lesser extent, unusually severe weather conditions during the second quarter of fiscal 2015 also adversely impacted the supply of scrap metal, which led to lower processed volumes further compressing operating margins compared to the prior year periods.

In the second quarter of fiscal 2015, we identified a triggering event requiring an interim impairment test of goodwill allocated to MRB. The impairment test resulted in a non-cash goodwill impairment charge of \$141 million. We also undertook a series of strategic actions at MRB by reducing shredding capacity on both the east and west coasts in order to improve operating efficiency while lowering costs. As a result of these actions, we tested the recoverability of certain assets and recorded a non-cash long-lived asset impairment charge at MRB of \$42 million, which is recorded in other asset impairment charges in the Unaudited Condensed Consolidated Statements of Operations. In connection with the reduction in shredder capacity, we also recognized accelerated depreciation costs of \$3 million, which are recorded in restructuring charges and other exit-related costs and are not reflected in MRB's operating results. Further, we recorded non-cash impairment charges of \$2 million on assets held for sale at MRB, which are reported within other asset impairment charges.

## Auto Parts Business

| (\$ in thousands)                           | Three Months Ended February 28, |          |          | Six Months Ended February 28, |           |          |
|---|---------------------------------|----------|----------|-------------------------------|-----------|----------|
|   | 2015                            | 2014     | % Change | 2015                          | 2014      | % Change |
| Revenues                                    | \$69,135                        | \$76,360 | (9)%     | \$150,056                     | \$155,995 | (4)%     |
| Cost of goods sold                          | 59,286                          | 58,119   | 2%       | 124,584                       | 117,501   | 6%       |
| Selling, general and administrative expense | 12,740                          | 13,666   | (7)%     | 26,402                        | 28,310    | (7)%     |
| Segment operating income (loss)             | \$(2,891)                       | \$4,575  | NM       | \$(930)                       | \$10,184  | NM       |
| Number of stores at period end              | 62                              | 61       | 2%       | 62                            | 61        | 2%       |
| Cars purchased (in thousands)               | 83                              | 85       | (2)%     | 180                           | 176       | 2%       |

## Revenues

Revenues in the second quarter and first six months of fiscal 2015 decreased by 9% and 4%, respectively, compared to the prior year periods primarily due to lower commodity prices as a result of continued weak market conditions.

## Segment Operating Income (Loss)

Operating loss for the second quarter and first six months of fiscal 2015 was \$3 million and \$1 million, respectively, compared to operating income of \$5 million and \$10 million, respectively, in the same periods in the prior year caused by a compression in operating margins primarily due to the sharp reduction in ferrous commodity selling prices during the first half of fiscal 2015, which led to an adverse effect on cost of goods sold from average inventory costs not decreasing as quickly as purchase costs for raw materials. SG&A expense for the second quarter and first six months of fiscal 2015 decreased by \$1 million, or 7%, and \$2 million, or 7%, respectively, compared to the prior year periods, primarily as a result of the benefits from the cost-saving and productivity initiatives implemented in fiscal 2014 and 2015.

In the second quarter of fiscal 2015, we also recorded asset impairment and accelerated depreciation costs of \$3 million in connection with the planned closure of seven APB stores. These costs are recorded in restructuring charges and other exit-related costs in the Unaudited Condensed Consolidated Statement of Operations and are not reflected in APB's operating results.



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## SCHNITZER STEEL INDUSTRIES, INC.

## Steel Manufacturing Business

| (\$ in thousands, except for price)                                 | Three Months Ended February 28, |          |          | Six Months Ended February 28, |           |          |
|---|---------------------------------|----------|----------|-------------------------------|-----------|----------|
|   | 2015                            | 2014     | % Change | 2015                          | 2014      | % Change |
| Revenues  | \$93,126                        | \$81,456 | 14 %     | \$188,344                     | \$169,580 | 11 %     |
| Cost of goods sold  | 87,998                          | 76,689   | 15 %     | 175,301                       | 160,370   | 9 %      |
| Selling, general and administrative expense                         | 1,329                           | 1,194    | 11 %     | 3,037                         | 3,892     | (22) %   |
| Segment operating income  | \$3,799                         | \$3,573  | 6 %      | \$10,006                      | \$5,318   | 88 %     |
| Finished steel products average sales price (\$/ton) <sup>(1)</sup> | \$651                           | \$676    | (4) %    | \$667                         | \$666     | — %      |
| Finished steel products sold (tons, in thousands)                   | 131                             | 115      | 14 %     | 258                           | 243       | 6 %      |
| Rolling mill utilization  | 76                              | % 67     | %        | 74                            | % 66      | %        |

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

## Revenues

Revenues for the second quarter and first six months of fiscal 2015 increased by 14% and 11%, respectively, compared to the same periods in the prior year due to increased volumes as a result of higher demand in our West Coast markets mainly driven by improved non-residential construction.

## Segment Operating Income

Operating income for the second quarter and first six months of fiscal 2015 was \$4 million and \$10 million, respectively, compared to \$4 million and \$5 million, respectively, in the same periods in the prior year due to increased sales volumes and higher rolling mill utilization. In the second quarter of fiscal 2015, these benefits were partially offset by lower average selling prices for finished steel products reflecting lower raw material costs and higher import activity.

## Liquidity and Capital Resources

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

## Sources and Uses of Cash

We had cash balances of \$8 million and \$26 million as of February 28, 2015 and August 31, 2014, respectively. Cash balances are intended to be used primarily for working capital, capital expenditures, acquisitions, dividends and share repurchases. We use excess cash on hand to reduce amounts outstanding under our credit facilities. As of February 28, 2015, debt, net of cash, was \$306 million compared to \$294 million as of August 31, 2014 (refer to Non-GAAP Financial Measures below), an increase of \$12 million mainly as a result of higher net working capital. Our cash balances as of February 28, 2015 and August 31, 2014 include \$3 million and \$4 million, respectively, which are indefinitely reinvested in Puerto Rico and Canada.

## Operating Activities

Net cash provided by operating activities in the first six months of fiscal 2015 was \$16 million, compared to \$46 million in the first six months of fiscal 2014.

Sources of cash in the first six months of fiscal 2015 included a \$69 million decrease in accounts receivable primarily due to the timing of sales and collections. Uses of cash included in the first six months of fiscal 2015 included a \$38 million increase in inventory due to higher volumes on hand including the impact of timing of purchases and sales and a \$22 million decrease in accounts payable due to the timing of payments.

Sources of cash in the first six months of fiscal 2014 included a \$5 million decrease in accounts receivable due to the timing of sales and collections. Uses of cash included a \$8 million increase in inventory due to higher volumes on hand including the impact of timing of purchases and sales.

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SCHNITZER STEEL INDUSTRIES, INC.

Investing Activities

Net cash used in investing activities in the first six months of fiscal 2015 was \$16 million, compared to \$24 million in the first six months of fiscal 2014.

Cash used in investing activities in the first six months of fiscal 2015 included capital expenditures of \$17 million to upgrade our equipment and infrastructure, compared to \$21 million in the same prior year period.

Financing Activities

Net cash used in financing activities in the first six months of fiscal 2015 was \$19 million, compared to \$15 million in the first six months of fiscal 2014.

Cash used in financing activities in the first six months of fiscal 2015 was primarily due to \$10 million for dividends and \$5 million in net repayments of debt (refer to Non-GAAP Financial Measures below).

Cash used in financing activities in the first six months of fiscal 2014 was primarily due to \$10 million for dividends and \$4 million in net repayments of debt (refer to Non-GAAP Financial Measures below).

Credit Facilities

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

We had borrowings outstanding under the credit facility of \$300 million as of February 28, 2015 and \$305 million as of August 31, 2014. The weighted average interest rate on amounts outstanding under this facility was 1.92% and 1.91% as of February 28, 2015 and August 31, 2014, respectively.

We also have an unsecured, uncommitted \$25 million credit line with Wells Fargo Bank, N.A. that expires April 1, 2016. Interest rates are set by the bank at the time of borrowing. We had no borrowings outstanding under this line of credit as of February 28, 2015 and August 31, 2014.

We use these credit facilities to fund working capital requirements, acquisitions, capital expenditures, dividends and share repurchases. The two bank credit agreements contain various representations and warranties, events of default and financial and other covenants which could limit or restrict our ability to create liens, raise additional capital, enter into transactions with affiliates, acquire and dispose of businesses, guarantee debt, and consolidate or merge. The financial covenants include a consolidated fixed charge coverage ratio, defined as the four-quarter rolling sum of consolidated adjusted EBITDA less defined maintenance capital expenditures divided by consolidated fixed charges, and a consolidated leverage ratio, defined as consolidated funded indebtedness divided by the sum of consolidated net worth and consolidated funded indebtedness. We refer to the Forms 8-K dated February 14, 2011 and April 16, 2012, which include as attachments copies of the unsecured committed bank credit agreement, as amended, for the detailed methodology for calculating the financial covenants.

As of February 28, 2015, we were in compliance with these financial covenants. The consolidated fixed charge coverage ratio is required to be no less than 1.50 to 1 and was 2.10 to 1 as of February 28, 2015. The consolidated leverage ratio is required to be no more than 0.55 to 1 and was 0.38 to 1 as of February 28, 2015. If a further

deterioration from current market conditions or other negative factors which adversely impact our results of operations and financial position were to lead to consolidated operating losses in future periods, there can be no assurance that we will be able to remain in compliance with these covenants. Should it become necessary to do so, we would seek to obtain amendments to the covenants from our lenders, which, if obtained, could require payment of additional fees, increased interest rates or other conditions or restrictions. If we do not maintain compliance with our financial covenants and are unable to obtain an amendment or waiver from our lenders, a breach of either covenant would constitute an event of default and allow the lenders to exercise remedies under the agreements, the most severe of which is the termination of the credit facility under our committed bank credit agreement and acceleration of the amounts owed under both agreements. In such case, we would be required to evaluate available alternatives and take appropriate steps to obtain alternative funds. There can be no assurance that any such alternative funds, if sought, could be obtained or, if obtained, would be adequate or on acceptable terms.

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## SCHNITZER STEEL INDUSTRIES, INC.

In addition, as of February 28, 2015 and August 31, 2014, we had \$8 million of long-term tax-exempt bonds outstanding that mature in January 2021.

#### Capital Expenditures

Capital expenditures totaled \$17 million for the first six months of fiscal 2015, compared to \$21 million for the same period in the prior year. We currently plan to invest up to \$35 million in capital expenditures on upgrades in fiscal 2015, similar to the upgrades in fiscal 2014, exclusive of any capital expenditures for growth projects, using cash generated from operations and available lines of credit.

#### Dividends

On January 30, 2015 our Board of Directors declared a dividend for the second quarter of fiscal 2015 of \$0.1875 per common share, which equates to an annual cash dividend of \$0.75 per common share. The dividend was paid on February 23, 2015.

#### Environmental Compliance

Our commitment to sustainable recycling and to operating our business in an environmentally responsible manner requires us to continue to invest in facilities that improve our environmental presence in the communities in which we operate. As part of our capital expenditures, we invested \$3 million in capital expenditures for environmental projects during the first six months of fiscal 2015, and plan to invest up to \$11 million for such projects in fiscal 2015. These projects include investments in storm water systems and equipment to ensure ongoing compliance with air quality and other environmental regulations.

We have been identified by the United States Environmental Protection Agency (“EPA”) as one of the potentially responsible parties (“PRPs”) that own or operate or formerly owned or operated sites which are part of or adjacent to the Portland Harbor Superfund site (“the Site”). A group of PRPs is conducting an investigation and study to identify and characterize the contamination at the Site and develop alternative approaches to remediation of the contamination. On March 30, 2012 the group submitted to the EPA a draft feasibility study (“draft FS”) based on approximately ten years of work and \$100 million in costs classified as investigation-related. The draft FS identifies ten possible remedial alternatives which range in estimated cost from approximately \$170 million to \$250 million (net present value) for the least costly alternative to approximately \$1.08 billion to \$1.76 billion (net present value) for the most costly and estimates a range of two to 28 years to implement the remedial work, depending on the selected alternative. The draft FS does not determine who is responsible for remediation costs, define the precise cleanup boundaries or select remedies. The draft FS is being revised by the EPA and the revisions may be significant and could materially impact the scope or cost of remediation. While the draft FS is an important step in the EPA’s development of a proposed plan for addressing the Site, a final decision on the nature and extent of the required remediation will occur only after the EPA has prepared a proposed plan for public review and issued a record of decision (“ROD”). Currently available information indicates that the EPA does not expect to issue its final ROD selecting a remedy for the Site until at least 2017 or commence remediation activities until 2024. Responsibility for implementing and funding the EPA’s selected remedy will be determined in a separate allocation process, which is currently underway. Because there has not been a determination of the total cost of the investigations, the remediation that will be required, the amount of natural resource damages or how the costs of the ongoing investigations and any remedy and natural resource damages will be allocated among the PRPs, we believe it is not reasonably possible to estimate the amount or range of costs which we are likely or which are reasonably possible to incur in connection with the Site, although such costs could be material to our financial position, results of operations, future cash flows and liquidity. Any material liabilities recorded in the future related to the Site could result in our failure to maintain compliance with certain covenants in our debt agreements. Significant cash outflows in the future related to the Site could reduce the amounts available for borrowing that could otherwise be used for investment in capital expenditures, acquisitions, dividends and share repurchases. See Note 6 - Commitments and Contingencies in the Notes to the Unaudited Condensed Consolidated

Financial Statements in Part I, Item 1 of this report.

#### Assessment of Liquidity and Capital Resources

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

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

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SCHNITZER STEEL INDUSTRIES, INC.

Off-Balance Sheet Arrangements

None.

Contractual Obligations

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

We maintain stand-by letters of credit to provide support for certain obligations, including workers' compensation and performance bonds. At February 28, 2015, we had \$16 million outstanding under these arrangements.

Critical Accounting Policies and Estimates

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

Goodwill

In the second quarter of fiscal 2015, we identified the combination of a significant weakening in market conditions, continued constrained supply of raw materials due to the lower price environment which adversely impacted volumes, the planned idling or closure of certain production facilities and retail stores, our recent financial performance and the decline in our market capitalization during the first half of fiscal 2015 as a triggering event requiring an interim impairment test of goodwill allocated to our reporting units. The measurement date for the interim goodwill impairment test was February 1, 2015. For the APB reporting unit, the calculated fair value using the income approach exceeded its carrying value. For the MRB reporting unit with goodwill of \$141 million as of February 1, 2015, the first step of the impairment test showed that the reporting unit's fair value was less than its carrying amount, indicating a potential impairment. Based on the second step of the impairment test, we concluded that the implied fair value of goodwill for the MRB reporting unit was less than its carrying amount, resulting in impairment of the remaining carrying amount of MRB's goodwill totaling \$141 million. For the APB reporting unit with goodwill of \$176 million as of February 1, 2015, the estimated fair value of the reporting unit exceeded its carrying value by approximately 20%.

See Note 4 - Goodwill in the Notes to the Unaudited Condensed Consolidated Financial Statements, Part 1, Item 1 of this report for further detail.

Recently Issued Accounting Standards

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

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## SCHNITZER STEEL INDUSTRIES, INC.

## Non-GAAP Financial Measures

## Debt, net of cash

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

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

|   | February 28, 2015 | August 31, 2014 |
|---|-------------------|-----------------|
| Short-term borrowings                     | \$618             | \$523           |
| Long-term debt, net of current maturities | 312,902           | 318,842         |
| Total debt                                | 313,520           | 319,365         |
| Less: cash and cash equivalents           | 7,601             | 25,672          |
| Total debt, net of cash                   | \$305,919         | \$293,693       |

## Net borrowings (repayments) of debt

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

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

|                                     | Six Months Ended February 28, |           |
|-------------------------------------|-------------------------------|-----------|
|                                     | 2015                          | 2014      |
| Borrowings from long-term debt      | \$109,694                     | \$185,027 |
| Proceeds from line of credit        | 145,000                       | 257,500   |
| Repayment of long-term debt         | (114,965)                     | (180,477) |
| Repayment of line of credit         | (145,000)                     | (266,000) |
| Net borrowings (repayments) of debt | \$(5,271)                     | \$(3,950) |

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

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

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



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## SCHNITZER STEEL INDUSTRIES, INC.

|  | Three Months Ended February 28, |            | Six Months Ended February 28, |             |
|--|---------------------------------|------------|-------------------------------|-------------|
|  | 2015                            | 2014       | 2015                          | 2014        |
| Consolidated operating income (loss):  |                                 |            |                               |             |
| As reported  | \$(204,909)                     | ) \$6,584  | \$(204,830)                   | ) \$2,957   |
| Goodwill impairment charge   | 141,021                         | —          | 141,021                       | —           |
| Other asset impairment charges   | 43,838                          | 928        | 43,838                        | 928         |
| Restructuring charges and other exit-related costs                                       | 8,371                           | 2,006      | 8,994                         | 3,819       |
| Resale or modification of certain previously contracted shipments                        | 1,347                           | —          | 6,928                         | —           |
| Adjusted   | \$(10,332)                      | ) \$9,518  | \$(4,049)                     | ) \$7,704   |
| MRB operating income (loss):   |                                 |            |                               |             |
| As reported  | \$(186,679)                     | ) \$10,605 | \$(184,757)                   | ) \$11,195  |
| Goodwill impairment charge   | 141,021                         | —          | 141,021                       | —           |
| Other asset impairment charges   | 43,093                          | 928        | 43,093                        | 928         |
| Resale or modification of certain previously contracted shipments                        | 1,347                           | —          | 6,928                         | —           |
| Adjusted   | \$(1,218)                       | ) \$11,533 | \$6,285                       | \$12,123    |
| Net income (loss) attributable to SSI:   |                                 |            |                               |             |
| As reported  | \$(195,642)                     | ) \$1,789  | \$(198,115)                   | ) \$(4,440) |
| Goodwill impairment charge, net of tax   | 131,423                         | —          | 131,423                       | —           |
| Other asset impairment charges, net of tax   | 43,846                          | 521        | 43,846                        | 521         |
| Restructuring charges and other exit-related costs, net of tax                           | 8,793                           | 1,120      | 9,270                         | 2,401       |
| Resale or modification of certain previously contracted shipments, net of tax            | 2,831                           | —          | 7,010                         | —           |
| Adjusted   | \$(8,749)                       | ) \$3,430  | \$(6,566)                     | ) \$(1,518) |
| Diluted earnings per share attributable to SSI:  |                                 |            |                               |             |
| As reported  | \$(7.24)                        | ) \$0.07   | \$(7.34)                      | ) \$(0.17)  |
| Goodwill impairment charge, net of tax, per share  | 4.86                            | —          | 4.87                          | —           |
| Other asset impairment charges, net of tax, per share                                    | 1.62                            | 0.02       | 1.63                          | 0.02        |
| Restructuring charges and other exit-related costs, net of tax, per share                | 0.33                            | 0.04       | 0.34                          | 0.09        |
| Resale or modification of certain previously contracted shipments, net of tax, per share | 0.10                            | —          | 0.26                          | —           |
| Adjusted   | \$(0.33)                        | ) \$0.13   | \$(0.24)                      | ) \$(0.06)  |

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

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## SCHNITZER STEEL INDUSTRIES, INC.

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

## Commodity Price Risk

We are exposed to commodity price risk, mainly associated with variations in the market price for finished steel products, ferrous and nonferrous metals, including scrap metal, autobody and other commodities. The timing and magnitude of industry cycles are difficult to predict and are impacted by general economic conditions. We respond to increases and decreases in forward selling prices by adjusting purchase prices on a timely basis. We actively manage our exposure to commodity price risk and monitor the actual and expected spread between forward selling prices and purchase costs and processing and shipping expense. Sales contracts are based on prices negotiated with our customers, and generally orders are placed 30 to 60 days ahead of the shipment date. However, financial results may be negatively impacted when forward selling prices fall more quickly than we can adjust purchase prices or when customers fail to meet their contractual obligations. We assess the net realizable value of inventory (“NRV”) each quarter based upon contracted sales orders and estimated future selling prices. Based on contracted sales and estimates of future selling prices at February 28, 2015, a 10% decrease in the selling price per ton of finished steel products would have caused an NRV inventory write down of \$3 million at SMB and \$2 million at MRB. A 10% decrease in the selling price of inventory would not have had a material NRV impact on APB as of February 28, 2015.

## Interest Rate Risk

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

## Credit Risk

As of February 28, 2015 and August 31, 2014, 21% and 39%, respectively, of our trade accounts receivable balance was covered by letters of credit. Of the remaining balance as of February 28, 2015 and August 31, 2014, 97% and 96% was less than 60 days past due, respectively.

## Foreign Currency Exchange Rate Risk

We are exposed to foreign currency exchange rate risk, mainly associated with sales transactions and related accounts receivable denominated in the U.S. Dollar by our Canadian subsidiary with a functional currency of the Canadian Dollar. In certain instances, we use derivatives to manage some portion of this risk. Our derivatives are agreements with independent counterparties that provide for payments based on a notional amount. As of February 28, 2015, all of our derivative transactions were related to actual or anticipated economic transactions in the normal course of business. A change in foreign exchange rates by 10% would have changed the fair value of these contracts reported in our Unaudited Condensed Consolidated Balance Sheets by \$3 million at February 28, 2015.

## ITEM 4. CONTROLS AND PROCEDURES

## Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives. Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, has completed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of February 28, 2015, our disclosure controls and procedures were effective at the reasonable assurance level.

## Changes in Internal Control Over Financial Reporting

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



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SCHNITZER STEEL INDUSTRIES, INC.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 6 - Commitments and Contingencies in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item I, incorporated by reference herein.

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

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

ITEM 1A. RISK FACTORS

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

ITEM 5. OTHER INFORMATION

On April 3, 2015, subsequent to the end of our second quarter of fiscal 2015, we committed to certain restructuring initiatives aimed at further reducing our annual operating expenses, primarily SG&A, at Corporate, MRB and APB through headcount reductions, reducing organizational layers, consolidating functions and other non-headcount measures. This initiative is an expansion of our strategic actions commenced at the end of the second quarter of fiscal 2015 consisting of idling shredding and other processing equipment at MRB to reduce capacity and increase operating efficiency, and initiating the closure, by the end of fiscal 2015, of seven APB stores. We expect to incur aggregate estimated restructuring charges, as defined in ASC 420, Exit Costs, of approximately \$10 million in connection with these initiatives, \$3 million of which relate to the idling of facilities and closure of stores and \$7 million of which relate to the initiatives committed to on April 3, 2015. The estimated restructuring charges consist of employee termination benefits of \$6 million, contract termination costs of \$3 million and other restructuring-related costs of \$1 million. We recognized \$1 million of these restructuring charges in the second quarter of fiscal 2015 and expect the substantial majority of the remaining restructuring charges to be recognized by the end of fiscal 2015, all of which require the Company to make cash payments.

In the second quarter of fiscal 2015, we also recognized a goodwill impairment charge of \$141 million and, in connection with the idling of assets and closure of operations, incurred impairment charges on long-lived assets of \$44 million and other exit-related costs of \$6 million consisting of asset impairments and accelerated depreciation. See Note 1 - Summary of Significant Accounting Policies, Note 4 - Goodwill and Note 7 - Restructuring Charges and Other Exit-Related Costs in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item I, and Management's Discussion and Analysis in Part I, Item II of this report for additional details on goodwill impairment charges, long-lived asset impairment charges, other asset impairment charges and restructuring charges and other exit-related costs.

ITEM 6. EXHIBITS

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SCHNITZER STEEL INDUSTRIES, INC.

Exhibit Number Exhibit Description

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following financial information from Schnitzer Steel Industries, Inc.'s Quarterly Report on Form 10-Q for the quarter ended February 28, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Condensed Consolidated Statements of Operations for the three and six months ended February 28, 2015 and 2014, (ii) Unaudited Condensed Consolidated Balance Sheets as of February 28, 2015, and August 31, 2014, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended February 28, 2015 and 2014; (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended February 28, 2015 and 2014; and (v) the Notes to Unaudited Condensed Consolidated Financial Statements.

\* Management contract or compensatory plan or arrangement.

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SCHNITZER STEEL INDUSTRIES, INC.

SIGNATURES

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

SCHNITZER STEEL INDUSTRIES, INC.  
(Registrant)

Date: April 7, 2015

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

Date: April 7, 2015

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