

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 May 31, 1996 or

☐ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.

Commission file number 0-22496

SCHNITZER STEEL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

OREGON

93-0341923

(State or other jurisdiction of
incorporation or organization)

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

3200 N.W. Yeon Ave., P.O. Box 10047
Portland, OR

97296-0047

(Address of principal executive offices)

(Zip Code)

(503) 224-9900

(Registrant's telephone number, including area code)

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

Yes ☒ No ☐

The Registrant had 5,813,399 shares of Class A Common Stock, par value of \$1.00 per share and 4,575,255 Class B Common Stock, par value of \$1.00 per share outstanding at July 1, 1996.

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SCHNITZER STEEL INDUSTRIES, INC.

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SCHNITZER STEEL INDUSTRIES, INC.
CONSOLIDATED BALANCE SHEET
(in thousands, except per share amounts)

| | 5/31/96 (Unaudited) | 8/31/95 (Audited) |
|------------------------------------------------------------------------------------------------|------------------------|----------------------|
| | ----- | ----- |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash | \$ 1,604 | \$ 1,598 |
| Accounts receivable, less allowance for doubtful accounts of \$365 and \$797 | 19,920 | 17,124 |
| Accounts receivable from related parties | 1,041 | 912 |
| Inventories (Note 2) | 102,057 | 71,853 |
| Deferred income taxes | 4,557 | 4,835 |
| Prepaid expenses and other | 4,043 | 2,313 |
| | ----- | ----- |
| TOTAL CURRENT ASSETS | 133,222 | 98,635 |
| | ----- | ----- |
| NET PROPERTY, PLANT & EQUIPMENT | 152,344 | 119,664 |
| | ----- | ----- |
| OTHER ASSETS: | | |
| Investment in joint venture partnerships | 9,537 | 9,026 |
| Advances to joint venture partnerships | 3,521 | 3,839 |
| Goodwill | 43,748 | 44,665 |
| Intangibles and other | 4,650 | 4,476 |
| | ----- | ----- |
| | 61,456 | 62,006 |
| | ----- | ----- |
| | \$ 347,022 | \$ 280,305 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Current portion of long-term debt | \$ 252 | \$ 247 |
| Accounts payable | 20,544 | 20,596 |
| Accrued payroll liabilities | 3,725 | 5,360 |
| Accounts payable to related parties | 740 | |
| Accrued income taxes payable | | 2,266 |
| Deferred revenues | 4,365 | 3,916 |
| Current portion of environmental liabilities (Note 4) | 2,334 | 2,513 |
| Other accrued liabilities | 6,353 | 6,900 |
| | ----- | ----- |
| TOTAL CURRENT LIABILITIES | 38,313 | 41,798 |
| | ----- | ----- |
| DEFERRED INCOME TAXES | 13,081 | 14,184 |
| | ----- | ----- |
| LONG-TERM DEBT LESS CURRENT PORTION | 54,006 | 64,698 |
| | ----- | ----- |
| ENVIRONMENTAL LIABILITIES, NET OF CURRENT PORTION (Note 4) | 20,771 | 22,342 |
| | ----- | ----- |
| OTHER LONG-TERM LIABILITIES | 1,310 | 1,310 |
| | ----- | ----- |
| COMMITMENTS | | |
| SHAREHOLDERS' EQUITY: | | |
| Preferred stock--20,000 shares authorized, none issued | | |
| Class A common stock--75,000 shares \$1 par value authorized, 5,814 and 3,128 shares issued | 5,814 | 3,128 |
| Class B common stock--25,000 shares \$1 par value authorized, 4,575 and 4,761 shares issued | 4,575 | 4,761 |
| Additional paid-in capital | 114,672 | 47,322 |
| Retained earnings | 94,480 | 80,762 |
| | ----- | ----- |
| | 219,541 | 135,973 |
| | ----- | ----- |
| | \$ 347,022 | \$ 280,305 |
| | ===== | ===== |

The accompanying notes are an integral part of this statement.

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

| | For the Three Months Ended | | For the Nine Months Ended | |
|-------------------------------------------------|----------------------------|------------|---------------------------|------------|
| | 5/31/96 | 5/31/95 | 5/31/96 | 5/31/95 |
| REVENUES | \$ 86,950 | \$ 106,611 | \$ 241,262 | \$ 225,951 |
| COSTS AND EXPENSES: | | | | |
| Cost of goods sold and other operating expenses | 74,858 | 89,661 | 205,449 | 194,104 |
| Selling and administrative | 4,897 | 4,993 | 13,484 | 11,576 |
| | 79,755 | 94,654 | 218,933 | 205,680 |
| Income From Joint Ventures | 836 | 745 | 2,484 | 1,789 |
| INCOME FROM OPERATIONS | 8,031 | 12,702 | 24,813 | 22,060 |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense | (891) | (1,254) | (3,001) | (1,489) |
| Other income (expense) | (346) | 926 | 743 | 2,162 |
| | (1,237) | (328) | (2,258) | 673 |
| INCOME BEFORE INCOME TAXES | 6,794 | 12,374 | 22,555 | 22,733 |
| Income Tax Provision | (2,243) | (4,520) | (7,527) | (8,352) |
| NET INCOME | \$ 4,551 | \$ 7,854 | \$ 15,028 | \$ 14,381 |
| EARNINGS PER SHARE | \$ 0.44 | \$ 0.98 | \$ 1.69 | \$ 1.80 |

The accompanying notes are an integral part of this statement.

SCHNITZER STEEL INDUSTRIES, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(in thousands)
(unaudited)

| | Class A Common Stock | | Class B Common Stock | | Additional Paid-In Capital | Retained Earnings | Total |
|--------------------------------------------------------------|-------------------------|----------|-------------------------|----------|----------------------------------|----------------------|------------|
| | Shares | Amount | Shares | Amount | | | |
| BALANCE AT 8/31/94 | 3,123 | \$ 3,123 | 4,766 | \$ 4,766 | \$ 47,322 | \$ 60,093 | \$ 115,304 |
| Class B common stock converted to Class A common stock | 5 | 5 | (5) | (5) | | | |
| Net income | | | | | | 22,247 | 22,247 |
| Dividends paid | | | | | | (1,578) | (1,578) |
| BALANCE AT 8/31/95 | 3,128 | 3,128 | 4,761 | 4,761 | 47,322 | 80,762 | 135,973 |
| Class A common stock issued | 2,500 | 2,500 | | | 67,350 | | 69,850 |
| Class B common stock converted to Class A common stock | 186 | 186 | (186) | (186) | | | |
| Net income | | | | | | 15,028 | 15,028 |
| Dividends paid | | | | | | (1,310) | (1,310) |
| BALANCE AT 5/31/96 | 5,814 | \$ 5,814 | 4,575 | \$ 4,575 | \$ 114,672 | \$ 94,480 | \$ 219,541 |

The accompanying notes are an integral part of this statement.

SCHNITZER STEEL INDUSTRIES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)
(unaudited)

| | For the Nine Months Ended | |
|---------------------------------------------------------------|---------------------------|--------------|
| | May 31, 1996 | May 31, 1995 |
| OPERATIONS: | | |
| Net income | \$ 15,028 | \$ 14,381 |
| Noncash items included in income: | | |
| Depreciation and amortization | 10,568 | 8,236 |
| Deferred income taxes | (825) | 780 |
| Equity in earnings of joint ventures and other investments | (2,484) | (1,789) |
| Gain on disposal of assets | (74) | (579) |
| Cash provided (used) by assets and liabilities: | | |
| Accounts receivable | (2,925) | (4,146) |
| Inventories | (30,204) | (12,173) |
| Prepaid expenses and other | (2,224) | (120) |
| Accounts payable | (52) | 929 |
| Deferred revenue | 449 | |
| Accrued expenses | (3,708) | 3,383 |
| Other assets and liabilities | (2,147) | (2,019) |
| | ----- | ----- |
| NET CASH (USED) PROVIDED BY OPERATIONS | (18,598) | 6,883 |
| | ----- | ----- |
| INVESTMENTS: | | |
| Payment for purchase of MMI, net of cash acquired | | (64,832) |
| Capital expenditures | (42,920) | (18,128) |
| Advances to joint ventures | 318 | (4,346) |
| Distributions from joint ventures | 1,945 | 570 |
| Proceeds from sale of assets | 1,408 | 585 |
| | ----- | ----- |
| NET CASH USED BY INVESTMENTS | (39,249) | (86,151) |
| | ----- | ----- |
| FINANCING: | | |
| Proceeds from sale of Class A common stock | 69,850 | |
| Dividends declared and paid | (1,310) | (1,181) |
| Increase in long-term debt | 38,216 | 76,700 |
| Reduction in long-term debt | (48,903) | (129) |
| | ----- | ----- |
| NET CASH PROVIDED BY FINANCING | 57,853 | 75,390 |
| | ----- | ----- |
| NET INCREASE (DECREASE) IN CASH | 6 | (3,878) |
| CASH AT BEGINNING OF PERIOD | 1,598 | 4,385 |
| | ----- | ----- |
| CASH AT END OF PERIOD | \$ 1,604 | \$ 507 |
| | ===== | ===== |

The accompanying notes are an integral part of this statement.

SCHNITZER STEEL INDUSTRIES, INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MAY 31, 1996 AND 1995

(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited interim financial statements of Schnitzer Steel Industries, Inc. (the Company) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all adjustments, consisting only of normal, recurring adjustments considered necessary for a fair statement, have been included. Although management believes that the disclosures made are adequate to ensure that the information presented is not misleading, it is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report for the fiscal year ended August 31, 1995. The results for the nine months ended May 31, 1996 are not necessarily indicative of the results of operations for the entire year.

Net Income Per Common Share

Net income per common share is based on the weighted average number of common shares outstanding of 10,444,143 and 7,987,731 for the three months ended May 31, 1996 and 1995, respectively, and 8,915,640 and 7,987,731 for the nine months ended May 31, 1996 and 1995, respectively.

NOTE 2. INVENTORIES

Inventories consist of the following (in thousands):

| | May 31, 1996 (Unaudited) | Aug. 31, 1995 (Audited) |
|-----------------|-----------------------------|----------------------------|
| Scrap metals | \$ 22,459 | \$11,861 |
| Work in process | 36,139 | 29,468 |
| Finished goods | 29,155 | 20,591 |
| Supplies | 14,304 | 9,933 |
| | ----- | ----- |
| | \$102,057 | \$71,853 |
| | ===== | ===== |

Scrap metal inventories are valued at LIFO; the remainder are at average cost. The determination of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Interim LIFO calculations are based on the Company's estimates of expected year-end inventory levels and costs. The cost of scrap metal inventories exceeded the stated LIFO value by \$8,428,000 and \$10,478,000 at May 31, 1996 and August 31, 1995, respectively.

SCHNITZER STEEL INDUSTRIES, INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MAY 31, 1996 AND 1995

(Unaudited)

NOTE 3. RELATED PARTY TRANSACTIONS

Certain shareholders of the Company own significant interests in, or are related to owners of, the entities discussed below. As such, these entities are considered related parties for financial reporting purposes.

Transactions Affecting Cost of Goods Sold and Other Operating Expenses

The Company charters several vessels from related shipping companies to transport scrap metal to foreign markets. In 1993, the Company signed a five-year time-charter agreement for one vessel. The agreement guarantees the ship owner a residual market value of \$2,500,000 at the end of the time-charter. The Company entered into two additional seven-year time charters in May 1995. Charges incurred for these charters were \$2,310,000 and \$1,230,000 for the three months ended May 31, 1996 and 1995, respectively, and \$6,536,000 and \$2,906,000 for the nine months ended May 31, 1996 and 1995, respectively.

The Company purchased scrap metals from its joint venture operations totalling \$2,260,000 and \$2,169,000 for the three months ended May 31, 1996 and 1995, respectively, and \$6,281,000 and \$5,680,000 for the nine months ended May 31, 1996 and 1995, respectively.

The Company leases certain land and buildings from a related real estate company. The rent expense was \$313,000 and \$358,000 for the three months ended May 31, 1996 and 1995, respectively, and \$942,000 and \$983,000 for the nine months ended May 31, 1996 and 1995, respectively.

Transactions Affecting Selling and Administrative Expenses

The Company performs some administrative services and provides operation and maintenance of management information systems for certain related parties. These services are charged to the related parties based upon costs plus a 15% margin for overhead and profit. The administrative charges totalled \$136,000 and \$77,000 for the three months ended May 31, 1996 and 1995, respectively, and \$636,000 and \$708,000 for the nine months ended May 31, 1996 and 1995, respectively.

Transactions Affecting Other Income (Expense)

The vessels discussed above are periodically sub-chartered to third parties. In this case, a related shipping agency company acts as the Company's agent in the collection of income and payment of expenses related to sub-charter activities. Charges incurred for these sub-charters were \$267,000 and \$2,858,000 for the three and nine months ended May 31, 1996, respectively. These charges were offset by income of \$251,000 and \$2,883,000 for the three and nine months ended May 31, 1996, respectively. There was no sub-charter activity in the nine months ended May 31, 1995.

Transactions Affecting Property, Plant & Equipment

From time to time, the law firm of Ball, Janik & Novack, of which director Robert S. Ball is a partner, provides legal services to the Company. Mr. Ball is a director, significant shareholder and the secretary of Electrical Construction Company (ECC), an electrical contractor, which has provided electrical construction services on the Company's new rolling mill. The Company paid ECC \$108,000 and \$314,000 for the three months ended May 31, 1996 and 1995, respectively, and \$9,048,000 and \$314,000 for the nine months ended May 31, 1996 and 1995, respectively.

SCHNITZER STEEL INDUSTRIES, INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED MAY 31, 1996 AND 1995

(Unaudited)

NOTE 4. ENVIRONMENTAL LIABILITIES

During fiscal 1995, in conjunction with the due diligence proceedings for the Company's acquisition of Manufacturing Management, Inc. (MMI), an independent third-party consultant was hired to estimate the costs to cure both current and future potential environmental liabilities. The cumulative provision for the total costs specified in the consultant's report aggregated \$24,366,000 and was included in MMI's statement of operations prior to its acquisition by the Company resulting in an increase in MMI's reserve for environmental liabilities to \$24,981,000. As of May 31, 1996, the environmental liability aggregated \$23,105,000.

A portion of the liability recorded in fiscal 1995 relates to MMI's status as a potentially responsible party (PRP) for the investigation and cleanup of sediment along the Hylebos Waterway, on which the Tacoma scrap yard is located, as well as for alleged damage to natural resources in the waterway. Additionally, the Washington State Department of Ecology issued a consent decree in 1990 which required paving of MMI's ferrous scrap yard, which is substantially completed, and the installation of a stormwater treatment system, which is completed. In 1994, MMI reached a settlement with its insurance carriers with respect to costs incurred under the 1990 Consent Decree and Hylebos Waterway projects. Under this settlement, the Company can be reimbursed for covered costs up to \$1,710,000 in 1996 through 1997 as funds are expended. The remaining recorded liability covers third-party sites at which MMI has been named as a PRP, as well as potential future cleanup of other sites at which MMI has conducted business or allegedly disposed of materials.

NOTE 5. SHAREHOLDERS' EQUITY

In February 1996, the Company sold 2.5 million shares of Class A common stock at \$29.50 per share in a public offering. Net proceeds to the Company from the sale of the shares were \$69.9 million after the underwriting discount and offering expenses.

NOTE 6. SUBSEQUENT EVENT

On July 8, 1996, the Board of Directors declared a 5 cent per share dividend on Class A and Class B common stock payable on August 23, 1996 to holders of record on August 8, 1996.

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

General

The Company operates in two business segments. Scrap Operations collects, processes and recycles steel scrap through facilities in Oregon, Washington and California. Steel Operations operates a mini-mill in Oregon which produces finished steel products and maintains mill depots in California.

Liquidity and Capital Resources

For the nine months ended May 31, 1996, net cash used by operations was \$18.6 million, compared with cash provided by operations of \$6.9 million for the same period last year. This decrease in cash flow from operations is primarily a result of increased inventories of \$30.2 million, reflecting a \$10.6 million increase in inventories at Scrap Operations and a \$19.6 million increase in inventories at Steel Operations. The increase in inventories at Scrap Operations is primarily due to the timing of export shipments. Steel Operations' finished goods inventories increased \$8.6 million predominately due to softened demand combined with increased production partially due to the startup of the bar mill portion of its new rolling mill in February 1996. The increase in work in progress inventories of \$6.7 million and the increase in supplies inventories of \$4.3 million, were both in anticipation of the new bar mill. Steel Operations' inventories are expected to decrease over the next two quarters as sales volumes are expected to exceed production volumes.

Capital expenditures for the nine months ended May 31, 1996 and 1995 were \$42.9 million and \$18.1 million, respectively. Fiscal year to date, capital expenditures include \$28.6 million in progress payments related to construction of the new wire rod and bar mill for Steel Operations. The Company expects to spend approximately \$12 million on capital improvements, including the new wire rod mill, during the remainder of fiscal 1996. At May 31, 1996, the Company had outstanding purchase commitments related to the wire rod mill aggregating \$3.9 million.

At May 31, 1996, the Company had a \$100.0 million, five year (expires March 2000), unsecured revolving credit facility and had additional lines of credit available of \$55 million, \$35 million of which was uncommitted. In aggregate, the Company had borrowings outstanding under its lines of credit at May 31, 1996 of \$51 million.

The Company believes that the current cash balance, internally generated funds, and existing credit facilities will provide adequate financing for capital expenditures, working capital and debt service requirements for the next twelve months. The Company does not presently anticipate that additional funding sources will be required for the completion of Steel Operations' wire rod mill, currently scheduled for fiscal 1997. In the longer term, the Company may seek to finance business expansion, including potential acquisitions, with additional borrowing arrangements or additional equity financing.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued):

Results of Operations

The Company's revenues and operating results by business segment are summarized below (in thousands, except number of shipments):

| | For the Three Months Ended | | For the Nine Months Ended | |
|------------------------------------|----------------------------|------------|---------------------------|------------|
| | 5/31/96 | 5/31/95 | 5/31/96 | 5/31/95 |
| | ----- | ----- | ----- | ----- |
| REVENUES: | | | | |
| Scrap Operations: | | | | |
| Ferrous sales | \$ 50,991 | \$ 71,798 | \$ 159,589 | \$ 134,900 |
| Nonferrous sales | 3,317 | 12,218 | 8,380 | 22,599 |
| Other sales | 1,762 | 2,505 | 5,393 | 4,323 |
| | ----- | ----- | ----- | ----- |
| Total Sales | 56,070 | 86,521 | 173,362 | 161,822 |
| Ferrous sales to Steel Operations | (13,444) | (13,965) | (41,304) | (40,016) |
| Steel Operations | 44,324 | 34,055 | 109,204 | 104,145 |
| | ----- | ----- | ----- | ----- |
| Total | \$ 86,950 | \$ 106,611 | \$ 241,262 | \$ 225,951 |
| | ===== | ===== | ===== | ===== |
| INCOME FROM OPERATIONS: | | | | |
| Scrap Operations | \$ 8,121 | \$ 11,609 | \$ 22,035 | \$ 18,028 |
| Steel Operations | 740 | 2,165 | 4,837 | 6,550 |
| Joint Ventures | 836 | 745 | 2,484 | 1,789 |
| Corporate Expense and Eliminations | (1,666) | (1,817) | (4,543) | (4,307) |
| | ----- | ----- | ----- | ----- |
| Total | \$ 8,031 | \$ 12,702 | \$ 24,813 | \$ 22,060 |
| | ===== | ===== | ===== | ===== |
| NET INCOME | \$ 4,551 | \$ 7,854 | \$ 15,028 | \$ 14,381 |
| | ===== | ===== | ===== | ===== |
| SHIPMENTS: | | | | |
| SCRAP OPERATIONS | | | | |
| Ferrous Scrap (Long Tons): | | | | |
| To Steel Operations | 114.2 | 108.4 | 343.2 | 320.0 |
| To Unaffiliated Customers | 236.6 | 317.6 | 747.4 | 522.6 |
| | ----- | ----- | ----- | ----- |
| Total | 350.8 | 426.0 | 1,090.6 | 842.6 |
| | ===== | ===== | ===== | ===== |
| Number of scrap export shipments | 7 | 10 | 22 | 17 |
| | ===== | ===== | ===== | ===== |
| Nonferrous scrap (pounds) | 7,438 | 18,717 | 19,148 | 38,703 |
| | ===== | ===== | ===== | ===== |
| STEEL OPERATIONS (Short Tons) | | | | |
| Finished steel products | 133.5 | 96.7 | 321.7 | 292.6 |
| | ===== | ===== | ===== | ===== |
| Billets | | 2.4 | | 21.2 |
| | ===== | ===== | ===== | ===== |

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued):

Revenues

Revenues for the three months ended May 31, 1996 decreased \$19.7 million (18%) but increased for the nine months ended May 31, 1996 \$15.3 million (7%), compared to the same periods last year. For the three months ended May 31, 1996, Scrap Operations' revenues before intercompany eliminations decreased \$30.5 million (35%), compared to the same period last year, reflecting lower ferrous shipments at lower average selling prices combined with decreased nonferrous scrap sales. Ferrous scrap revenues decreased \$20.8 million (29%) and shipments decreased by 75,000 tons (18%). Ferrous scrap sales to unaffiliated customers decreased \$20.3 million (35%) and shipments to unaffiliated customers decreased 81,000 tons (26%). Ferrous scrap shipments to unaffiliated customers included a 65,000 ton decrease in export shipments, due to the timing of export shipments, and a 16,000 ton decrease in shipments to other domestic steel mills. Average selling prices of ferrous scrap decreased \$12 per ton (8%) to \$145 per ton as a result of what the Company believes to be short term market conditions and seasonality. Compared to the second quarter of fiscal 1996, average selling prices of ferrous scrap increased \$2 per ton. Third quarter nonferrous scrap revenues were down \$8.9 million (73%) from the prior year due to a 60% decrease in nonferrous shipments primarily as a result of the sale in July 1995 of the Company's Portland, Oregon nonferrous operations.

For the nine months ended May 31, 1996, Scrap Operations' revenues before intercompany eliminations increased \$11.5 million (7%), compared to the same period last year, reflecting increased shipments of ferrous scrap offset by reduced average selling prices and decreased nonferrous scrap sales. Ferrous scrap revenues increased \$24.7 million (18%) and shipments increased 248,000 tons (29%). Ferrous scrap sales to unaffiliated customers increased \$23.5 million (25%), reflecting a 225,000 ton (43%) increase in shipments. Ferrous scrap to unaffiliated customers included a 190,000 ton increase in export shipments and a 35,000 ton increase in shipments to other domestic steel mills as a result of the acquisition of MMI in March 1995. Average selling prices of ferrous scrap decreased \$6 per ton (4%) to \$146 per ton. Nonferrous scrap revenues were down \$14.2 million (63%) from the prior year resulting from a 51% decrease in nonferrous shipments, due to the sale of the Company's Portland, Oregon nonferrous operations in July 1995, combined with a 25% decrease in average selling prices.

Steel Operations' revenues increased \$10.3 million (30%) for the three months ended May 31, 1996 compared to the same period last year resulting from increased shipments of finished steel products offset by lower average selling prices and decreased billet sales. Finished steel revenues increased \$10.8 million (32%) as shipments increased 37,000 tons (38%) primarily due to the new rolling mill, which began production in February. There were no billet sales in the three months ended May 31, 1996 compared to 2,000 tons of billet shipments in the same period last year. It is not the Company's intent to produce billets for resale. Average finished steel selling prices, excluding billets, decreased \$15 per ton (4%) to \$332 per ton as finished steel selling prices remained relatively soft throughout the third quarter. The Company expects pricing pressure to continue at least through the fourth fiscal quarter.

For the nine months ended May 31, 1996, Steel Operations' revenues increased \$5.1 million (5%) compared to the same period last year primarily due to increased shipments of finished steel products offset by lower billet sales. Finished steel revenues increased \$9.8 million (10%) as shipments increased 29,000 tons (10%). There were no billet sales in the nine months ended May 31, 1996 compared to 21,000 tons of billet shipments, or \$4.7 million in billet revenues, in the same period last year. For the nine months ended May 31, 1996, average finished steel prices, excluding billets, remained unchanged at \$339 per ton.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued):

Cost of Goods Sold

Overall cost of goods sold decreased \$14.6 million (16%) for the three months ended May 31, 1996 but increased \$11.6 million (6%) for the nine months ended May 31, 1996, compared to the same periods last year. However, cost of goods sold increased as a percentage of revenues from 84% to 86% for the three months ended May 31, 1996 and decreased from 86% to 85% for the nine months ended May 31, 1996, compared to the same periods last year. Gross profit decreased \$5.1 million (30%) to \$12.1 million for the three months ended May 31, 1996 and increased \$3.7 million (12%) to \$35.8 million for the nine months ended May 31, 1996, compared to the same periods last year.

Cost of goods sold for Scrap Operations for the three months ended May 31, 1996 decreased \$26.5 million (37%), and decreased as a percentage of revenues from 83% to 81%. Average cost of goods sold per ton for ferrous scrap decreased from \$127 to \$120, while the average cost per pound for nonferrous scrap decreased from \$.63 to \$.40. Scrap Operations' gross profit decreased \$4.0 million to \$10.6 million primarily as a result of a \$4.0 million decrease in ferrous scrap gross profit compared to the same period last year. Ferrous gross profit decreased as a result of a \$5 per ton decrease in average gross profit combined with a 75,000 ton decrease in shipments. Compared to the second quarter of fiscal 1996, average gross profit per ton increased by \$4 as the Company began to realize the benefit of its efforts to lower scrap purchase prices at the scale. Nonferrous gross profit decreased \$.1 million as a result of an \$.03 increase in average gross profit offset by an 11 million pound decrease in shipments.

For the nine months ended May 31, 1996, Scrap Operations' cost of goods sold increased \$6.2 million (4%), but decreased as a percentage of scrap revenues from 85% to 83%. For the same period, average cost of goods sold per ton of ferrous scrap decreased from \$129 to \$123. Scrap Operations' gross profit increased \$5.3 million to \$29.5 million primarily as a result of a \$5.1 million increase in ferrous scrap gross profit compared to the same period last year. Ferrous gross profit increased as a result of a 248,000 ton increase in shipments offset by a \$1 per ton decrease in average gross profit. For the nine months ended May 31, 1996, nonferrous gross profit decreased \$1.1 million primarily as a result of a 20 million pound decrease in shipments.

Steel Operations' cost of goods sold increased \$11.5 million (37%) in the three months ended May 31, 1996 compared to the same period last year, and increased as a percentage of revenues from 92% to 97%. Gross profit for Steel Operations decreased \$1.3 million to \$1.5 million as a result of a \$19 per ton (57%) decrease in average gross profit partially offset by a 37,000 ton increase in finished steel shipments. The \$19 per ton decrease resulted from a \$4 per ton increase in average cost of goods sold and a \$15 per ton decrease in average selling price. The \$4 per ton cost increase is primarily the result of increased rolling mill costs due to the start up of the new rolling mill offset by a decrease in billet production costs.

For the nine months ended May 31, 1996, Steel Operations' cost of goods sold increased \$6.8 million (7%) compared to the same period last year, and increased as a percentage of revenues from 92% to 94%. The increase in amount resulted predominately from increased finished steel shipments combined with a \$7 per ton increase in average finished steel cost of goods sold. The \$7 per ton increase reflects increased rolling mill costs primarily due to the start up of the new rolling mill. Steel Operations' gross profit decreased \$1.8 million to \$6.8 million, a decrease of \$8 per ton, as a result of the increase in cost of goods sold (with no change in average selling price) partially offset by the increase in finished steel shipments.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued):

Selling and Administrative Expense

Selling and administrative expenses decreased \$.1 million (2%) and increased \$1.9 million (16%) for the three and nine months ended May 31, 1996, respectively, compared to the same periods last year, primarily due to the Company's acquisition of MMI in March 1995.

Income from Joint Ventures

Income from joint ventures for the three months ended May 31, 1996 increased \$.1 million compared to the same period last year. For the nine months ended May 31, 1996, income from joint ventures increased \$.7 million compared to the same period last year, predominately due to increased earnings from the environmental remediation and used auto parts joint ventures.

Interest Expense

Interest expense decreased \$.4 million for the three months ended May 31, 1996, compared to the same period last year. This decrease reflects lower average borrowings during this period as the Company used the proceeds received from its February 1996 stock offering to pay down debt. For the nine months ended May 31, 1996, interest expense increased \$1.5 million compared to the same period last year, primarily as a result of higher average borrowings at higher interest rates offset by capitalized interest. Increased average borrowings were principally a result of the Company's acquisition of MMI in March 1995, purchases relating to the new wire rod and bar mill being constructed at Steel Operations and increased inventories.

Forward Looking Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward looking statements that involve a number of risks and uncertainties. In particular, the Company has stated its belief that decreases in scrap market prices are a result, at least in part, of short term market conditions. Future market conditions are subject to supply and demand conditions and decisions of other market participants over which the Company has no control and which are inherently difficult to predict. Accordingly, there can be no assurance that scrap prices will rise in the short term. In addition to the factors discussed above, among the other factors that could cause actual results to differ materially are the following: business conditions and growth in the scrap and steel industries; competitive factors, including pricing pressures from national steel companies; availability of scrap supply; fluctuations in scrap prices; seasonality of results; the uncertainty of the Company being able to complete future acquisitions; the risk that there will not be a successful start-up of the wire rod mill at Steel Operations in fiscal 1997; and the risk factors listed from time to time in the Company's SEC reports, including but not limited to the report on Form 10-K for the fiscal year ended August 31, 1995 (Part I, Item 1, Business).

PART II

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1 Second Extension of Lease dated May 28, 1996 between Schnitzer Investment Corp. and the Registrant, relating to the Corporate Headquarters.

10.2 Third Amendment of Lease dated May 29, 1996 between Schnitzer Investment Corp. and the Registrant, relating to the Corporate Headquarters.

10.3 Deferred Bonus Agreement dated January 1, 1996 between an executive officer and the Registrant.

27 Financial Data Schedule

(b) Reports on Form 8-K

None

SCHNITZER STEEL INDUSTRIES, INC.

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: July 12, 1996

By: /s/Barry A. Rosen

Barry A. Rosen
Vice President, Finance

SCHNITZER STEEL INDUSTRIES. INC.
INDEX TO EXHIBITS

- 10.1 Second Extension of Lease dated May 28, 1996 between Schnitzer Investment Corp. and the Registrant, relating to the Corporate Headquarters.
- 10.2 Third Amendment of Lease dated May 29, 1996 between Schnitzer Investment Corp. and the Registrant, relating to the Corporate Headquarters.
- 10.3 Deferred Bonus Agreement dated January 1, 1996 between an executive officer and the Registrant.
- 27 Financial Data Schedule

SECOND EXTENSION OF LEASE

THIS SECOND EXTENSION OF LEASE is written and made in duplicate on the 28th day of May, 1996, by and between SCHNITZER INVESTMENT CORP. (the "Landlord") and SCHNITZER STEEL INDUSTRIES, INC., (the "Tenant"). Each may be referred to from time to time as a "Party" and collectively as the "Parties."

RECITALS

WHEREAS, under a certain indenture of Lease (the "Lease") dated September 1, 1988, as amended by the Amendment of Lease dated May 31, 1991, the Extension of Lease dated August 27, 1993, and the Second Amendment of Lease dated October 18, 1995, the Landlord leased certain real property in Portland, Multnomah County, Oregon, as described in the Lease to the Tenant. The term of the Lease, unless extended, expires on August 31, 1998; and,

WHEREAS, the Parties now wish to extend the Term of the Lease for eight (8) years and four (4) months; and it is the purpose of this Second Extension of Lease to set forth all of the terms and conditions of the Parties' agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the mutual covenants and conditions contained in this Second Extension of Lease, the Parties covenant and agree as follows:

1. Extension Term: The term of the Lease is hereby extended to midnight on December 31, 2006 (the "Extension Term").
2. Rent: On September 1, 1998, September 1, 2001, and September 1, 2004 (the "Adjustment Dates"), Rent shall be adjusted upward to Fair Market Rental (FMR) as agreed between the Parties. If the Parties cannot agree on the FMR by sixty (60) days prior to any Adjustment Date, then each shall select a realtor who together shall select a third realtor and the majority of the three shall determine, by thirty (30) prior to the Adjustment Date, the FMR. The Realtors chosen shall be familiar with the industrial real estate market in northwest Portland. In no event shall the adjusted rental be less than the rental previously in effect.
3. Other Terms: Except as they may be modified by this Second Extension of Lease, all the other terms and conditions of the Lease shall remain in full force and effect.

IN WITNESS WHEREOF, the Landlord and the Tenant have signed this Second Extension of Lease as of the date first hereinabove written.

LANDLORD:

TENANT:

SCHNITZER INVESTMENT CORP.

SCHNITZER STEEL INDUSTRIES, INC.

By /s/Linda M. Wakefield

By /s/James W. Cruckshank

Title Vice President

Title Corporate Controller

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THIRD AMENDMENT OF LEASE

THIS THIRD AMENDMENT OF LEASE is written and made in duplicate on the 29th day of May, 1996, by and between SCHNITZER INVESTMENT CORP. (the "Landlord") and SCHNITZER STEEL INDUSTRIES, INC., Successor in Interest to Schnitzer Steel Products Co. (the "Tenant"). Each may be referred to from time to time as a "Party" and collectively as the "Parties".

RECITALS

WHEREAS, under a certain indenture of Lease (the "Lease") dated March 24, 1980, as amended by the Extension of Lease dated April 19, 1985, an Amendment to Lease dated June 4, 1987, a Second Extension of Lease dated April 15, 1988, a Third Extension of Lease dated September 1, 1988, and a Fourth Extension of Lease dated August 27, 1993, which are, with the Lease, incorporated by this reference, the Landlord leased certain real property to Tenant in Portland, Multnomah County, Oregon, as described in the Lease to the Tenant, and;

WHEREAS, the Parties now wish to amend the Lease to provide for increased square footage effective May 15, 1996, and it is the purpose of this Third Amendment of Lease to set forth all of the terms and conditions of the Parties' agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the mutual covenants and conditions contained in this Third Amendment of Lease, the Parties covenant and agree as follows:

1. Premises: Effective May 15, 1996, Paragraph 1. Premises of the Lease is amended to provide for 5,654 square feet of leased office space.
2. Basic Rent: Effective May 15, 1996, Paragraph 3. Rent of the Lease is amended to provide for equal monthly installments of \$5,476.67 each.
3. Operating Expenses: Effective May 15, 1996, Tenant's proportionate share of operating expense increases as set forth under Paragraph 6 of the Lease shall increase to 34%.
4. Other Terms: Except as they may be modified by this Third Amendment of Lease, all the other terms and conditions of the Lease shall remain in full force and effect.

IN WITNESS WHEREOF, the Landlord and Tenant have signed this Third Amendment of Lease as of the date first hereinabove written.

Landlord:

SCHNITZER INVESTMENT CORP.

Tenant:

SCHNITZER STEEL INDUSTRIES,
INC., Successor in Interest to
Schnitzer Steel Products Co.

By /s/Linda M. Wakefield

Title Vice President

By /s/L. Conner /s/James W. Cruckshank

Title Dir. MIS / Corporate Controller

DEFERRED BONUS AGREEMENT

THIS AGREEMENT is effective the first day of January, 1996, by and between Cascade Steel Rolling Mills, Inc., a wholly owned subsidiary of Schnitzer Steel Industries, Inc., both corporations organized under the laws of the State of Oregon (collectively referenced as "Company") and Kurt Zetzsche a resident of Oregon ("Employee").

WITNESSETH THAT:

In consideration of the agreements hereinafter contained the parties hereto agree as follows:

1. The Company has previously agreed to employ the Employee and the Employee has agreed to serve the Company in such capacity as the Board of Directors of the Company ("Board") may designate from time to time. During the term of his employment, Employee has agreed to devote all of his time and attention, skill and effort to the performance of his duties for the Company as directed by the Board.

2. The Company has agreed to pay the Employee during the term of his employment such salary payable bi-weekly as the Board may from time to time determine together with deferred compensation payable as provided in paragraph 5 below, in addition to being eligible for other benefits normally provided by the Company to its employees.

3. In addition to his salary payable as indicated in paragraph 2 above, the Company shall from time to time declare that the Employee shall be eligible for a bonus in an amount determined solely at the discretion of the Board, usually between the Company's year end of August 31 of each year and the subsequent calendar year end of December 31.

4. Any such annual bonus amount as declared by the Board shall be paid 60% in cash, subject to all usual and required income tax and other withholdings to the Employee, as soon as practicable. The balance and remainder of any such bonus shall be credited by the Company to a Deferred Compensation Account on the Company's books of account and treated as a liability by the Company to the Employee payable under terms as specified in this agreement as follows:

(a) The Deferred Compensation Account and amounts credited thereto shall continue at all times to be a general liability of the Company and shall not be required to be set aside or invested in cash, portfolio investments or other assets.

(b) In addition to the amounts of bonus credited to the Deferred Compensation Account each year, the Company shall also credit on January 1 of each year an interest factor based on 120% of the average annual applicable federal long term rate, with annual compounding (as prescribed under Section 1274(d) of the Internal Revenue Code) as published monthly during the prior calendar year. Such interest shall be computed and credited based on the average monthly outstanding balance in the deferred compensation account for the immediate prior calendar year.

(c) The Company may, solely at the discretion of the Board, choose to invest some or all of amounts credited to the Deferred Compensation Account in a separate cash account or in a portfolio of investment securities or other assets. However, title to and beneficial ownership of any such assets, including the Deferred Compensation Account itself, whether in cash or investments or other assets which the Company may earmark to pay Deferred Compensation to the Employee hereunder, shall at all times remain with the Company. The Employee and his designated beneficiary shall not have any property or beneficial interest whatsoever in any specific assets of the Company.

5. The benefits to be paid to the Employee as Deferred Compensation pursuant to this agreement are as follows:

(a) If the Employee's employment is terminated on or after the Employee shall have reached the age of 60 the Company shall pay him in 5 annual installments an amount which each year is computed based on the balance in the Deferred Compensation Account as of the prior December 31 divided by: 5 minus the number of annual installment payments which have already been paid.

(b) Notwithstanding the foregoing, the balance in the Deferred Compensation Account shall continue to be increased each year based on the interest rate specified in paragraph 4(b) of this agreement. If the Employee should die before 5 annual payments are made, the unpaid balance will continue to be paid for the unexpired portion of the 5 year period to the designated beneficiary or beneficiaries of the Employee in the same manner as set forth above.

(c) If the Employee's employment hereunder is terminated for any reason other than death or disability before the Employee shall have reached age 60, then the amount in the Deferred Compensation Account shall continue to be credited with annual increases based on the interest rate specified in Paragraph 4(b) of this agreement and no payment shall be made until the date when the employee reaches age 60 and such payments then shall be made to the Employee in the same manner and to the same extent as set forth in Paragraph 5(a) above to the Employee.

(d) If the Employee's employment has been terminated for any reason before he reaches age 60 and satisfactory evidence of the Employee's disability or death is submitted, then the Company shall make the 5 annual installment payments to the Employee or his designated beneficiaries in the same manner and to the same extent as provided in Paragraph 5(a) and (b) above. The beneficiary or beneficiaries designated by the Employee in this paragraph may be designated or changed by the Employee without the consent of any prior beneficiary on a form provided by the Company and delivered to the Company before the death of the Employee. If no such beneficiary shall have been designated or if no designated beneficiary shall survive the Employee, the installment payments under this agreement shall be payable to the Employee's estate.

(e) The Employee shall be deemed to have become disabled for purposes of this agreement if the Board shall find on the basis of medical evidence satisfactory to the Board that the Employee is totally disabled, mentally or physically, so as to be prevented from engaging in further employment by the Company and that such disability will be permanent and continuous during the remainder of his life.

(f) The installment payments to be made to the Employee on account of his death or disability shall commence on the first day of the month following the date of the Board determination based on evidence submitted that death or disability has occurred. The installment payment to be made to the Employee on account of any event other than death or disability shall commence on the first day of the month following the later of the date on which the Employee reaches age 60 or the date of his termination of employment.

6. Nothing contained in this agreement and no action taken pursuant to the provisions of this agreement shall create or be construed to create a trust of any kind, or a fiduciary relationship between the Company and the Employee, his designated beneficiary or any other person. Any funds which may be invested under the provisions of this agreement shall continue for all purposes to be a part of the general funds of the Company, and no person other than the Company shall by virtue of the provisions of this agreement have any interest in such funds. To the extent that any person acquires a right to receive payments from the Company under this agreement, such right shall be no greater than the right of any unsecured general creditor of the Company.

7. The right of the Employee or any other person to the payment of Deferred Compensation or other benefits under this agreement shall not be assigned, transferred, pledged or encumbered except by will or by laws of decent and distribution.

8. If the Board shall find that any person to whom any payment is payable under this agreement is unable to care for his affairs because of illness or accident, or is a minor, any payment due (unless a prior claim therefore shall have been made by a duly appointed guardian, committee or other legal representative) may be paid to the spouse, a child, a parent, or a brother or sister, or to any person deemed by the Board to have incurred expense for such person otherwise entitled to payment, in such manner and proportions as the Board may determine. Any such payment shall be a complete discharge of the liabilities of the Company under this agreement.

9. Nothing contained herein shall be construed as conferring upon the Employee the right to continue in the employee of the Company as an executive or in any other capacity.

10. Any Deferred Compensation payable under this agreement shall not be deemed salary or other compensation to the Employee for the propose of computing benefits for which he may be entitled under any retirement plan or other arrangement of the Company for the benefit of its employees.

11. The Board shall have full power and authority to interpret, construe and administer this agreement and the Board's interpretations and construction thereof, and actions thereunder including any valuation of Deferred Compensation account or the amount or recipient of the payment to be made therefrom, shall be binding and conclusive on all persons for all purposes. No member of the Board shall be liable to any person for any action taken or omitted in connection with the interpretation or administration of this agreement unless attributable to his own willful misconduct or lack of good faith.

12. This agreement shall be binding upon and inure to the benefit of the Company, its successors and assigns, and the Employee and his heirs, executors,

administrators and legal representative.

13. This agreement shall be construed in accordance with and governed by the laws of the State of Oregon.

IN WITNESS WHEREOF, the Company has caused this Deferred Bonus agreement to be executed by its duly authorized officer and the Employee has affixed his signature and date to this agreement as written.

SCHNITZER STEEL INDUSTRIES, INC.

/s/Robert Philip

Signature

President 1/10/96

Title Date

CASCADE STEEL ROLLING MILLS, INC.

/s/Edgar C. Shanks

Signature

VP Taxation 1/10/96

Title Date

EMPLOYEE

/s/Kurt C. Zetzsche

Signature

1/10/96

Date

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED BALANCE SHEET AND THE CONSOLIDATED STATEMENT OF INCOME FILED AS PART OF THE QUARTERLY REPORT ON FORM 10-Q AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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