

SCHNITZER STEEL INDUSTRIES INC

Form 10-Q

January 05, 2017

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the Quarterly Period Ended November 30, 2016

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.)

299 SW Clay Street, Suite 350

97201

Portland, Oregon

(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

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 26,803,375 shares of Class A common stock, par value of \$1.00 per share, and 200,000 shares of Class B common stock, par value of \$1.00 per share, outstanding as of January 3, 2017.

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**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 future events or our expectations, intentions, beliefs and strategies regarding the future, which may include statements regarding trends, cyclicity and changes in the markets we sell into; the Company's outlook or expected results, including pricing, sales volumes and profitability; strategic direction; changes to manufacturing and production processes; the cost of and the status of any agreements or actions related to our compliance with environmental and other laws; expected tax rates, deductions and credits; the realization of deferred tax assets; planned capital expenditures; liquidity positions; ability to generate cash from continuing operations; the potential impact of adopting new accounting pronouncements; obligations under our retirement plans; benefits, savings or additional costs from business realignment, cost containment and productivity improvement programs; and the adequacy of accruals.

Forward-looking statements by their nature address matters that are, to different degrees, uncertain, and often contain words such as “outlook,” “believes,” “expects,” “anticipates,” “intends,” “assumes,” “estimates,” “evaluates,” “may,” “will,” “opinions,” “forecasts,” “projects,” “plans,” “future,” “forward,” “potential,” “probable,” and similar expressions. However, the use of these words or similar expressions does not mean that a statement is not forward-looking.

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” in Part I of our Annual Report on Form 10-K. Examples of these risks include: potential environmental cleanup costs related to the Portland Harbor Superfund site; the cyclicity and impact of general economic conditions; instability in international markets; volatile supply and demand conditions affecting prices and volumes in the markets for both our products and raw materials we purchase; imbalances in supply and demand conditions in the global steel industry; the impact of goodwill impairment charges; the impact of long-lived asset and joint venture investment impairment charges; the realization of expected benefits or cost reductions associated with productivity improvement and restructuring initiatives; difficulties associated with acquisitions and integration of acquired businesses; customer fulfillment of their contractual obligations; changes in the relative value of the U.S. dollar; 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 consolidation in the steel industry; inability to realize expected benefits from investments in technology; freight rates and the availability of transportation; the impact of equipment upgrades, equipment failures and facility damage on production; product liability claims; the impact of legal proceedings and legal compliance; the adverse impact of climate change; the impact of not realizing deferred tax assets; the impact of tax increases and changes in tax rules; the impact of a cybersecurity incident; costs associated with compliance with environmental regulations; 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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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

## SCHNITZER STEEL INDUSTRIES, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share amounts)

	November 30, 2016	August 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 8,100	\$26,819
Accounts receivable, net of allowance for doubtful accounts of \$2,331 and \$2,315	112,665	113,952
Inventories	148,094	132,972
Refundable income taxes	1,452	1,254
Prepaid expenses and other current assets	23,967	24,809
Total current assets	294,278	299,806
Property, plant and equipment, net of accumulated depreciation of \$726,287 and \$714,965	385,750	392,820
Investments in joint ventures	13,766	13,616
Goodwill	166,432	166,847
Intangibles, net of accumulated amortization of \$3,486 and \$3,457	4,775	4,931
Other assets	13,893	13,409
Total assets	\$ 878,894	\$ 891,429
Liabilities and Equity		
Current liabilities:		
Short-term borrowings	\$ 701	\$8,374
Accounts payable	68,867	58,439
Accrued payroll and related liabilities	19,017	29,116
Environmental liabilities	2,038	1,967
Other accrued liabilities	35,287	35,758
Total current liabilities	125,910	133,654
Deferred income taxes	16,856	16,682
Long-term debt, net of current maturities	186,944	184,144
Environmental liabilities, net of current portion	44,210	44,383
Other long-term liabilities	10,907	11,134
Total liabilities	384,827	389,997
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, 26,803 and 26,482 shares issued and outstanding	26,803	26,482
Class B common stock – 25,000 shares \$1.00 par value authorized, 200 and 306 shares issued and outstanding	200	306
Additional paid-in capital	30,841	30,948
Retained earnings	473,630	480,100
Accumulated other comprehensive loss	(41,214	) (40,115 )
Total SSI shareholders' equity	490,260	497,721
Noncontrolling interests	3,807	3,711
Total equity	494,067	501,432
Total liabilities and equity	\$ 878,894	\$ 891,429

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

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

	Three Months Ended November 30,	
	2016	2015
Revenues	\$334,161	\$321,198
Operating expense:		
Cost of goods sold	295,892	284,854
Selling, general and administrative	37,492	38,418
(Income) loss from joint ventures	(412	) 29
Other asset impairment charges	401	—
Restructuring charges and other exit-related activities	201	1,925
Operating income (loss)	587	(4,028 )
Interest expense	(1,741	) (1,859 )
Other income, net	437	407
Loss from continuing operations before income taxes	(717	) (5,480 )
Income tax benefit	62	578
Loss from continuing operations	(655	) (4,902 )
Loss from discontinued operations, net of tax	(53	) (65 )
Net loss	(708	) (4,967 )
Net income attributable to noncontrolling interests	(618	) (329 )
Net loss attributable to SSI	\$(1,326	) \$(5,296 )
Net loss per share attributable to SSI:		
Basic:		
Loss per share from continuing operations attributable to SSI	\$(0.05	) \$(0.19 )
Loss per share from discontinued operations attributable to SSI	—	—
Net loss per share attributable to SSI <sup>(1)</sup>	\$(0.05	) \$(0.20 )
Diluted:		
Loss per share from continuing operations attributable to SSI	\$(0.05	) \$(0.19 )
Loss per share from discontinued operations attributable to SSI	—	—
Net loss per share attributable to SSI <sup>(1)</sup>	\$(0.05	) \$(0.20 )
Weighted average number of common shares:		
Basic	27,372	27,121
Diluted	27,372	27,121
Dividends declared per common share	\$0.1875	\$0.1875

(1) May not foot due to rounding.

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

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

	Three Months Ended November 30,	
	2016	2015
Net loss	\$(708 )	\$(4,967)
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(1,034 )	(1,009 )
Cash flow hedges, net	—	240
Pension obligations, net	(65 )	41
Total other comprehensive loss, net of tax	(1,099 )	(728 )
Comprehensive loss	(1,807 )	(5,695 )
Less comprehensive income attributable to noncontrolling interests	(618 )	(329 )
Comprehensive loss attributable to SSI	\$(2,425)	\$(6,024)

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

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

	Three Months Ended November 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	\$(708 )	\$(4,967 )
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	12,543	14,828
Exit-related asset impairment charges	158	—
Other asset impairment charges	401	—
Share-based compensation expense	3,408	2,937
Deferred income taxes	(60 )	(513 )
Inventory write-down	—	478
Undistributed equity in earnings of joint ventures	(412 )	29
Loss on disposal of assets	45	21
Unrealized foreign exchange gain, net	(23 )	(57 )
Bad debt expense, net	17	47
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	(1,546 )	38,369
Inventories	(12,586)	4,797
Income taxes	(150 )	(219 )
Prepaid expenses and other current assets	(614 )	1,578
Other long-term assets	164	202
Accounts payable	14,343	(5,026 )
Accrued payroll and related liabilities	(10,080)	(8,311 )
Other accrued liabilities	899	(3,534 )
Environmental liabilities	(29 )	(514 )
Other long-term liabilities	(193 )	381
Distributed equity in earnings of joint ventures	350	100
Net cash provided by operating activities	5,927	40,626
Cash flows from investing activities:		
Capital expenditures	(10,603)	(9,341 )
Joint venture payments, net	(55 )	(4 )
Proceeds from sale of assets	73	730
Net cash used in investing activities	(10,585)	(8,615 )
Cash flows from financing activities:		
Borrowings from long-term debt	102,631	11,439
Repayment of long-term debt	(107,491)	(35,976 )
Proceeds from line of credit	—	53,500
Repayment of line of credit	—	(53,500 )
Payment of debt issuance costs	(53 )	—
Taxes paid related to net share settlement of share-based payment arrangements	(3,301 )	(1,887 )
Repurchase of Class A common stock	—	(3,479 )
Distributions to noncontrolling interest	(522 )	(827 )
Dividends paid	(5,185 )	(5,100 )
Net cash used in financing activities	(13,921)	(35,830 )



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Effect of exchange rate changes on cash	(140 )	(11 )
Net decrease in cash and cash equivalents	(18,719)	(3,830 )
Cash and cash equivalents as of beginning of period	26,819	22,755
Cash and cash equivalents as of end of period	\$8,100	\$18,925

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, 2016. The results for the three months ended November 30, 2016 and 2015 are not necessarily indicative of the results of operations for the entire fiscal year.

Discontinued Operations

The results of discontinued operations are presented separately, net of tax, from the results of ongoing operations for all periods presented. The expenses included in the results of discontinued operations are the direct operating expenses incurred by the disposed components that may be reasonably segregated from the costs of the ongoing operations of the Company. Asset impairments related to the disposed components are also included in the results of discontinued operations.

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 \$19 million and \$3 million as of November 30, 2016 and August 31, 2016, respectively.

Long-Lived Assets

Changes in circumstances may merit a change in the estimated useful lives or salvage values of individual long-lived assets, which are accounted for prospectively in the period of change. For such assets, the useful life is shortened based on the Company’s plans to dispose of or abandon the asset before the end of its original useful life and depreciation is accelerated beginning when that determination is made. During the three months ended November 30, 2016, the Company recognized accelerated depreciation of less than \$1 million due to shortening the useful lives of decommissioned machinery and equipment assets in the Steel Manufacturing Business reportable segment, which is reported within other asset impairment charges in the Unaudited Condensed Consolidated Statements of Operations.

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, and notes and other contractual receivables from suppliers. The majority of cash and cash equivalents is maintained with two major financial institutions. Balances with these and certain other institutions exceeded the Federal Deposit Insurance Corporation insured amount of \$250,000 as of November 30, 2016. 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 \$46 million and \$40 million of open letters of credit as of November 30, 2016 and August 31, 2016, respectively.

Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and debt. 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.

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NOTES TO THE UNAUDITED CONDENSED  
CONSOLIDATED FINANCIAL STATEMENTS

#### Fair Value Measurements

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

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

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

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

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

#### Restructuring Charges

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

#### Note 2 - Recent Accounting Pronouncements

In May 2014, an accounting standard update was issued that clarifies the principles for recognizing revenue from contracts with customers. The update will supersede the existing standard for recognizing revenue. Additional updates have been issued since May 2014 amending aspects of the initial update and providing implementation guidance. 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 2019, including interim periods within that fiscal year. Upon becoming effective, the Company will apply the amendments in the 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.

In February 2016, an accounting standard was issued that will supersede the existing lease standard and requiring a lessee to recognize a lease liability and a lease asset on its balance sheet for all leases, including those classified as operating leases under the existing lease standard. The update also expands the required quantitative and qualitative disclosures surrounding leases. This standard is effective for the Company beginning in the first quarter of fiscal 2020, including interim periods within that fiscal year. This standard will be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is evaluating the impact of adopting this standard on its consolidated financial position, results of operations and cash flows.

In March 2016, an accounting standard update was issued that amends several aspects of the accounting for share-based payments, including accounting for income taxes, forfeitures and statutory tax withholding requirements,

and classification within the statement of cash flows. The standard is effective for the Company beginning in the first quarter of fiscal 2018, including interim periods within that fiscal year. Early adoption is permitted in any interim or annual period; however, if the Company elects early adoption, it must adopt all of the amendments in the same period. The Company does not expect adoption to have an immediate material impact on its consolidated financial position, results of operations and cash flows.

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 NOTES TO THE UNAUDITED CONDENSED  
 CONSOLIDATED FINANCIAL STATEMENTS

In June 2016, an accounting standard update was issued that amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, which include trade and other receivables, loans and other financial instruments, the update amends the initial recognition threshold to require a company to estimate expected credit losses rather than delaying the recognition of the full amount of credit losses until the loss is probable of occurring. For available for sale debt securities, credit losses should be measured in a manner similar to current GAAP; however, the update requires that credit losses be presented as an allowance rather than as a write-down. This standard is effective for the Company beginning in the first quarter of fiscal 2021, including interim periods within that fiscal year. The standard will be applied using a modified retrospective transition approach through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. Adoption of the standard is not expected to have a material impact on the Company's consolidated financial position.

In August 2016, an accounting standard update was issued that addresses how certain cash receipts and cash payments are presented and classified in the statement of cash flows. Among the cash flow matters addressed in the update are payments for costs related to debt prepayments or extinguishments, payments related to settlement of certain types of debt instruments, payments of contingent consideration made after a business combination, proceeds from insurance claims and corporate-owned life insurance policies, and distributions received from equity method investees, among others. The standard is effective for the Company beginning in the first quarter of fiscal 2019, including interim periods within that fiscal year. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period, and all of the amendments must be adopted together in the same period. The amendments will be applied using a retrospective transition method to each period presented, unless impracticable for specific cash flow matters, in which case the amendments would be applied prospectively as of the earliest date practicable. The Company is evaluating the impact of adopting this standard on its consolidated statement of cash flows.

In October 2016, an accounting standard update was issued that amends the existing guidance on the accounting for the income tax effects of intra-entity transfers of assets other than inventory. Current accounting standards prohibit the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. The amendments in the update require that entities recognize the income tax effects of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments do not change accounting standards for the pre-tax effects of an intra-entity asset transfer under accounting standards applicable to consolidation, or for an intra-entity transfer of inventory. The standard is effective for the Company beginning in the first quarter of fiscal 2019, including interim periods within that fiscal year. Early adoption is permitted in the first interim period of a fiscal year. The amendments will be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is evaluating the impact of adopting this standard on its consolidated financial position, results of operations and cash flows.

### Note 3 - Inventories

Inventories consisted of the following (in thousands):

	November 30, August 31,	
	2016	2016
Processed and unprocessed scrap metal	\$ 65,402	\$ 49,061
Semi-finished goods (billets)	9,785	8,320
Finished goods	39,482	40,646
Supplies	33,425	34,945

Inventories	\$ 148,094	\$ 132,972
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Note 4 - Goodwill

The Company evaluates goodwill for impairment annually on July 1 and upon the occurrence of certain triggering events or substantive changes in circumstances that indicate that the fair value of goodwill may be impaired. There were no triggering events identified during the first quarter of fiscal 2017 requiring an interim goodwill impairment test.

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 NOTES TO THE UNAUDITED CONDENSED  
 CONSOLIDATED FINANCIAL STATEMENTS

The gross changes in the carrying amount of goodwill by reportable segment for the three months ended November 30, 2016 were as follows (in thousands):

	Auto and Metals Recycling
August 31, 2016	\$ 166,847
Foreign currency translation adjustment (415 )	
November 30, 2016	\$ 166,432

Accumulated goodwill impairment charges were \$471 million as of November 30, 2016 and August 31, 2016.

#### Note 5 - Debt

As of August 31, 2016, the Company had \$8 million of tax-exempt economic development revenue bonds outstanding with the State of Oregon and scheduled to mature in January 2021. In August 2016, the Company exercised its option to redeem the bonds prior to maturity. The Company repaid the bonds in full in September 2016. The obligation is reported as a current liability within short-term borrowings as of August 31, 2016 on the Unaudited Condensed Consolidated Balance Sheet, and the \$8 million repayment is reported as a cash outflow from financing activities for the three months ended November 30, 2016 on the Unaudited Condensed Consolidated Statement of Cash Flows.

#### 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 three months ended November 30, 2016 were as follows (in thousands):

Reportable Segment	Balance as of August 31, 2016	Liabilities Established (Released), Net	Payments and Other	Balance as of November 30, 2016	Short-Term	Long-Term
Auto and Metals Recycling	\$46,122	\$ 100	\$ (184 )	\$ 46,038	\$ 1,948	\$ 44,090
Corporate	228	—	(18 )	210	90	120
Total	\$46,350	\$ 100	\$ (202 )	\$ 46,248	\$ 2,038	\$ 44,210

#### Auto and Metals Recycling ("AMR")

As of November 30, 2016 and August 31, 2016, AMR had environmental liabilities of \$46 million for the potential remediation of locations where it has conducted business and has environmental liabilities from historical or recent activities.

#### Portland Harbor

In December 2000, the Company was notified by the United States Environmental Protection Agency ("EPA") under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") that it is one of the potentially responsible parties ("PRPs") that own or operate or formerly owned or operated sites which are part of or adjacent to the



Portland Harbor Superfund site (the "Site"). The precise nature and extent of any cleanup of the Site, the parties to be involved, the process to be followed for any cleanup and the allocation of the costs for any cleanup among responsible parties have not yet been determined, but the process of identifying additional PRPs and beginning allocation of costs is underway. It is unclear to what extent the Company will be liable for environmental costs or natural resource damage claims or third party contribution or damage claims with respect to the Site. While the Company participated in certain preliminary Site study efforts, it is not party to the consent order entered into by the EPA with certain other PRPs, referred to as the "Lower Willamette Group" ("LWG"), for a remedial investigation/feasibility study ("RI/FS"). During fiscal 2007, the Company and certain other parties agreed to an interim settlement with the LWG under which the Company made a cash contribution to the LWG RI/FS. The Company has also joined with more than 80 other PRPs, including the LWG, in a voluntary process to establish an allocation of costs at the Site. These parties have selected an allocation team and have entered into an allocation process design agreement. The LWG has also commenced federal court litigation, which has been stayed, seeking to bring additional parties into the allocation process.

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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 (“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 submitted by the LWG identified ten possible remedial alternatives which ranged 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 alternative and estimated a range of two to 28 years to implement the remedial work, depending on the selected alternative. However, the EPA largely rejected this draft FS, and took over the drafting process. The EPA provided their revised draft FS to the LWG and other key stakeholders in sections, with the final section being made available in August 2015. The revised draft FS identified five possible remedial alternatives which ranged in estimated cost from approximately \$550 million to \$1.19 billion (net present value) for the least costly alternative to approximately \$1.71 billion to \$3.67 billion (net present value) for the most costly alternative and estimated a range of four to 18 years to implement the remedial work, depending on the selected alternative.

In November 2015, EPA Region 10 presented its preferred alternative remedy to the National Remedy Review Board (“NRRB”), a peer review group that has been established to review proposed Superfund cleanup decisions for consistency with the Superfund statute, regulations, and guidance. EPA Region 10’s preferred alternative presented to the NRRB was a modified version of one of the alternatives (Alternative E) in the revised draft FS, and EPA Region 10 estimated that its preferred alternative would take seven years to implement, with an estimated cost of \$1.4 billion (net present value).

In June 2016, the EPA issued its Proposed Plan for the cleanup of the in-river portion of the Site. In the Proposed Plan, the EPA identified its preferred alternative, which includes a combination of dredging, capping, and enhanced natural recovery and which the EPA estimates will take approximately seven years to construct with additional time for monitored natural recovery to occur and cost an estimated \$746 million (net present value). This is approximately half of the estimated \$1.4 billion (net present value) cost of the very similar preferred alternative that EPA Region 10 presented in November 2015. The Proposed Plan also describes other alternatives that were considered and the criteria the EPA used to compare the alternatives, including estimated costs and construction timelines. In conjunction with the Proposed Plan, the EPA issued its final FS in June 2016. The final FS identifies eight possible remedial alternatives (some of which contain two disposal alternatives, for a total of 13 possible alternative remedial scenarios) which ranged in estimated cost from approximately \$316 million to \$677 million (net present value) for the least costly alternative to approximately \$1.21 billion to \$2.67 billion (net present value) for the most costly alternative that the EPA did not screen out and estimates a range of four to 19 years to implement the remedial work, depending on the selected alternative. The final FS includes one alternative (Alternative H) which would involve capping/dredging the entire Site with an estimated cost range from approximately \$6.61 billion to \$14.29 billion and 62 years to implement. The EPA screened out this Alternative H due to implementability and cost considerations. Each of the draft and final FS also contain a No Action alternative considered as a baseline for comparison with the other alternatives. The FS and the Proposed Plan do not determine or allocate the responsibility for remediation costs. Issuance of the Proposed Plan is part of the continuing process for evaluation and remediation of the Site. There was a 90-day public comment period on the Proposed Plan that closed on September 6, 2016. Approximately 5,300 commenters submitted comments. Following its review and consideration of these comments, the EPA will prepare a summary responding to the submitted comments and select a remedy for the Site in a Record of Decision (“ROD”). The EPA has indicated that it plans to issue the ROD in early January 2017. In the ROD, the EPA may modify the

preferred alternative or select a different alternative than that presented in the Proposed Plan based on new information or public comments. It is uncertain whether the preferred alternative identified by the EPA in the Proposed Plan will be the selected remedy in the ROD or whether the EPA will be able to maintain its proposed schedule for issuing the ROD. Even when the ROD is issued, it is likely that there will continue to be significant uncertainty regarding the costs of the selected remedy.

The Company and other stakeholders have identified a number of serious concerns regarding the EPA's risk and remedial alternatives assessments and the EPA's cost estimates, scheduling assumptions and conclusions regarding the feasibility, effectiveness and assignment of remediation technologies. The EPA's FS and Proposed Plan are based on data that are more than a decade old and may not accurately represent site or background conditions. In its Proposed Plan, the EPA acknowledged that the assumptions used to estimate costs for the remedial alternatives were developed based on the existing data and will be finalized during the remedial design, after design level data to refine the baseline conditions are obtained. In addition, the FS and Proposed Plan provide only site-wide cost estimates and do not provide sufficient detail regarding costs for specific sediment management areas.

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Accordingly, it is anticipated that additional pre-remedial design investigative work will need to occur after the ROD is issued in order to provide a re-baseline for costs and determine particular remedial actions for specific areas within the Site.

The next phase in the process following the ROD is the remedial design. The remedial design phase is an engineering phase during which additional technical information and data will be collected, identified and incorporated into technical drawings and specifications developed for the subsequent remedial action. The EPA is expected to seek a new coalition of PRPs to perform the remedial design activities. Remediation activities are not expected to commence for a number of years and responsibility for implementing and funding the EPA's selected remedy will be determined in a separate allocation process. While an allocation process is currently underway, the EPA's FS and its approach to the proposed alternative remedies have raised questions and uncertainty as to how that allocation process will proceed. 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 to or which it is reasonably possible that it will 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 being developed 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, remediation and mitigation for natural resource damages claims in connection with the Site, although there is no assurance that those policies will cover all of the costs which the Company may incur. The Company previously recorded a liability for its estimated share of the costs of the investigation of \$1 million.

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

#### Other AMR Sites

As of November 30, 2016 and August 31, 2016, the Company had environmental liabilities related to various AMR sites other than Portland Harbor of \$45 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.

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

SMB had no environmental liabilities as of November 30, 2016 and August 31, 2016.

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, after taking into consideration expected insurance recoveries, will have a material adverse effect on its results of operations, financial condition, or cash flows.

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Note 7 - Restructuring Charges and Other Exit-Related Activities

The Company has implemented a number of restructuring initiatives designed to reduce operating expenses and improve profitability and to achieve further integration and synergistic cost efficiencies in its operating platform. The restructuring charges incurred by the Company during the periods presented primarily pertain to the plan announced in the second quarter of fiscal 2015 and expanded in subsequent periods (the "Q2'15 Plan").

At the end of the second quarter of fiscal 2015, the Company commenced additional restructuring and exit-related initiatives by undertaking strategic actions consisting of idling underutilized assets at AMR and initiating the closure of seven auto parts stores to align the Company's business to market conditions. The Company expanded these initiatives in April 2015 and also announced the integration of the former Metals Recycling Business and Auto Parts Business into the combined AMR platform in order to achieve operational synergies and reduce the Company's annual operating expenses, primarily selling, general and administrative expenses, through headcount reductions, reducing organizational layers, consolidating shared service functions and other non-headcount measures. Additional cost savings and productivity improvement initiatives, including reductions in personnel, savings from procurement activities, streamlining of administrative and supporting services functions, and adjustments to its operating capacity through facility closures, were identified and initiated in subsequent periods. Collectively, these initiatives are referred to as the Q2'15 Plan.

The Company incurred restructuring charges of less than \$1 million and \$2 million during the three months ended November 30, 2016 and 2015, respectively. The remaining charges relating to these initiatives are expected to be substantially incurred by the end of fiscal 2017. The significant 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 charges associated with other exit-related activities of less than \$1 million during the three months ended November 30, 2016, consisting of asset impairments and accelerated depreciation of assets in connection with site closures and idled equipment. The Company did not incur charges associated with other exit-related activities during the three months ended November 30, 2015.

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

	Three Months Ended November 30, 2016			Three Months Ended November 30, 2015		
	All Other Plans	Q2'15 Plan	Total Charges	All Other Plans	Q2'15 Plan	Total Charges
Restructuring charges:						
Severance costs	\$—	\$(62)	\$(62)	\$—	\$1,161	\$1,161
Contract termination costs	88	(2)	86	90	645	735
Other restructuring costs	—	—	—	—	—	—
Total restructuring charges	88	(64)	24	90	1,806	1,896
Other exit-related activities:						
Asset impairments and accelerated depreciation	—	158	158	—	—	—
Total other exit-related activities	—	158	158	—	—	—
Total restructuring charges and other exit-related activities	\$88	\$94	\$182	\$90	\$1,806	\$1,896
Restructuring charges and other exit-related activities included in continuing operations			\$201			\$1,925
			\$(19)			\$(29)

Restructuring charges (recoveries) and other exit-related activities  
included in discontinued operations

	Q2'15 Plan
Total restructuring charges to date	\$ 14,270
Total expected restructuring charges	\$ 14,400

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The following illustrates the reconciliation of the restructuring liability by major type of costs for the three months ended November 30, 2016 (in thousands):

	Q2'15 Plan				Total	Total
	Balance	Charges	Payments	Balance	Charges	Expected
	8/31/2016		and	11/30/2016	to	Charges <sup>(1)</sup>
			Other		Date <sup>(1)</sup>	
Severance costs	\$918	\$ (62 )	\$ (427 )	\$ 429	\$ 10,213	\$ 10,213
Contract termination costs	1,159	(2 )	(159 )	998	2,008	2,138
Other restructuring costs	—	—	—	—	2,049	2,049
Total	\$2,077	\$ (64 )	\$ (586 )	\$ 1,427	\$ 14,270	\$ 14,400

<sup>(1)</sup> Total charges to date and total expected charges by major type of cost reflect amounts related to the Q2'15 Plan only. Remaining charges related to prior plans are not material.

Restructuring charges and other exit-related activities by reportable segment and discontinued operations were as follows (in thousands):

	Three Months		Total	Total
	Ended	November 30,	Charges	Expected
	2016	2015	to	Charges <sup>(1)</sup>
			Date <sup>(1)</sup>	
Restructuring charges:				
Auto and Metals Recycling	\$45	\$1,922	\$9,450	\$ 9,525
Unallocated (Corporate)	(2 )	3	3,176	3,176
Discontinued operations	(19 )	(29 )	1,644	1,699
Total restructuring charges	24	1,896	14,270	14,400
Other exit-related activities:				
Auto and Metals Recycling	158	—	4,837	
Discontinued operations	—	—	3,613	
Total other exit-related activities	158	—	8,450	
Total restructuring charges and other exit-related activities	\$182	\$1,896	\$22,720	

<sup>(1)</sup> Total charges to date and total expected charges by reportable segment and discontinued operations reflect amounts related to the Q2'15 Plan only. Remaining charges related to prior plans are not material.

The Company does not allocate restructuring charges and other exit-related activities 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

Changes in equity were comprised of the following (in thousands):

	Three Months Ended November 30, 2016			Three Months Ended November 30, 2015		
	SSI Shareholders' Equity	Noncontrolling Interests	Total	SSI Shareholders' Equity	Noncontrolling Interests	Total
Balance - September 1 (Beginning of period)	\$497,721	\$ 3,711	\$501,432	\$534,535	\$ 4,016	\$538,551
Net income (loss)	(1,326 )	618	(708 )	(5,296 )	329	(4,967 )
Other comprehensive loss, net of tax	(1,099 )	—	(1,099 )	(728 )	—	(728 )
Distributions to noncontrolling interests	—	(522 )	(522 )	—	(827 )	(827 )
Share repurchases	—	—	—	(3,479 )	—	(3,479 )
Restricted stock withheld for taxes	(3,301 )	—	(3,301 )	(1,887 )	—	(1,887 )
Share-based compensation	3,408	—	3,408	2,937	—	2,937
Dividends	(5,143 )	—	(5,143 )	(5,152 )	—	(5,152 )
Balance - November 30 (End of period)	\$490,260	\$ 3,807	\$494,067	\$520,930	\$ 3,518	\$524,448

## 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 November 30, 2016			Three Months Ended November 30, 2015			
	Foreign Currency Translation Adjustments	Pension Obligations, net	Total	Foreign Currency Translation Adjustments	Pension Obligations, net	Net Unrealized Gain (Loss) on Cash Flow Hedges	Total
Balances - September 1 (Beginning of period)	\$(34,539)	\$(5,576 )	\$(40,115)	\$(34,009)	\$(4,273 )	\$(240 )	\$(38,522)
Other comprehensive income (loss) before reclassifications	(1,034 )	49	(985 )	(1,009 )	—	—	(1,009 )
Income tax expense	—	(194 )	(194 )	—	—	—	—
Other comprehensive loss before reclassifications, net of tax	(1,034 )	(145 )	(1,179 )	(1,009 )	—	—	(1,009 )
Amounts reclassified from accumulated other comprehensive loss	—	125	125	—	64	312	376
Income tax benefit	—	(45 )	(45 )	—	(23 )	(72 )	(95 )
Amounts reclassified from accumulated other comprehensive loss, net of tax	—	80	80	—	41	240	281
Net periodic other comprehensive income (loss)	(1,034 )	(65 )	(1,099 )	(1,009 )	41	240	(728 )

Balances - November 30 (End of period)	\$ (35,573)	\$ (5,641 )	\$ (41,214)	\$ (35,018)	\$ (4,232 )	\$ —	\$ (39,250)
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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.

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Note 10 - Share-Based Compensation

In the first quarter of fiscal 2017, as part of the annual awards under the Company's Long-Term Incentive Plan, the Compensation Committee of the Company's Board of Directors ("Compensation Committee") granted 142,635 restricted stock units ("RSUs") and 134,899 performance share awards to the Company's key employees and officers under the Company's 1993 Amended and Restated Stock Incentive Plan ("SIP"). The RSUs generally have a five-year term and vest 20% per year commencing October 31, 2017. The aggregate fair value of all of the RSUs granted was based on the market closing price of the underlying Class A common stock on the grant date and totaled \$3 million. The compensation expense associated with the RSUs is recognized over the requisite service period of the awards, net of forfeitures.

The performance share awards are comprised of two separate and distinct awards with different vesting conditions. The Compensation Committee granted 65,506 performance share awards based on a relative Total Shareholder Return ("TSR") metric over a performance period spanning November 1, 2016 to August 31, 2019. Award share payouts range from a threshold of 50% to a maximum of 200% based on the relative ranking of the Company's TSR among a designated peer group of 16 companies. The TSR award stipulates certain limitations to the payout in the event the payout reaches a defined ceiling level or the Company's TSR is negative. The TSR awards contain a market condition and, therefore, once the award recipients complete the requisite service period, the related compensation expense based on the grant-date fair value is not changed, regardless of whether the market condition has been satisfied. The estimated fair value of the TSR awards at the date of grant was \$2 million. The Company estimated the fair value of the TSR awards using a Monte-Carlo simulation model utilizing several key assumptions including expected Company and peer company share price volatility, correlation coefficients between peers, the risk-free rate of return, the expected dividend yield and other award design features.

The remaining 69,393 performance share awards have a three-year performance period consisting of the Company's fiscal 2017, 2018 and 2019. The performance targets are based on the Company's cash flow return on investment ("CFROI") over the three-year performance period, with award payouts ranging from a threshold of 50% to a maximum of 200%. The fair value of the awards granted was based on the market closing price of the underlying Class A common stock on the grant date and totaled \$2 million.

The compensation expense associated with performance share awards is recognized over the requisite service period, net of forfeitures. Performance share awards will be paid in Class A common stock as soon as practicable after the end of the requisite service period and vesting date of October 31, 2019.

Note 11 - Income Taxes

The effective tax rate for the Company's continuing operations for the three months ended November 30, 2016 was a benefit of 8.6%, compared to a benefit of 10.5% for the three months ended November 30, 2015.

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

	Three Months Ended November 30,	
	2016	2015
Federal statutory rate	35.0 %	35.0 %
State taxes, net of credits	2.1	0.8
Foreign income taxed at different rates	(3.4 )	(9.1 )
Non-deductible officers' compensation	2.7	1.5
Noncontrolling interests	(4.4 )	(3.9 )
Research and development credits	(1.4 )	(0.2 )

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Valuation allowance on deferred tax assets	(25.0)	(16.4)
Unrecognized tax benefits	1.9	1.2
Other non-deductible expenses	1.3	2.1
Other	(0.2 )	(0.5 )
Effective tax rate	8.6 %	10.5 %

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The effective tax rate from continuing operations for the first quarter of fiscal 2017 and 2016 was lower than the federal statutory rate of 35% primarily due to the low projected annual effective tax rate applied to the quarterly results. The low projected annual effective tax rate is the result of the Company's full valuation allowance positions partially offset by increases in deferred tax liabilities from indefinite-lived assets in all jurisdictions. 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 2012 to 2016 remain subject to examination under the statute of limitations. The Company's U.S. federal income tax return for fiscal 2015 is currently under examination.

#### Note 12 - Net Loss Per Share

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

	Three Months Ended November 30,	
	2016	2015
Loss from continuing operations	\$(655 )	\$(4,902)
Net income attributable to noncontrolling interests	(618 )	(329 )
Loss from continuing operations attributable to SSI	(1,273 )	(5,231 )
Loss from discontinued operations, net of tax	(53 )	(65 )
Net loss attributable to SSI	\$(1,326)	\$(5,296)
Computation of shares:		
Weighted average common shares outstanding, basic	27,372	27,121
Incremental common shares attributable to dilutive stock options, performance share awards, DSUs, and RSUs	—	—
Weighted average common shares outstanding, diluted	27,372	27,121

Common stock equivalent shares of 1,086,335 were considered antidilutive and were excluded from the calculation of diluted net loss per share for the three months ended November 30, 2016, compared to 794,579 common stock equivalent shares for the three months ended November 30, 2015.

#### Note 13 - Related Party Transactions

The Company purchases recycled metal from its joint venture operations at prices that approximate fair market value. These purchases totaled \$3 million for the three months ended November 30, 2016 and 2015.

#### Note 14 - Segment Information

The accounting standards for reporting information about operating segments define an operating segment as a component of an enterprise that engages in business activities from which it may earn revenues and incur expenses 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 has two reportable segments as follows: AMR and SMB.

AMR buys and processes ferrous and nonferrous metal for sale to foreign and other domestic steel producers or their representatives and to SMB. AMR also purchases ferrous metal from other processors for shipment directly to SMB. AMR also procures salvaged vehicles and sells serviceable used auto parts from these vehicles through a network of

self-service auto parts stores. Additionally, the Company is a noncontrolling partner in joint ventures, which are either in the metals recycling business or are suppliers of unprocessed metal. The Company's allocable portion of the results of these joint ventures is reported within the AMR reportable segment.

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 AMR to SMB are made at rates that approximate market prices for shipments from the West Coast of the U.S. These intercompany sales tend to produce intercompany profits which are not recognized until the finished products are ultimately sold to third parties.

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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 segment operating income to measure segment performance. The Company does not allocate corporate interest income and expense, income taxes and other income and expense to its reportable segments. Expenses related to shared services that support operational activities and transactions is allocated from Corporate to the segments. Unallocated Corporate expense consists primarily of expense for management and certain administrative services that benefit both reportable segments. In addition, the Company does not allocate restructuring charges and other exit-related activities to the segment operating income because management does not include this information in its measurement of the performance of the operating segments.

The table below illustrates the Company's revenues from continuing operations by reportable segment (in thousands):

	Three Months Ended	
	November 30,	
	2016	2015
Revenues:		
Auto and Metals Recycling:		
Revenues	\$304,938	\$272,965
Less: Intersegment revenues	(23,373 )	(23,668 )
AMR external customer revenues	281,565	249,297
Steel Manufacturing Business:		
Revenues	52,596	71,901
Total revenues	\$334,161	\$321,198

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

	Three Months	
	Ended November	
	30,	
	2016	2015
Auto and Metals Recycling	\$12,419	\$2,036
Steel Manufacturing Business	(3,081 )	2,754
Segment operating income	9,338	4,790
Restructuring charges and other exit-related activities	(201 )	(1,925 )
Corporate and eliminations	(8,550 )	(6,893 )
Operating income (loss)	587	(4,028 )
Interest expense	(1,741 )	(1,859 )
Other income, net	437	407
Loss from continuing operations before income taxes	\$(717 )	\$(5,480)

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

	November 30, August 31,	
	2016	2016
Auto and Metals Recycling <sup>(1)</sup>	\$1,520,912	\$1,510,688
Steel Manufacturing Business	359,112	373,130
Total segment assets	1,880,024	1,883,818
Corporate and eliminations <sup>(2)</sup>	(1,001,130 )	(992,389 )
Total assets	\$878,894	\$891,429

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- (1) AMR total assets include \$14 million as of November 30, 2016 and August 31, 2016 for investments in joint ventures.
  - (2) The substantial majority of Corporate and eliminations total assets is comprised of Corporate intercompany payables to the Company's operating segments and intercompany eliminations.



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

This section includes a discussion of our operations for the three months ended November 30, 2016 and November 30, 2015. 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, 2016 and the Unaudited Condensed Consolidated Financial Statements and the related Notes thereto included in Part I, Item 1 of this report.

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, including end-of-life vehicles, and a manufacturer of finished steel products. Our internal organizational and reporting structure supports two operating and reportable segments: the Auto and Metals Recycling ("AMR") business and the Steel Manufacturing Business ("SMB").

AMR sells and brokers ferrous scrap metal (containing iron) to foreign and domestic steel producers, including SMB, and nonferrous scrap metal (not containing iron) to both foreign and domestic markets. AMR procures scrap supply from salvaged vehicles, rail cars, home appliances, industrial machinery, manufacturing scrap and construction and demolition scrap. Our largest source of autobodies is our own network of auto parts stores, which operate under the commercial brand-name Pick-n-Pull. AMR procures salvaged vehicles and sells serviceable used auto parts from these vehicles through 52 self-service auto parts stores. The remaining portions of the vehicles, primarily autobodies and major parts containing ferrous and nonferrous materials, are shipped to our metal recycling facilities, or sold to wholesalers where geographically more economical. AMR then processes mixed and large pieces of scrap metal into smaller pieces by crushing, torching, shearing, shredding and sorting, resulting in scrap metal pieces of a size, density and metal content required by customers to meet their production needs. Processed recycled metals are shipped to our own domestic steel mill and to other metal producers globally.

SMB operates a steel mini-mill that produces a wide range of finished steel products. SMB's scrap metal raw material requirements are sourced almost entirely through AMR. SMB uses its mini-mill in McMinnville, Oregon to melt recycled metal and other raw materials to produce finished steel products. SMB also maintains a mill depot in Southern California.

The results of discontinued operations are excluded from segment operating results and are presented separately, net of tax, from the results of ongoing operations for all periods presented.

For further information regarding our reportable segments, see Note 14 - Segment Information in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report.

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

Our quarterly operating results fluctuate based on a variety of factors including, but not limited to, changes in market conditions for ferrous and nonferrous recycled metal and finished steel products, the supply of scrap metal in our domestic markets, and varying demand for used auto parts from our self-service retail stores. These factors are influenced, to a degree, by the impact of seasonal changes including severe weather conditions in winter and summer months, which can impact the timing of shipments and inhibit construction activity utilizing our products, scrap metal collection at our facilities, and retail admissions at our auto parts stores.



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## Executive Overview of Financial Results for the First Quarter of Fiscal 2017

We generated consolidated revenues of \$334 million in the first quarter of fiscal 2017, an increase of 4% from the \$321 million of consolidated revenues in the first quarter of fiscal 2016, primarily due to stronger demand in our export markets resulting in higher average net selling prices for ferrous scrap metal and increased export sales volumes compared to the prior year period. The effects of these increases compared to the prior year period were partially offset by decreases in finished steel average net selling prices and sales volumes primarily due to competition from lower-priced imports. While overall demand for recycled metals in our end-markets improved compared to the prior year period, including an upward trend in ferrous prices near the end of the first quarter, low global economic growth and the relative strength of the U.S. dollar continued to adversely impact overall market conditions.

Consolidated operating income was \$1 million in the first quarter of fiscal 2017, compared to consolidated operating loss of \$4 million in the first quarter of fiscal 2016. Adjusted consolidated operating income in the first quarter of fiscal 2017 was \$1 million, compared to adjusted consolidated operating loss of \$2 million in the first quarter of fiscal 2016. Adjusted results in the first quarter of fiscal 2017 and 2016 exclude the impact of restructuring charges and other exit-related activities, and also exclude the impact of other asset impairment charges and benefits from contract settlements recognized in the first quarter of fiscal 2017. See the reconciliation of adjusted operating income (loss) in Non-GAAP Financial Measures at the end of this Item 2.

Operating results in the first quarter of fiscal 2017 benefited from relatively stable ferrous average net selling prices on shipped volumes during the quarter compared to the lower and sharply declining price environment experienced during the first quarter of fiscal 2016 which had adversely impacted operating margins and overall results at AMR during the prior year period. While ferrous prices decreased leading into the first quarter of fiscal 2017 before increasing near the end of the period, the resulting adverse impact from average inventory accounting was significantly less than the adverse impact during the first quarter of fiscal 2016. The improved operating results at AMR were partially offset by a decrease in SMB's operating results compared to the prior year period. The decrease in SMB's operating results was due to a combination of a decline in finished steel selling prices and sales volumes driven by competition from lower-priced imports, and lower rolling mill utilization caused by downtime associated with major equipment upgrades, commissioning and maintenance having a combined \$2 million adverse impact on SMB's first quarter operating results. Consolidated selling, general and administrative ("SG&A") expense decreased by \$1 million, or 2%, compared to the prior year period primarily due to incremental benefits from cost saving and productivity improvement measures initiated in fiscal 2015 and further expanded in subsequent periods. These measures also reduced direct costs of production primarily at AMR contributing to its improved operating results in the first quarter of fiscal 2017 compared to the prior year period.

In recent years, we implemented a number of cost reduction and productivity improvement measures to more closely align our business to market conditions. The combined benefit of the measures initiated since the beginning of fiscal 2015 represents a targeted annual improvement to operating performance of approximately \$95 million, of which \$78 million had been achieved in total by the end of fiscal 2016. In the first quarter of fiscal 2017, we achieved approximately \$22 million in combined benefits related to these measures, reflecting approximately \$7 million in incremental benefits compared to the prior year quarter. We expect to achieve substantially all of the remainder of the annual improvement target of \$95 million associated with these measures in fiscal 2017. Charges incurred in connection with the foregoing initiatives are discussed in Results of Operations, Restructuring Charges and Other Exit-Related Activities in this Item 2.

Net loss from continuing operations attributable to SSI in the first quarter of fiscal 2017 was \$1 million, or \$(0.05) per diluted share, compared to \$5 million, or \$(0.19) per diluted share, in the prior year period. Adjusted net loss from continuing operations attributable to SSI in the first quarter of fiscal 2017 was \$1 million, or \$(0.03) per diluted share, compared to \$4 million, or \$(0.13) per diluted share, in the prior year period. See the reconciliation of adjusted net loss from continuing operations attributable to SSI in Non-GAAP Financial Measures at the end of this Item 2.

The following items further highlight selected liquidity and capital structure metrics for the first quarter of fiscal 2017: Net cash provided by operating activities of \$6 million, compared to net cash provided by operating activities of \$41 million in the prior year period;

Debt of \$188 million as of November 30, 2016, compared to \$193 million as of August 31, 2016; and  
Debt, net of cash, of \$180 million, compared to \$166 million as of August 31, 2016 (see the reconciliation of debt, net of cash, in Non-GAAP Financial Measures at the end of this Item 2).

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## Results of Operations

(\$ in thousands)	Three Months Ended November 30,		
	2016	2015	% Change
Revenues:			
Auto and Metals Recycling	\$304,938	\$272,965	12 %
Steel Manufacturing Business	52,596	71,901	(27) %
Intercompany revenue eliminations <sup>(1)</sup>	(23,373 )	(23,668 )	(1) %
Total revenues	334,161	321,198	4 %
Cost of goods sold:			
Auto and Metals Recycling	266,011	242,393	10 %
Steel Manufacturing Business	53,709	67,478	(20) %
Intercompany cost of goods sold eliminations <sup>(1)</sup>	(23,828 )	(25,017 )	(5) %
Total cost of goods sold	295,892	284,854	4 %
Selling, general and administrative expense:			
Auto and Metals Recycling	26,943	28,450	(5) %
Steel Manufacturing Business	1,567	1,669	(6) %
Corporate <sup>(2)</sup>	8,982	8,299	8 %
Total selling, general and administrative expense	37,492	38,418	(2) %
(Income) loss from joint ventures:			
Auto and Metals Recycling	(435 )	86	NM
Change in intercompany profit elimination <sup>(3)</sup>	23	(57 )	NM
Total (income) loss from joint ventures	(412 )	29	NM
Other asset impairment charges:			
Steel Manufacturing Business	401	—	NM
Total other asset impairment charges	401	—	NM
Operating income (loss):			
Auto and Metals Recycling	12,419	2,036	510 %
Steel Manufacturing Business	(3,081 )	2,754	NM
Segment operating income	9,338	4,790	95 %
Restructuring charges and other exit-related activities <sup>(4)</sup>	(201 )	(1,925 )	(90) %
Corporate expense <sup>(2)</sup>	(8,982 )	(8,299 )	8 %
Change in intercompany profit elimination <sup>(5)</sup>	432	1,406	(69) %
Total operating income (loss)	\$587	\$(4,028 )	NM

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NM = Not Meaningful

(1) AMR sells recycled ferrous metal to SMB at rates per ton that approximate West Coast U.S. market prices. These intercompany revenues and cost of goods sold are eliminated in consolidation.

(2) Corporate expense consists primarily of unallocated expenses for management and certain administrative services that benefit both reportable segments.

The joint ventures sell recycled metal to AMR and to SMB at prices that approximate local market rates, which 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 management does not include in its measurement of the performance of the reportable segments. Other exit-related activities consist of asset impairments and accelerated depreciation related to site closures and idled equipment.

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

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

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## Auto and Metals Recycling

(\$ in thousands, except for prices)	Three Months Ended			
	November 30,			
	2016	2015	% Change	
Ferrous revenues	\$183,754	\$163,413	12	%
Nonferrous revenues <sup>(1)</sup>	90,936	77,590	17	%
Retail and other revenues <sup>(1)</sup>	30,248	31,962	(5)	)%
Total segment revenues	\$304,938	\$272,965	12	%
Segment operating income	\$12,419	\$2,036	510	%
Average ferrous recycled metal sales prices (\$/LT): <sup>(2)</sup>				
Domestic	\$184	\$180	2	%
Foreign	\$202	\$179	13	%
Average	\$196	\$179	9	%
Ferrous sales volume (LT, in thousands):				
Domestic	288	290	(1)	)%
Foreign	546	515	6	%
Total ferrous sales volume (LT, in thousands)	834	805	4	%
Average nonferrous sales price (\$/pound) <sup>(2)(3)</sup>	\$0.58	\$0.63	(8)	)%
Nonferrous sales volumes (pounds, in thousands) <sup>(3)</sup>	136,057	111,077	22	%
Cars purchased (in thousands) <sup>(4)</sup>	94	77	22	%
Number of auto parts stores at period end	52	55	(5)	)%
Outbound freight in cost of goods sold	\$24,336	\$22,156	10	%

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NM = Not Meaningful

LT = Long Ton equivalent to 2,240 pounds

An adjustment of certain intrasegment items was made between nonferrous revenues and retail and other revenues

(1) for the three months ended November 30, 2015 to conform to the presentation for the three months ended

November 30, 2016. The adjustment had no impact on previously reported total revenues or earnings.

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

(3) Average sales price and volume information excludes platinum group metals ("PGMs") in catalytic converters.

(4) Cars purchased by auto parts stores only.

**AMR Segment Revenues**

Revenues in the first quarter of fiscal 2017 increased by 12% compared to the prior year period primarily due to stronger demand in our export markets resulting in higher average net selling prices for ferrous scrap metal and increased export sales volumes for both ferrous and nonferrous scrap metal compared to the prior year period.

Average net selling prices for shipments of ferrous scrap metal in the first quarter increased by 9% compared to the prior year period reflecting stronger export demand and higher market prices for other steel-making raw materials generally than experienced during the first quarter of fiscal 2016. Ferrous export sales volumes in the first quarter increased by 6% compared to the prior year period. Nonferrous revenues in the first quarter increased by 17% compared to the prior year period primarily due to a 22% increase in nonferrous sales volumes partially offset by lower nonferrous average net selling prices. While overall demand for recycled metals in our end-markets improved compared to the prior year period, including an upward trend in ferrous prices near the end of the first quarter, low global economic growth and the relative strength of the U.S. dollar continued to adversely impact overall market conditions.

**AMR Segment Operating Income**

Operating income for the first quarter of fiscal 2017 was \$12 million, compared to \$2 million in the first quarter of fiscal 2016. Adjusted operating income for the first quarter of fiscal 2017 was also \$12 million, compared to \$2

million in the first quarter of fiscal 2016. See the reconciliation of AMR adjusted operating income in Non-GAAP Financial Measures at the end of this Item 2.



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Operating results in the first quarter of fiscal 2017 benefited from relatively stable ferrous average net selling prices on shipped volumes during the quarter compared to the lower and sharply declining price environment experienced during the first quarter of fiscal 2016 which had adversely impacted operating margins and overall results at AMR during the prior year period. While ferrous prices decreased leading into the first quarter of fiscal 2017 before increasing near the end of the period, the resulting adverse impact from average inventory accounting was significantly less than the adverse impact during the first quarter of fiscal 2016. AMR operating results in the first quarter of fiscal 2017 were also positively impacted by \$5 million of incremental benefits from cost saving and productivity improvement measures initiated in fiscal 2015, and further expanded in subsequent periods, to reduce direct costs of production and SG&A expense. SG&A expense within AMR decreased \$2 million, or 5%, in the first quarter of fiscal 2017 compared to the prior year quarter primarily resulting from reduced employee-related expense.

## Steel Manufacturing Business

(\$ in thousands, except for price)	Three Months Ended November 30,		
	2016	2015	% Change
Revenues <sup>(1)</sup>	\$52,596	\$71,901	(27)%
Segment operating income (loss)	\$(3,081)	\$2,754	NM
Finished steel average sales price (\$/ST) <sup>(2)</sup>	\$492	\$554	(11)%
Finished steel products sold (tons, in thousands)	101	123	(18)%
Rolling mill utilization <sup>(3)</sup>	65%	68%	

ST = Short Ton, which is 2,000 pounds

NM = Not Meaningful

(1) Revenues include sales of semi-finished goods (billets) and finished steel products.

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

Rolling mill utilization for the first quarter of fiscal 2017 is based on effective annual production capacity under

(3) current conditions of 580 thousand tons of finished steel products, reflecting a decrease in the effective finished steel production capacity resulting from the decommissioning of the older rolling mill during the quarter.

## SMB Segment Revenues

Revenues for the first quarter of 2017 decreased by 27% compared to the prior year period primarily due to reduced selling prices for finished steel products and lower sales volumes reflecting competition from lower-priced steel imports and customer de-stocking.

## SMB Segment Operating Income (Loss)

Operating loss for the first quarter of fiscal 2017 was \$3 million, compared to operating income of \$3 million in the prior year period. Adjusted operating loss for the first quarter of fiscal 2017 was \$3 million, compared to adjusted operating income of \$3 million in the prior year period. See the reconciliation of SMB adjusted operating income (loss) in Non-GAAP Financial Measures at the end of this Item 2.

The decrease in operating results was primarily due to the adverse impact of lower sales volumes and selling prices falling faster than cost of goods sold on the first quarter results. Additionally, downtime associated with major equipment upgrades, commissioning and maintenance led to lower rolling mill utilization that reduced overall profitability in the first quarter by \$2 million.

Through the end of fiscal 2016, SMB operated two computerized rolling mills. In the first quarter of fiscal 2017, we implemented the plan, to which we committed in August 2016, to shut down and decommission the older and less technologically advanced rolling mill, which was entered into service over 40 years ago, and which in recent years has been producing a small proportion of SMB's finished steel products. This plan was implemented in conjunction with an initiative to enhance the operating efficiency of the newer and more technologically advanced rolling mill, improve product quality, and expand its overall effective annual production capacity. In the first quarter of fiscal 2017, we

recognized accelerated depreciation of less than \$1 million due to shortening the useful lives of decommissioned machinery and equipment assets, which is reported within other asset impairment charges in the Unaudited Condensed Consolidated Statements of Operations.

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Restructuring Charges and Other Exit-Related Activities

Consolidated operating results for the first quarter of fiscal 2017 and 2016 also included restructuring charges and other exit-related activities of less than \$1 million and \$2 million, respectively. Restructuring charges consisted of severance, contract termination and other restructuring costs. Other exit-related activities in the first quarter of fiscal 2017 consisted of asset impairment charges and accelerated depreciation in connection with site closures and idled equipment. The charges incurred during the periods presented primarily pertain to restructuring initiatives announced in the second quarter of fiscal 2015 and expanded in subsequent periods (the "Q2'15 Plan"). Consolidated operating results for the periods presented also reflect benefits from cost reduction and productivity improvement measures initiated prior to the second quarter of fiscal 2015 and an immaterial amount of associated costs.

Since the beginning of fiscal 2015, we have initiated and implemented a number of cost reduction and productivity improvement measures with a targeted annual benefit of \$95 million. These initiatives included those announced in the first quarter of fiscal 2015 (the "Q1'15 Plan") followed by further cost-saving and exit-related measures as part of the Q2'15 Plan targeting a combined benefit to annual operating performance of approximately \$60 million, subsequently increased by \$5 million in the first quarter of fiscal 2016. In the second quarter of fiscal 2016, we expanded the Q2'15 Plan initiatives by an additional \$30 million.

The cost reduction and productivity improvements associated with the Q1'15 Plan are driven by a combination of revenue drivers and production and SG&A cost reduction initiatives with a targeted aggregate annual improvement of \$14 million, which was achieved in fiscal 2016. The improvements to performance associated with the Q2'15 Plan include two components. The first component reflects strategic actions initiated in the second quarter of fiscal 2015 consisting of idling shredding equipment and closing seven auto parts stores at AMR to align our business to market conditions, targeting a benefit to annual operating performance of approximately \$18 million, of which approximately one-third is from reduced depreciation expense. As part of the second component of the Q2'15 Plan, in April 2015, we initiated measures, and also announced the integration of the former Metals Recycling Business and Auto Parts Business into the combined AMR platform, in order to achieve operational synergies and further reduce our annual operating expenses, primarily SG&A expense, by approximately \$28 million through personnel reductions, eliminating organizational layers, consolidating shared service functions and reducing other administrative costs. We expanded the Q2'15 Plan and target by initiating measures primarily in the first and second quarters of fiscal 2016 with an additional \$35 million in expected benefits primarily through further reductions in personnel, savings from procurement activities, streamlining of administrative and supporting services functions, and adjustments to our operating capacity through additional facility closures, with approximately two-thirds of the target coming from a reduction in SG&A expense and the rest from a reduction in production costs, primarily at AMR.

In the first quarter of fiscal 2017, we achieved approximately \$22 million in combined benefits related to the Q1'15 and Q2'15 Plans, reflecting approximately \$7 million in incremental benefits compared to the prior year quarter. We expect to achieve substantially all of the combined annual improvement target of \$95 million associated with these measures in fiscal 2017.

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Restructuring charges and other exit-related activities incurred in connection with cost reduction and productivity improvement plans were comprised of the following (in thousands):

	Three Months Ended November 30, 2016			Three Months Ended November 30, 2015		
	All Other Plans	Q2'15 Plan	Total Charges	All Other Plans	Q2'15 Plan	Total Charges
Restructuring charges:						
Severance costs	\$—	\$(62)	\$ (62 )	\$—	\$1,161	\$ 1,161
Contract termination costs	88	(2 )	86	90	645	735
Other restructuring costs	—	—	—	—	—	—
Total restructuring charges	88	(64 )	24	90	1,806	1,896
Other exit-related activities:						
Asset impairments and accelerated depreciation	—	158	158	—	—	—
Total other exit-related activities	—	158	158	—	—	—
Total restructuring charges and other exit-related activities	\$88	\$94	\$ 182	\$90	\$1,806	\$ 1,896
Restructuring charges and other exit-related activities included in continuing operations			\$ 201			\$ 1,925
Restructuring charges (recoveries) and other exit-related activities included in discontinued operations			\$ (19 )			\$ (29 )

See Note 7 - Restructuring Charges and Other Exit-Related Activities 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**

Our effective tax rate from continuing operations for the first quarter of fiscal 2017 was a benefit of 8.6%, compared to a benefit of 10.5% for the prior year period.

The effective tax rate from continuing operations for the first quarter of fiscal 2017 and 2016 was lower than the federal statutory rate of 35% primarily due to the low projected annual effective tax rate applied to the quarterly results. The low projected annual effective tax rate was the result of our full valuation allowance positions partially offset by increases in deferred tax liabilities from indefinite-lived assets in all jurisdictions.

The effective tax rate from continuing operations for fiscal 2017 is expected to be approximately 9%, subject to financial performance for the remainder of the year.

**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 \$27 million as of November 30, 2016 and August 31, 2016, respectively. Cash balances are intended to be used primarily for working capital, capital expenditures, dividends, share repurchases and acquisitions. We use excess cash on hand to reduce amounts outstanding under our credit facilities. As of November 30, 2016, debt was \$188 million, compared to \$193 million as of August 31, 2016, and debt, net of cash, was \$180 million, compared to \$166 million as of August 31, 2016 (refer to Non-GAAP Financial Measures below), an increase of \$14 million primarily resulting from reduced cash on hand due to working capital spending. Our cash balances as of November 30, 2016 and August 31, 2016 include \$6 million and \$7 million, respectively, that are indefinitely reinvested in Puerto Rico and Canada.

Operating Activities

Net cash provided by operating activities in the first three months of fiscal 2017 was \$6 million, compared to \$41 million in the first three months of fiscal 2016.

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Sources of cash in the first three months of fiscal 2017 included a \$14 million increase in accounts payable due to the timing of payments. Uses of cash in the first three months of fiscal 2017 included a \$13 million increase in inventory due to higher volumes on hand and the impact of timing of purchases and sales, and a \$10 million decrease in accrued payroll and related liabilities primarily due to incentive compensation payments.

Sources of cash in the first three months of fiscal 2016 included a \$38 million decrease in accounts receivable primarily due to reductions in recycled metal and finished steel selling prices and the timing of sales and collections, and a \$5 million decrease in inventory due to the impacts of declining scrap metal purchase prices and timing of purchases and sales. Uses of cash in the first three months of fiscal 2016 included a \$5 million decrease in accounts payable and an \$8 million decrease in accrued payroll and related liabilities due to the timing of payments.

**Investing Activities**

Net cash used in investing activities was \$11 million in the first three months of fiscal 2017, compared to \$9 million in the first three months of fiscal 2016.

Cash used in investing activities in the first three months of fiscal 2017 included capital expenditures of \$11 million to upgrade our equipment and infrastructure and for additional investments in environmental and safety-related assets, compared to \$9 million in the prior year period.

**Financing Activities**

Net cash used in financing activities in the first three months of fiscal 2017 was \$14 million, compared to \$36 million in the first three months of fiscal 2016.

Cash used in financing activities in the first three months of fiscal 2017 included \$5 million in net repayments of debt (refer to Non-GAAP Financial Measures below) and \$5 million for dividends, compared to \$25 million and \$5 million, respectively, in the prior year period. Cash used in financing activities in the first three months of fiscal 2016 also included \$3 million for share repurchases.

**Debt**

Our senior secured revolving credit facilities, which provide for revolving loans of \$335 million and C\$15 million, mature in April 2021 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 ("LIBOR"), or the Canadian equivalent, plus a spread of between 1.75% and 2.75%, with the amount of the spread based on a pricing grid tied to the Company's leverage ratio but no less than 2.50% for the fiscal quarters ended May 31, 2016, August 31, 2016 and November 30, 2016, or the greater of (a) the prime rate, (b) the federal funds rate plus 0.50% or (c) the daily rate equal to one-month LIBOR plus 1.75%, in each case plus a spread of between zero and 1.00% based on a pricing grid tied to the Company's leverage ratio. In addition, commitment fees are payable on the unused portion of the credit facilities at rates between 0.20% and 0.40% based on a pricing grid tied to our leverage ratio.

We had borrowings outstanding under the credit facilities of \$183 million as of November 30, 2016 and \$180 million as of August 31, 2016. The weighted average interest rate on amounts outstanding was 3.07% and 3.01% as of November 30, 2016 and August 31, 2016, respectively.

We use the credit facilities to fund working capital, capital expenditures, dividends, share repurchases and acquisitions. The credit agreement contains various representations and warranties, events of default and financial and other customary covenants which limit (subject to certain exceptions) our ability to, among other things, incur or suffer to exist certain liens, make investments, incur or guaranty additional indebtedness, enter into consolidations, mergers, acquisitions, and sales of assets, make distributions and other restricted payments, change the nature of our business, engage in transactions with affiliates and enter into restrictive agreements, including agreements that restrict the ability of our subsidiaries to make distributions. The financial covenants under the credit agreement include (a) 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; (b) a consolidated leverage ratio, defined as consolidated funded indebtedness divided by the sum of consolidated net worth and consolidated funded indebtedness; and (c) a consolidated asset coverage ratio, defined as the consolidated asset value of eligible assets divided by the consolidated funded indebtedness. The financial covenants require maintenance of a minimum

consolidated fixed charge coverage ratio of 1.25 to 1.00 for the fiscal quarter ended November 30, 2016, and 1.50 to 1.00 thereafter, a maximum leverage ratio of 0.55 to 1.00, and a minimum asset coverage ratio of 0.90 to 1.00 for fiscal quarter ended November 30, 2016, and 1.00 to 1.00 thereafter.

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As of November 30, 2016, we were in compliance with the financial covenants under the credit agreement. The consolidated fixed charge coverage ratio was required to be no less than 1.25 to 1.00 and was 2.42 to 1.00 as of November 30, 2016. The consolidated leverage ratio was required to be no more than 0.55 to 1.00 and was 0.28 to 1.00 as of November 30, 2016. The asset coverage ratio was required to be no less than 0.90 to 1.00 and was 1.28 to 1.00 as of November 30, 2016.

The Company's obligations under the credit agreement are guaranteed by substantially all of our subsidiaries. The credit facilities and the related guarantees are secured by senior first priority liens on certain of our and our subsidiaries' assets, including equipment, inventory and accounts receivable.

While we expect to remain in compliance with the financial covenants under the credit agreement, there can be no assurances that we will be able to do so in the event market conditions or other negative factors which adversely impact our results of operations and financial position lead to a trend of consolidated net losses. If we do not maintain compliance with our financial covenants and are unable to obtain an amendment or waiver from our lenders, a breach of a financial 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 facilities under our committed bank credit agreement and acceleration of the amounts owed under the agreement. In such case, we would be required to evaluate available alternatives and take appropriate steps to obtain alternative funds. There can be no assurances that any such alternative funds, if sought, could be obtained or, if obtained, would be adequate or on acceptable terms.

As of August 31, 2016, we had \$8 million of tax-exempt economic development revenue bonds outstanding with the State of Oregon and scheduled to mature in January 2021. In August 2016, we exercised our option to redeem the bonds prior to maturity. We repaid the bonds in full in the first quarter of fiscal 2017. The obligation is reported as a current liability within short-term borrowings as of August 31, 2016 on the Unaudited Condensed Consolidated Balance Sheet, and the \$8 million repayment is reported as a cash outflow from financing activities for the three months ended November 30, 2016 on the Unaudited Condensed Consolidated Statement of Cash Flows.

#### Capital Expenditures

Capital expenditures totaled \$11 million for the first three months of fiscal 2017, compared to \$9 million for the prior year period. We currently plan to invest in the range of \$45 million in capital expenditures on maintenance and environmental compliance and safety-related projects in fiscal 2017 using cash generated from operations and available credit facilities.

#### Dividends

On October 27, 2016, our Board of Directors declared a dividend for the first quarter of fiscal 2017 of \$0.1875 per common share, which equates to an annual cash dividend of \$0.75 per common share. The dividend was paid on November 21, 2016.

#### Environmental Compliance

Our commitment to recycling and 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 in the first three months of fiscal 2017, and plan to invest in the range of \$20 million for such projects in fiscal 2017. 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 that own or operate or formerly owned or operated sites which are part of or adjacent to the Portland Harbor Superfund site ("the Site"). See Note 6 - Commitments and Contingencies in the Notes to the Unaudited Condensed Consolidated Financial Statements in Part I, Item 1 of this report for a discussion of this matter. We believe it is not possible to reasonably estimate the amount or range of costs which we are likely to or which it is reasonably possible that we will incur in connection with the Site, although such costs could be material to our financial position, results of operations, cash flows and liquidity. We have insurance policies that we believe will provide reimbursement for costs we incur for defense, remediation and mitigation for natural resource damages claims in connection with the Site, although there are no assurances that those policies will cover all of the costs which we may incur. Significant cash outflows in the future related to the Site could reduce the amounts available for borrowing



that could otherwise be used for working capital, capital expenditures, dividends, share repurchases, and acquisitions and could result in our failure to maintain compliance with certain covenants in our debt agreements, and could adversely impact our liquidity.

#### Share Repurchase Program

Pursuant to our amended share repurchase program, we have existing authorization to repurchase up to approximately 1.8 million shares of our Class A common stock when we deem such repurchases to be appropriate. We evaluate long- and short-range forecasts as well as anticipated sources and uses of cash before determining the course of action in our share repurchase program.

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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 working capital, capital expenditures, share repurchases, dividends, joint ventures, debt service requirements, environmental obligations and acquisitions. However, in the event of a sustained market deterioration, we may need additional liquidity, which would require us to evaluate available alternatives and take appropriate steps to obtain sufficient additional funds. There can be no assurances that any such supplemental funding, if sought, could be obtained or, if obtained, would be adequate or on acceptable terms.

Off-Balance Sheet Arrangements

None.

Contractual Obligations

There were no material changes related to contractual obligations and commitments from the information provided in our Annual Report on Form 10-K for the fiscal year ended August 31, 2016.

We maintain stand-by letters of credit to provide support for certain obligations, including workers' compensation and performance bonds. At November 30, 2016, we had \$8 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, 2016.

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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## 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 borrowings (i.e., total debt) and (ii) cash and cash equivalents. We believe that debt, net of cash is a useful measure for investors because, as cash and cash equivalents can be used, among other things, to repay indebtedness, netting this against total debt is a useful measure of our leverage.

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

	November 30, August 31,	
	2016	2016
Short-term borrowings	\$ 701	\$ 8,374
Long-term debt, net of current maturities	186,944	184,144
Total debt	187,645	192,518
Less: cash and cash equivalents	8,100	26,819
Total debt, net of cash	\$ 179,545	\$ 165,699

## 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 to investors as a meaningful presentation of the change in debt.

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

	Three Months Ended	
	November 30,	
	2016	2015
Borrowings from long-term debt	\$ 102,631	\$ 11,439
Repayment of long-term debt	(107,491 )	(35,976 )
Proceeds from line of credit	—	53,500
Repayment of line of credit	—	(53,500 )
Net repayments of debt	\$(4,860 )	\$(24,537)

Adjusted consolidated operating income (loss), adjusted AMR operating income, adjusted SMB operating income (loss), adjusted net loss from continuing operations attributable to SSI, and adjusted diluted earnings (loss) per share from continuing operations attributable to SSI

Management believes that providing these non-GAAP financial measures provides a meaningful presentation of our results from business operations excluding adjustments for other asset impairment charges, restructuring charges and other exit-related activities, recoveries related to the resale or modification of previously contracted shipments, and income tax expense (benefit) associated with these adjustments, items which are not related to underlying business operational performance, and improves the period-to-period comparability of our results from business operations. These non-GAAP financial measures also exclude the impact on operating results in fiscal 2015 from the resale or modification of the terms, each at significantly lower prices due to sharp declines in selling prices, of certain previously-contracted bulk shipments for delivery during fiscal 2015. Recoveries resulting from settlements with the original contract parties, which began in fiscal 2016, are reported within SG&A expense in the Unaudited Condensed Consolidated Statements of Operations and are also excluded from the measures.

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

	Three Months Ended November 30,	
	2016	2015
Consolidated operating income (loss):		
As reported	\$587	\$(4,028)
Other asset impairment charges	401	—
Restructuring charges and other exit-related activities	201	1,925
Recoveries related to the resale or modification of previously contracted shipments	(139 )	—
Adjusted	\$1,050	\$(2,103)
AMR operating income:		
As reported	\$12,419	\$2,036
Recoveries related to the resale or modification of previously contracted shipments	(139 )	—
Adjusted	\$12,280	\$2,036
SMB operating income (loss):		
As reported	\$(3,081 )	\$2,754
Other asset impairment charges	401	—
Adjusted	\$(2,680 )	\$2,754
Net loss from continuing operations attributable to SSI:		
As reported	\$(1,273 )	\$(5,231)
Other asset impairment charges	401	—
Restructuring charges and other exit-related activities	201	1,925
Recoveries related to the resale or modification of previously contracted shipments	(139 )	—
Income tax expense (benefit) allocated to adjustments <sup>(1)</sup>	(40 )	(311 )
Adjusted	\$(850 )	\$(3,617)
Diluted earnings (loss) per share from continuing operations attributable to SSI:		
As reported	\$(0.05 )	\$(0.19 )
Other asset impairment charges, per share	0.01	—
Restructuring charges and other exit-related activities, per share	0.01	0.07
Recoveries related to the resale or modification of previously contracted shipments, per share	(0.01 )	—
Income tax expense (benefit) allocated to adjustments, per share <sup>(1)</sup>	—	(0.01 )
Adjusted <sup>(2)</sup>	\$(0.03 )	\$(0.13 )

Income tax allocated to the aggregate adjustments reconciling reported and adjusted net loss from continuing (1) operations attributable to SSI and diluted earnings per share from continuing operations attributable to SSI is determined based on a tax provision calculated with and without the adjustments.

(2) May not foot due to rounding.

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 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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**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 and ferrous and nonferrous metals including scrap metal, end-of-life vehicles and other commodities. The timing and magnitude of industry cycles are difficult to predict and are impacted by general economic conditions. We respond to increases and decreases in forward selling prices by adjusting purchase prices on a timely basis. We actively manage our exposure to commodity price risk and monitor the actual and expected spread between forward selling prices and purchase costs and processing and shipping expense. Sales contracts are based on prices negotiated with our customers, and generally orders are placed 30 to 60 days ahead of the shipment date. However, financial results may be negatively impacted when forward selling prices fall more quickly than we can adjust purchase prices or when customers fail to meet their contractual obligations. We assess the net realizable value of inventory (“NRV”) each quarter based upon contracted sales orders and estimated future selling prices. Based on contracted sales and estimates of future selling prices at November 30, 2016, a 10% decrease in the selling price per ton of finished steel products would have caused an NRV inventory write-down of \$5 million at SMB. A 10% decrease in the selling price of inventory would not have had a material NRV impact on AMR as of November 30, 2016.

**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, 2016.

**Credit Risk**

As of November 30, 2016 and August 31, 2016, 39% and 34%, respectively, of our trade accounts receivable balance was covered by letters of credit. Of the remaining balance, 88% and 94%, respectively, was less than 60 days past due as of November 30, 2016 and August 31, 2016.

**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 may use derivatives to manage some portion of this risk. Our derivatives are agreements with independent counterparties that provide for payments based on a notional amount. As of November 30, 2016 and August 31, 2016, we did not have any derivative contracts.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives. Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, has completed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of November 30, 2016, 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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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information regarding reportable legal proceedings is contained in Part I, "Item 3. Legal Proceedings" in our Annual Report on Form 10-K for the fiscal year ended August 31, 2016. Also 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.

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, 2016, which was filed with the Securities and Exchange Commission on October 25, 2016.



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ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description
10.1*	Form of Long-Term Incentive Award Agreement under the 1993 Stock Incentive Plan used for awards granted in the first quarter of fiscal 2017.
10.2*	Form of Restricted Stock Unit Award Agreement used for award to certain employees on November 1, 2016 under the 1993 Stock Incentive Plan.
10.3*	Fiscal 2017 Annual Performance Bonus Program for the Chief Executive Officer.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial information from Schnitzer Steel Industries, Inc.'s Quarterly Report on Form 10-Q for the quarter ended November 30, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Condensed Consolidated Statements of Operations for the three months ended November 30, 2016 and 2015, (ii) Unaudited Condensed Consolidated Balance Sheets as of November 30, 2016, and August 31, 2016, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Loss for the three months ended November 30, 2016 and 2015, (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended November 30, 2016 and 2015, and (v) the Notes to Unaudited Condensed Consolidated Financial Statements.

\* Management contract or compensatory plan or arrangement.

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SIGNATURES

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

SCHNITZER STEEL INDUSTRIES, INC.  
(Registrant)

Date: January 5, 2017 By: /s/ Tamara L. Lundgren  
Tamara L. Lundgren  
President and Chief Executive Officer

Date: January 5, 2017 By: /s/ Richard D. Peach  
Richard D. Peach  
Senior Vice President, Chief Financial Officer and Chief of Corporate Operations