

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended January 31, 2005

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 1-5725

QUANEX CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

38-1872178
(I.R.S. Employer
Identification No.)

1900 West Loop South, Suite 1500, Houston, Texas 77027
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: **(713) 961-4600**

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at January 31, 2005
Common Stock, par value \$0.50 per share	25,082,452

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

QUANEX CORPORATION
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	January 31, 2005	October 31, 2004
(In thousands)		
ASSETS		
Current assets:		
Cash and equivalents	\$ 28,191	\$ 41,743
Accounts and notes receivable, net of allowance of \$8,259 and \$6,882	196,600	176,358
Inventories	143,075	115,367
Deferred income taxes	10,742	10,744
Other current assets	4,840	2,363
Current assets of discontinued operations	—	9,759
Total current assets	383,448	356,334
Property, plant and equipment	1,017,387	842,147
Less accumulated depreciation and amortization	(585,510)	(491,165)
Property, plant and equipment, net	431,877	350,982
Goodwill, net	197,088	134,670
Cash surrender value insurance policies, net	24,122	24,439
Intangible assets, net	88,463	27,556
Other assets	9,350	9,391
Assets of discontinued operations	2,678	26,150
Total assets	\$ 1,137,026	\$ 929,522
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 161,924	\$ 161,674
Accrued liabilities	54,579	45,844
Income taxes payable	8,997	4,127
Current maturities of long-term debt	483	456
Current liabilities of discontinued operations	1,166	4,102
Total current liabilities	227,149	216,203
Long-term debt	307,669	130,496
Deferred pension credits	6,709	8,804
Deferred postretirement welfare benefits	7,709	7,745
Deferred income taxes	45,284	53,983
Non-current environmental reserves	8,966	8,188
Other liabilities	3,076	2,973
Liabilities of discontinued operations	383	423
Total liabilities	606,945	428,815
Stockholders' equity:		
Preferred stock, no par value, shares authorized 1,000,000; issued and outstanding none	—	—
Common stock, \$0.50 par value, shares authorized 50,000,000; issued 25,170,173 and 24,976,293	12,583	12,486
Additional paid-in-capital	197,681	187,513
Retained earnings	328,326	307,754
Unearned compensation	(2,256)	(824)
Accumulated other comprehensive income	(4,478)	(4,463)
	531,856	502,466
Less common stock held by rabbi trust, 87,721 and 87,208 shares	(1,775)	(1,759)
Total stockholders' equity	530,081	500,707
	\$ 1,137,026	\$ 929,522

QUANEX CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended January 31,	
	2005	2004
(In thousands, except per share data)		
Net sales	\$ 470,183	\$ 252,007
Cost of sales	372,802	217,814
Selling, general and administrative expense	23,148	12,013
Depreciation and amortization	15,119	11,587

Gain on sale of land	—	(454)
Operating income	59,114	11,047
Interest expense	(2,379)	(925)
Other, net	(1,920)	440
Income from continuing operations before income taxes	54,815	10,562
Income tax expense	(21,104)	(3,915)
Income from continuing operations	33,711	6,647
Loss from discontinued operations, net of tax of \$3,037 and \$141	(5,476)	(220)
Net income	\$ 28,235	\$ 6,427
Basic earnings per common share:		
Earnings from continuing operations	\$ 1.35	\$ 0.27
Loss from discontinued operations	\$ (0.22)	\$ (0.01)
Basic earnings per share	<u>\$ 1.13</u>	<u>\$ 0.26</u>
Diluted earnings per common share:		
Earnings from continuing operations	\$ 1.31	\$ 0.27
Loss from discontinued operations	\$ (0.21)	\$ (0.01)
Diluted earnings per share	<u>\$ 1.10</u>	<u>\$ 0.26</u>
Weighted average common shares outstanding:		
Basic	24,984	24,477
Diluted	25,770	24,884
Cash dividends per share	\$ 0.1350	\$ 0.1133

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QUANEX CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOW
(Unaudited)

	Three Months Ended January 31,	
	2005	2004
(In thousands)		
Operating activities:		
Net income	\$ 28,235	\$ 6,427
Loss from discontinued operations	5,476	220
Income from continuing operations	33,711	6,647
Adjustments to reconcile net income to cash provided by operating activities:		
Gain on sale of land	—	(454)
Depreciation and amortization	15,269	11,695
Deferred income taxes	7,458	1,501
Deferred pension and postretirement benefits	(2,131)	(7,540)
Changes in assets and liabilities net of effects from acquisitions and dispositions:		
Increase in accounts and notes receivable	(8,922)	(4,507)
Increase in inventories	(17,778)	(5,255)
Increase (decrease) in accounts payable	(12,669)	6,567
Increase (decrease) in accrued liabilities	(8,057)	3,765
Increase (decrease) in income taxes payable	4,871	(767)
Other, net	(673)	(2,210)
Operating cash flow from discontinued operations	(664)	1,479
Cash provided by operating activities	<u>10,415</u>	<u>10,921</u>
Investment activities:		
Acquisitions, net of cash acquired	(197,376)	(231,913)
Proceeds from sale of discontinued operations	11,592	—
Proceeds from sale of land	—	637
Capital expenditures, net of retirements	(8,816)	(3,950)
Other, net	(353)	(617)
Cash used for investment activities from discontinued operations	(179)	(201)
Cash used for investment activities	<u>(195,132)</u>	<u>(236,044)</u>
Financing activities:		
Bank borrowings (repayments), net	170,000	210,000
Common stock dividends paid	(3,473)	(2,789)
Issuance of common stock, net	4,438	6,715
Other, net	190	(738)
Cash provided by financing activities	<u>171,155</u>	<u>213,188</u>
Effect of exchange rate changes on cash equivalents	10	9
Decrease in cash and equivalents	<u>(13,552)</u>	<u>(11,926)</u>

Cash and equivalents at beginning of period		41,743	22,108
Cash and equivalents at end of period	\$	<u>28,191</u>	<u>\$ 10,182</u>
Supplemental disclosure of cash flow information:			
Cash paid during the period for interest	\$	2,485	\$ 301
Cash paid during the period for income taxes	\$	3,955	\$ 1,503
Cash received during the period for income tax refunds	\$	31	\$ 284

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1. Basis of Presentation

The interim unaudited consolidated financial statements of Quanex Corporation and its subsidiaries (“Quanex” or the “Company”) include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the Company’s financial position and results of operations. All such adjustments are of a normal recurring nature. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X.

Certain reclassifications, none of which affected net income attributable to common stockholders, have been made to prior period amounts to conform to the current period presentation.

The Company sold its Nichols Aluminum – Golden business and Piper Impact business in the fourth quarter of 2004 and first quarter of 2005, respectively. Accordingly, the assets and liabilities of Nichols Aluminum – Golden and Piper Impact are reported as discontinued operations in the Consolidated Balance Sheets presented, and their operating results are reported as discontinued operations in the Consolidated Statements of Income (see Note 15).

In December 2004, the Company effected a three-for-two stock split in the form of a 50% stock dividend. All prior periods presented have been adjusted on a retroactive basis after giving effect to such stock split.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with Management’s Discussion and Analysis and financial statements and notes thereto included in the Quanex Corporation Form 10-K for the fiscal year ended October 31, 2004.

2. New Accounting Pronouncements

In September 2004, the Emerging Issues Task Force (“EITF”) reached a consensus on Issue 04-8, “Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effects on Diluted Earnings Per Share,” that was then ratified by the Financial Accounting Standards Board (“FASB”) in October 2004. The consensus that was reached requires that all instruments that have embedded conversion features that are contingent on market conditions indexed to an issuer’s share price should be included in diluted earnings per share computations (if dilutive) regardless of whether the market conditions have been met. The consensus should be applied to reporting periods ending after December 15, 2004. The consensus reached should be applied retroactively to instruments outstanding at the date of adoption of this consensus. The Company adopted the consensus reached by the EITF on Issue 04-8 on January 31, 2005. The adoption of the consensus is not expected to have a material impact on the Company’s consolidated financial position or results of operations. See Note 7 for further discussion of the impact of such adoption.

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In December 2004, the FASB issued Statements of Financial Accounting Standards (“SFAS”) No. 123R, “Share-Based Payment,” a revision of SFAS No. 123, “Accounting for Stock-Based Compensation.” SFAS No. 123R requires companies to measure all employee stock-based compensation awards using a fair value method and record such expense in the Company’s consolidated financial statements. The provisions of SFAS No. 123R are effective for the first interim or annual reporting period that begins after June 15, 2005; therefore, Quanex will adopt the new requirements no later than the beginning of the fourth quarter of fiscal 2005. Adoption of the expensing requirements will reduce the Company’s reported earnings. Management is currently evaluating the specific impacts of adoption, which include whether the Company should adopt the requirements on a retrospective basis and which valuation model is most appropriate. Disclosure of the pro forma effect on earnings per share is presented in Note 3.

3. Stock Based Employee Compensation

In accordance with SFAS No. 123, “Accounting for Stock-Based Compensation,” the Company continues to apply the rules for stock-based compensation contained in Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” using the intrinsic value method. The pro forma effect on net income and earnings per share of the fair value based method of accounting for stock-based compensation as required by SFAS No. 123 and SFAS No. 148 “Accounting for the Stock-Based Compensation – Transition and Disclosure” is presented below (in thousands, except per share amounts):

	Three Months Ended January 31,	
	2005	2004
Net income, as reported	\$ 28,235	\$ 6,427
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(484)	(563)
Pro forma net income	<u>\$ 27,751</u>	<u>\$ 5,864</u>
Earnings per common share:		
Basic as reported	\$ 1.13	\$ 0.26
Basic pro forma	\$ 1.11	\$ 0.24

Diluted as reported	\$	1.10	\$	0.26
Diluted pro forma	\$	1.08	\$	0.24

In December 2004, the FASB issued SFAS No. 123R "Share-Based Payment." SFAS No. 123R requires companies to measure all employee stock-based compensation awards using a fair value method and record such expense in the Company's consolidated financial statements. The provisions of SFAS No. 123R are effective for the first interim or annual reporting period that begins after June 15, 2005; therefore, Quanex will adopt the new requirements no later than the beginning of the fourth quarter of fiscal 2005.

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4. Business Acquisitions

On December 9, 2004, the Company completed the acquisition of all of the outstanding stock, through a subsidiary merger, of Mikron Industries, Inc. ("Mikron"), a privately-held Washington corporation. Mikron, an industry-leading manufacturer of engineered vinyl and thermoplastic alloy composite (MikronWood™) window components, window coverings and door components, serves the residential building and remodeling markets. Headquartered in the Seattle suburb of Kent, WA, Mikron operates modern and highly automated extrusion facilities located in the Kent area; Winnebago, IL; and Richmond, KY.

The Mikron acquisition was accounted for under the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." Accordingly, the estimated fair value of assets acquired and liabilities assumed in the acquisition and the results of operations were included in the Company's consolidated financial statements as of the effective date of the acquisition. Prior to the acquisition, Mikron did not make a provision for Federal income taxes under Subchapter S of the Internal Revenue Code. From the effective date of the acquisition, the Company has been making a provision for Federal income tax. Except for the tax provision, there were no other material differences between the Company's accounting policies and those of Mikron.

Mikron has been integrated into the Engineered Products division within the Building Products segment. The Company acquired Mikron to further expand the broad range of high quality components and products currently supplied to existing customers and to expand the customers served. Mikron has a broad presence in the vinyl window market, which increases the Company's diversification within the window market and furthers the expansion into the vinyl and aluminum market niches. The Company now has a broad product offering ranging from wood to vinyl and aluminum. As consideration for the acquisition of all of the outstanding capital stock of Mikron, the Company paid \$198.2 million in cash, subject to a working capital adjustment, and assumed \$7.2 million of debt. The Company also incurred \$0.7 million in transaction fees, including legal, valuation and accounting fees.

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The preliminary allocation of assets and liabilities acquired and assumed is summarized below. The preliminary allocation was based on independent appraisal and management's estimates of fair values. The allocations are not final and are subject to change based on final estimates of fair value and useful lives. Because the allocation below is preliminary, the allocation of certain assets could change materially upon finalization of the independent appraisal report.

	<u>As of Date of Opening Balance Sheet (In thousands)</u>
Cash and equivalents	\$ 1,485
Accounts receivable, net of allowance for doubtful accounts	13,808
Inventories	9,941
Other current assets	1,040
Total current assets	<u>26,274</u>
Property, plant and equipment, net	86,600
Goodwill, net	62,422
Other intangible assets, net:	
Trade names	29,700
Patents	10,600
Customer relationships	21,200
Total other intangible assets	<u>61,500</u>
Other assets	17
Total assets	<u>\$ 236,813</u>
Accounts payable	\$ 12,920
Accrued liabilities	17,858
Total current liabilities	<u>30,778</u>
Other liabilities	7,175
Total liabilities	<u>37,953</u>
Investment	198,860
Total liabilities and equity	<u>\$ 236,813</u>

The preliminary allocations resulted in goodwill of \$62.4 million, all of which is expected to be deductible for tax purposes. The other intangible assets are being amortized over periods which reflect the pattern in which the economic benefits of the assets are expected to be realized. Specifically, the trade names are being amortized over an average estimated useful life of 25 years, the patents are being amortized over an average of 7 years and the customer relationships are being amortized over an average of 30 years. The weighted average useful life of intangible assets, excluding goodwill, created as a result of the acquisition is 23 years. No residual value is estimated for the intangible assets. Note that useful lives of the identified intangible assets may change once the valuation is finalized.

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The acquisition of Mikron resulted in preliminary goodwill of \$62.4 million. The Company previously marketed and sold a wide range of products to the same customer base served by Mikron. With the acquisition, the Company has expanded its product offering and its customer base and can now market more broadly within the entire base of OEM customers in the window and door manufacturing market. The reliability, service levels and synergies established with the Company's base of customers within this segment allow for the potential of improved performance from Mikron. In addition, Mikron has several new products in the early stages of the product life cycle that build upon their existing offerings. The ability to provide customers a suite of complimentary products and the expanded product offerings being rolled out are of considerable value to the Company.

The following table provides unaudited proforma results of operations for the three months ended January 31, 2005 and January 31, 2004, as if Mikron had been acquired as of the beginning of each fiscal year presented. The proforma results include certain adjustments including estimated interest impact from the funding of the acquisition, estimated depreciation and amortization of fixed and identifiable intangible assets and estimated income taxes based upon an effective tax rate of 38.5%. However, the proforma results presented do not include any anticipated cost savings or other synergies related to the acquisition. Accordingly, such amounts are not necessarily indicative of the results that would have occurred if the acquisition had occurred on the dates indicated or that may result in the future.

	Proforma	
	Three Months Ended	
	January 31,	
	2005	2004
(In thousands)		
Net sales	\$ 492,750	\$ 293,712
Net income attributable to common stockholders	28,181	7,578
Diluted net earnings per common share	\$ 1.09	\$ 0.30

5. Inventories

Inventories consist of the following:

	January 31,	October 31,
	2005	2004
(In thousands)		
Raw materials	\$ 38,228	\$ 24,562
Finished goods and work in process	91,346	78,088
	129,574	102,650
Other	13,501	12,717
	<u>\$ 143,075</u>	<u>\$ 115,367</u>

The values of inventories in the consolidated balance sheets are based on the following accounting methods:

	January 31,	October 31,
	2005	2004
(In thousands)		
LIFO	\$ 68,718	\$ 50,382
FIFO	74,357	64,985
	<u>\$ 143,075</u>	<u>\$ 115,367</u>

For purposes of valuing LIFO inventories, a projection of the year-end LIFO reserve is calculated each quarter. Based on this projection, the Company records an estimate of the LIFO change during the year. At the end of the fiscal year, the actual LIFO inventory change is calculated and recorded. With respect to inventories valued using the LIFO method, replacement cost exceeded the LIFO value by approximately \$34.4 million as of January 31, 2005 and October 31, 2004.

6. Acquired Intangible Assets

Intangible assets, including the preliminary valuation of those acquired as part of Mikron, consist of the following (in thousands):

	As of January 31, 2005			As of October 31, 2004		
	Gross Carrying Amount	Accumulated Amortization	Weighted Average Remaining Life	Gross Carrying Amount	Accumulated Amortization	Weighted Average Remaining Life
Amortized intangible assets:						
Non-compete Agreements	\$ 313	\$ 204	2 years	\$ 313	\$ 187	2 years
Patents*	25,877	1,119	12	15,277	883	16
Trademarks and Trade Names*	37,930	546	23	8,230	420	14
Customer Relationships*	23,691	555	27	2,491	416	5
Other intangibles	1,201	325	3	1,201	250	3
Total	<u>\$ 89,012</u>	<u>\$ 2,749</u>	<u>21 years</u>	<u>\$ 27,512</u>	<u>\$ 2,156</u>	<u>13 years</u>
Unamortized intangible assets:						
Trade Name	\$ 2,200			\$ 2,200		

* - Values and useful lives of the identified intangible assets identified as part of the preliminary Mikron valuation are subject to change upon finalization of the valuation.

The aggregate amortization expense for the three month periods ended January 31, 2005 and 2004 is \$597 thousand and \$233 thousand, respectively. Estimated amortization expense for the next five years, based upon the amortization of preexisting intangibles as well as preliminary amortization estimates for the intangibles acquired as part of Mikron, follows (in thousands):

Fiscal Years Ending October 31,	Estimated Amortization
2005 (remaining nine months)	\$ 8,461
2006	7,146
2007	6,454
2008	5,380
2009	3,295

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7. Earnings Per Share

The computational components of basic and diluted earnings per share are as follows (shares and dollars in thousands except per share amounts):

	For the Three Months Ended January 31, 2005			For the Three Months Ended January 31, 2004		
	Income (Numerator)	Shares (Denominator)	Per- Share Amount	Income (Numerator)	Shares (Denominator)	Per- Share Amount
Basic Earnings Per Share Computation	\$ 28,235	24,984	\$ 1.13	\$ 6,427	24,477	\$ 0.26
Effect of Dilutive Securities						
Effect of common stock equivalents arising from stock options	—	373		—	329	
Effect of common stock equivalents arising from settlement of contingent convertible debentures	—	326		—	—	
Effect of common stock held by rabbi trust	—	87		—	78	
Diluted Earnings Per Share Computation						
Total diluted net earnings	\$ 28,235	25,770	\$ 1.10	\$ 6,427	24,884	\$ 0.26

On January 26, 2005, the Company announced that it had irrevocably elected to settle the principal amount of its 2.50% Convertible Senior Debentures due 2034 (the "Debentures") in cash when they become convertible and are surrendered by the holders thereof. The Company retains its option to satisfy any premium obligation (stock price in excess of conversion price) with either shares, cash or a combination of shares and cash. On January 31, 2005, the Company adopted the consensus reached by the EITF on Issue 04-8 which requires that the Company include in diluted earnings per share all instruments that have embedded conversion features that are contingent on market conditions indexed to an issuer's share price. As a result of the Company's election, diluted earnings per share includes only the amount of shares it would take to satisfy the premium obligation assuming all of the Debentures were surrendered. For calculation purposes, the average closing price of the Company's common stock for each of the periods presented is the basis used to determine dilution.

8. Comprehensive Income

Comprehensive income is defined as the sum of net income and all other non-owner changes in equity, including realized and unrealized gains and losses on derivatives, minimum pension liability adjustments and foreign currency translation adjustments. Total comprehensive income for the three months ended January 31, 2005 is \$28.2 million. Total comprehensive income for the three months ended January 31, 2004 is \$6.4 million.

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9. Long-term Debt

Long-term debt consists of the following:

	January 31, 2005	October 31, 2004
	(In thousands)	
"Bank Agreement" Revolver	\$ 170,000	\$ —
2.50% Convertible Senior Debentures due 2034	125,000	125,000
City of Huntington, Indiana Economic Development Refunding Revenue Bonds	1,665	1,665
City of Richmond, Kentucky Industrial Building Revenue Bonds	7,175	—
Scott County, Iowa Industrial Waste Recycling Revenue Bonds	2,000	2,000
Temroc Industrial Development Revenue Bonds	1,975	2,027
Other	337	260
	\$ 308,152	\$ 130,952
Less maturities due within one year included in current liabilities	483	456
	\$ 307,669	\$ 130,496

Bank Agreement

In November 2002, the Company entered into a secured \$200 million Revolving Credit Agreement ("Bank Agreement"). The Bank Agreement is secured by all Company assets, excluding land and buildings. The Bank Agreement expires November 15, 2005 and provides up to \$25 million for standby

letters of credit, limited to the undrawn amount available under the Bank Agreement. All borrowings under the Bank Agreement bear interest, at the option of the Company, at either (a) the prime rate or federal funds rate plus one percent, whichever is higher, or (b) a Eurodollar based rate.

On December 19, 2003, the Company executed an agreement with the banks to increase the Bank Agreement revolver from \$200 million to \$310 million to provide funds necessary for acquisitions. On April 9, 2004, the Company requested and received consent from its credit facility bank group to extend the maturity date of its Revolving Credit Agreement from November 15, 2005 to February 28, 2007.

The Bank Agreement requires maintenance of certain financial ratios and maintenance of a minimum consolidated tangible net worth. As of January 31, 2005, the Company was in compliance with all current Bank Agreement covenants.

Convertible Senior Debentures

On May 5, 2004, the Company issued \$125 million of the Debentures in a private placement to Credit Suisse First Boston, Bear, Stearns & Co. Inc., Robert W. Baird & Co., and KeyBanc Capital Markets as initial purchasers. The Debentures were offered only to "qualified institutional buyers," in accordance with Rule 144A under the Securities Act of 1933. The Debentures are convertible into shares of Quanex common stock, upon the occurrence of certain events, at an initial conversion rate of 17.3919 shares of common stock per \$1,000 principal amount of notes. This conversion rate is equivalent to an initial conversion price of \$57.50 per share of common stock, subject to adjustment in some events such as a common stock dividend or an increase in the cash dividend. Adjustments to the conversion rate are made when the cumulative adjustments exceed 1% of the conversion rate.

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The net proceeds from the offering, totaling approximately \$122 million, were used to repay a portion of the amounts outstanding under the revolving credit agreement.

The December 31, 2004 three-for-two stock split coupled with the dividend increases authorized in September 2004 and December 2004 resulted in the Company having to adjust the conversion rate of the Debentures. The adjusted conversion rate of 26.1113 shares of our common stock per \$1,000 principal amount of debentures is equivalent to an adjusted conversion price of \$38.2976 per share of common stock subject to adjustment in some events.

The Debentures are only convertible under certain circumstances, including: (i) during any fiscal quarter if the closing price of the Company's common stock for at least 20 trading days in the 30 trading-day period ending on the last trading day of the previous fiscal quarter is more than 120% of the conversion price per share of the Company's common stock on such last trading day; (ii) if the Company calls the Debentures for redemption; or (iii) upon the occurrence of certain corporate transactions, as defined. Upon conversion, the Company has the right to deliver common stock, cash or a combination of cash and common stock. The Company may redeem some or all of the Debentures for cash any time on or after May 15, 2011 at the Debentures' full principal amount plus accrued and unpaid interest, if any. Holders of the Debentures may require the Company to purchase, in cash, all or a portion of the Debentures on May 15, 2011, 2014, 2019, 2024 and 2029, or upon a fundamental change, as defined, at the Debentures' full principal amount plus accrued and unpaid interest, if any.

As of January 31, 2005, the Debentures were not convertible. During the month of February 2005, the Company's common stock has been trading at prices in excess of 120% of the conversion price per share.

On January 25, 2005, the Company and the trustee for the Debentures executed a supplemental indenture to the indenture governing the Debentures. The indenture previously allowed the Company, on the date the Debentures first become convertible, to make an election to settle the principal amount of its obligation with either common stock, cash or a combination of the two. The amendment effectuated by the supplemental indenture permits the Company to elect the method by which the principal amount of the obligation will be settled in advance of when the Debentures become convertible.

On January 26, 2005, the Company announced that it had irrevocably elected to settle the principal amount of its Debentures in cash when they become convertible and are surrendered by the holders thereof. The Company retains its option to satisfy any premium obligation (stock price in excess of conversion price) with either shares, cash or a combination of shares and cash.

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10. Pension Plans and Other Postretirement Benefits

The components of net pension and other postretirement benefit cost are as follows:

	Three Months Ended January 31,	
	2005	2004
(In thousands)		
Pension Benefits:		
Service cost	\$ 856	\$ 864
Interest cost	858	866
Expected return on plan assets	(718)	(724)
Amortization of unrecognized transition asset	(33)	(33)
Amortization of unrecognized prior service cost	57	57
Amortization of unrecognized net loss	199	201
Net periodic pension cost	<u>\$ 1,219</u>	<u>\$ 1,231</u>
Three Months Ended January 31,		
2005 2004		
(In thousands)		
Postretirement Benefits:		

Service cost	\$	36	\$	27
Interest cost		150		112
Net amortization and deferral		(56)		(42)
Net periodic postretirement benefit cost	\$	130	\$	97

During the three months ended January 31, 2005, the Company made contributions of \$50,000 to its defined benefit pension plans. The Company estimates that it will contribute a total of \$300,000 to its defined benefit plans during fiscal 2005.

11. Industry Segment Information

Quanex has two market-focused segments: Vehicular Products and Building Products. The Vehicular Products segment produces engineered steel products and extruded products for the light vehicle, heavy duty truck, agricultural, military, recreational and energy markets. The Building Products segment produces engineered products and aluminum sheet for window and door components used by the residential building and remodeling markets. The presentation of segment disclosure information provided below has been restated for discontinued operations:

	Three Months Ended January 31,	
	2005	2004
(In thousands)		
Net Sales		
Vehicular Products(1)(2)	\$ 274,576	\$ 131,046
Building Products(3)(4)	195,607	120,961
Consolidated	\$ 470,183	\$ 252,007
Operating Income (Loss)		
Vehicular Products(1)(2)	\$ 44,219	\$ 9,592
Building Products(3)	22,143	4,960
Corporate & Other(5)	(7,248)	(3,505)
Consolidated	\$ 59,114	\$ 11,047
(In thousands)		
Identifiable Assets		
Vehicular Products(1)(2)	\$ 497,801	\$ 475,491
Building Products(3)(4)	611,988	378,688
Corporate & Other(5)	24,559	39,432
Discontinued Operations(2)(4)	2,678	35,911
Consolidated	\$ 1,137,026	\$ 929,522
Goodwill		
Vehicular Products	\$ 13,496	\$ 13,496
Building Products(3)(4)	183,592	121,174
Consolidated	\$ 197,088	\$ 134,670

(1) Fiscal 2004 includes MACSTEEL Monroe as of January 1, 2004.

(2) Piper Impact is included in discontinued operations for all periods presented.

(3) Fiscal 2004 includes TruSeal as of January 1, 2004. Fiscal 2005 includes Mikron as of December 10, 2004.

(4) Nichols Aluminum – Golden is included in discontinued operations for all periods presented.

(5) Included in “Corporate & Other” are inter-segment eliminations, consolidated LIFO inventory adjustments, corporate expenses and assets.

12. Treasury Stock and Stock Option Exercises

On August 26, 2004, the Board of Directors authorized the Company to reload its stock buyback program, increasing the existing authorization up to 1 million shares. No shares were purchased during the three months ended January 31, 2005 nor were any purchased during all of fiscal 2004. At January 31, 2005, there were no shares in treasury stock.

The Company has various restricted stock and stock option plans for key employees and directors as described in its Annual Report on Form 10-K for the fiscal year ended October 31, 2004. Below is a table summarizing the stock option activity in all plans since October 31, 2004:

	Shares Exercisable	Shares Under Option	Average Price Per Share
Balance at October 31, 2004	663,693	1,207,670	\$ 21
Granted		312,826	40
Exercised		(161,656)	19
Cancelled / Lapsed		(3,925)	35
Balance at January 31, 2005	702,684	1,354,915	\$ 25

13. Income Taxes

The provision for income taxes is determined by applying an estimated annual effective income tax rate to income before income taxes. The rate is based on the most recent annualized forecast of pretax income, permanent book versus tax differences and tax credits. It also includes the effect of any valuation allowance expected to be necessary at the end of the year. The Company's estimated annual effective tax rate increased to 38.5% in fiscal 2004 primarily due to an increase in state tax expense. The Company continues to use an estimated annual effective tax rate of 38.5% in fiscal 2005.

Included in income taxes payable as of January 31, 2005, is \$7.4 million of income tax contingencies primarily associated with the Company's case before the Tax Court. See Note 14 for further explanation.

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14. Contingencies

Environmental

Quanex is subject to extensive laws and regulations concerning the discharge of materials into the environment and the remediation of chemical contamination. To satisfy such requirements, Quanex must make capital and other expenditures on an ongoing basis. The Company accrues its best estimates of its remediation obligations and adjusts such accruals as further information and circumstances develop. Those estimates may change substantially depending on information about the nature and extent of contamination, appropriate remediation technologies, and regulatory approvals. Costs of future expenditures for environmental remediation are not discounted to their present value, unless the amount and timing of the expenditures are fixed or reliably determinable. When environmental laws might be deemed to impose joint and several liability for the costs of responding to contamination, the Company accrues its allocable share of liability taking into account the number of parties participating, their ability to pay their shares, the volumes and nature of the wastes involved, the nature of anticipated response actions, and the nature of the Company's alleged connections. The cost of environmental matters has not had a material adverse effect on Quanex's operations or financial condition in the past, and management is not aware of any existing conditions that it currently believes are likely to have a material adverse effect on Quanex's operations, financial condition or cash flows.

Total remediation reserves, at January 31, 2005, for Quanex's current plants, former operating locations, and disposal facilities were approximately \$9.3 million. This represents an increase of \$0.8 million from the balance as of October 31, 2004. The difference is primarily attributable to new information received during the first quarter of 2005 about the Company's alleged responsibility for cleanup activities. Of the current remediation reserve, approximately \$2.0 million represents administrative costs; the balance represents estimated costs for investigation, studies, cleanup, and treatment. On the balance sheet, \$9.0 million of the remediation reserve is included in non-current liabilities with the remainder in accrued liabilities (current).

Approximately 55% of the total remediation reserve is currently allocated to cleanup work relating to the former Piper Impact operation. At present, the largest component is for remediation of soil and groundwater contamination from prior operators at the Piper Impact plant site on Highway 15 in New Albany, Mississippi. The Company voluntarily implemented a state-approved remedial action plan there that includes natural attenuation together with a groundwater collection and treatment system, but the Company continues to investigate site conditions and evaluate performance of the remedy. During the first quarter of 2005, the Company sold the Piper Impact business, including its sole operating facility on Barkley Drive in New Albany. The Company currently owns the Highway 15 location, which no longer is operating.

Included in the current reserve is the estimated cost of operating the existing groundwater remediation system at the Highway 15 location over the next 20 years, which was discounted to a net present value using an interest rate of 3.0%. The Company has estimated the annual cost of operating the existing system to be approximately \$0.2 million and has assumed that the existing system will continue to be effective.

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The final remediation costs and the timing of the expenditures at Piper Impact and other sites will depend upon such factors as the nature and extent of contamination, the cleanup technologies employed, and regulatory concurrences. While actual remediation costs therefore may be more or less than amounts accrued, management believes it has established adequate reserves for all probable and reasonably estimable remediation liabilities. It is not possible at this point to reasonably estimate the amount of any obligation for remediation in excess of current accruals that would be material to Quanex's financial statements because of uncertainties as to the extent of environmental impact, cleanup technologies, and concurrence of governmental authorities. The Company currently expects to pay the accrued remediation reserve through at least fiscal 2025, although some of the same factors discussed earlier could accelerate or extend the timing.

For fiscal 2005, the Company estimates expenses at its facilities will be approximately \$2.9 million for continuing environmental compliance. In addition, the Company estimates that capital expenditures for environmental compliance in fiscal 2005 will be approximately \$2.7 million. Future expenditures relating to environmental matters will necessarily depend upon the application to Quanex and its facilities of future regulations and government decisions. Quanex will continue to have expenditures in connection with environmental matters beyond fiscal 2005, but it is not possible at this time to reasonably estimate the amount of those expenditures except as discussed above. Based upon its analysis and experience to date, Quanex does not believe that its compliance with the Clean Air Act or other environmental requirements will have a material adverse effect on its operations or financial condition.

Tax Liability

As reported in the annual report on Form 10-K for the year ended October 31, 2004, the Company is currently involved in a case in Tax Court regarding the disallowance of a capital loss realized in 1997 and 1998. During 2004, the Company made a tax payment of \$10.0 million related to the case. The payment was made to curtail the running of the interest outstanding. Adequate provision had been made in prior years and the Company believes the outcome of the case will not have a material impact on its financial position or results of operation.

Other

From time to time, the Company and its subsidiaries are involved in various litigation matters arising in the ordinary course of their business. Although the ultimate resolution and impact of such litigation on the Company is not presently determinable, the Company's management believes that the eventual outcome of such litigation will not have a material adverse effect on the overall financial condition or results of operations of the Company.

15. Discontinued Operations

The Company classified Piper Impact and Nichols Aluminum – Golden as held for sale in the third quarter and fourth quarter of fiscal year 2004, respectively. Piper Impact was historically included in the Company’s Vehicular Products segment, while Nichols Aluminum – Golden was included in the Building Products segment. In accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” the results of operations, financial position and cash flows of both Piper Impact and Nichols Aluminum – Golden have been reflected in the consolidated financial statements and notes as a discontinued operation for all periods presented. Nichols Aluminum – Golden was sold September 30, 2004, while the Piper Impact business was sold January 25, 2005. During fiscal 2004, Piper Impact’s operations were consolidated from two facilities into one.

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The sale of Piper Impact in the first quarter of 2005, including only the one operating facility, resulted in a net loss of \$2.2 million for the quarter. As a result of the sale of the Piper Impact business, the Company reduced the carrying value of the remaining facility to an estimated fair market value as a standalone facility. This resulted in an additional net loss of \$2.1 million during the first quarter of 2005. The loss on sale of Piper Impact and loss from the reduction of the fair market value of the remaining Piper Impact facility combined with a \$0.1 million loss as a result to the working capital adjustment for the Nichols Aluminum – Golden sale and a \$1.1 million net loss for Piper Impact during the quarter resulted in a net loss from discontinued operations of \$5.5 million for the first quarter of 2005.

Comparative balance sheets of the discontinued operations were as follows:

	January 31, 2005	October 31, 2004
	(In thousands)	
Accounts and notes receivable, net	\$ —	\$ 2,658
Inventories	—	2,695
Deferred income taxes	—	492
Other current assets	—	3,914
Total current assets	—	9,759
Property, plant and equipment, net	500	10,796
Other assets	2,178	15,354
	<u>\$ 2,678</u>	<u>\$ 35,909</u>
Accounts payable	\$ 297	\$ 1,763
Accrued and other	869	2,339
Total current liabilities	1,166	4,102
Other liabilities	383	423
Total liabilities	<u>\$ 1,549</u>	<u>\$ 4,525</u>

Operating results of the discontinued operations were as follows:

	Three Months Ended January 31,	
	2005	2004
	(In thousands)	
Net sales	\$ 4,099	\$ 29,214
Loss from discontinued operations	(1,825)	(361)
Loss on sale of discontinued operations	(6,688)	—
Income tax benefit	3,037	141
Net loss from discontinued operations	<u>\$ (5,476)</u>	<u>\$ (220)</u>

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Item 2. Management’s Discussion and Analysis of Results of Operations and Financial Condition

General

The discussion and analysis of Quanex Corporation and its subsidiaries’ (the “Company”) financial condition and results of operations should be read in conjunction with the January 31, 2005 and October 31, 2004 Consolidated Financial Statements of the Company and the accompanying notes.

Private Securities Litigation Reform Act

Certain of the statements contained in this document and in documents incorporated by reference herein, including those made under the caption “Management’s Discussion and Analysis of Results of Operations and Financial Condition” are “forward-looking” statements as defined under the Private Securities Litigation Reform Act of 1995. Generally, the words “believe,” “expect,” “intend,” “estimate,” “anticipate,” “project,” “will” and similar expressions identify forward-looking statements, which generally are not historical in nature. All statements which address future operating performance, events or developments that we expect or anticipate will occur in the future, including statements relating to volume, sales, operating income and earnings per share, and statements expressing general optimism about future operating results, are forward-looking statements. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our Company’s historical experience and our present expectations or projections. As and when made, management believes that these forward-looking statements are reasonable. However, caution should be taken not to place undue reliance on any such forward-looking statements since such statements speak only as of the date when made and there can be no assurance that such forward-looking statements will occur. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Factors exist that could cause the Company's actual results to differ materially from the expected results described in or underlying the Company's forward-looking statements. Such factors include domestic and international economic activity, prevailing prices of steel and aluminum scrap and other raw material costs, availability of steel and aluminum scrap, energy costs, interest rates, construction delays, market conditions, particularly in the vehicular, home building and remodeling markets, any material changes in purchases by the Company's principal customers, labor supply and relations, environmental regulations, changes in estimates of costs for known environmental remediation projects and situations, world-wide political stability and economic growth, the Company's successful implementation of its internal operating plans and acquisition strategies, successful integration of recent acquisitions, performance issues with key customers, suppliers and subcontractors, and regulatory changes and legal proceedings. Accordingly, there can be no assurance that the forward-looking statements contained herein will occur or that objectives will be achieved. All written and verbal forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by such factors.

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Consolidated Results of Operations

Summary Information

	Three Months Ended January 31,			
	2005	2004	Change	%
	(In millions)			
Net sales	\$ 470.2	\$ 252.0	\$ 218.2	86.6%
Cost of sales	372.8	217.8	155.0	71.2
Selling, general and administrative	23.2	12.0	11.2	93.3
Depreciation and amortization	15.1	11.6	3.5	30.2
Gain on sale of land	—	(0.4)	0.4	(100.0)
Operating income	59.1	11.0	48.1	437.3
Operating income margin	12.6%	4.4%	8.2%	
Interest expense	(2.4)	(0.9)	(1.5)	166.7
Other, net	(1.9)	0.4	(2.3)	(575.0)
Income tax expense	(21.1)	(3.9)	(17.2)	441.0
Income from continuing operations	\$ 33.7	\$ 6.6	\$ 27.1	410.6%

Overview

Net sales for the three months ended January 31, 2005, were a record for the quarter, up 86.6% over the first quarter of 2004. Combined net sales from the Company's December 31, 2003, acquisitions of MACSTEEL Monroe and TruSeal Technologies were \$123.7 million in the first quarter of 2005. Combined first quarter earnings of MACSTEEL Monroe and TruSeal contributed \$0.36 (after interest expense) to diluted earnings per share versus \$0.04 per share reported for one month's combined results in last year's first quarter.

Demand at the Vehicular Products and Building Products segments was solid throughout the quarter, and backlogs remain healthy. Income from continuing operations was a record, up \$27.1 million in the first quarter of 2005, compared to the same period last year. While raw material costs were higher in the first quarter of 2005 compared to the first quarter of 2004, increased average prices, both base price and surcharges, resulted in margin expansion for the quarter.

Business Segments

Quanex has two market-focused segments: Vehicular Products and Building Products. The Vehicular Products segment produces engineered steel bars and extruded products for the light vehicle, heavy duty truck, agricultural, defense, recreational and energy markets. The Vehicular Products segment's primary market drivers are North American light vehicle builds and, to a lesser extent, heavy duty truck builds. The Building Products segment produces engineered products and components serving the window and door industry, and mill finished and coated aluminum sheet serving the broader building products markets. The main market drivers of this segment are residential housing starts and remodeling expenditures.

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2005 First Quarter Compared to 2004 First Quarter

Vehicular Products

	Three Months Ended January 31,(2)			
	2005	2004(1)	Change	%
	(In millions)			
Net sales	\$ 274.6	\$ 131.0	\$ 143.6	109.6%
Cost of sales	215.9	110.5	105.4	95.4
Selling, general and administrative	6.0	3.6	2.4	66.7
Depreciation and amortization	8.5	7.3	1.2	16.4
Operating income	\$ 44.2	\$ 9.6	\$ 34.6	360.4%
Operating income margin	16.1%	7.3%	8.8%	

(1) Fiscal 2004 includes MACSTEEL Monroe as of January 1, 2004.

(2) All periods presented exclude Piper Impact which is included in discontinued operations.

North American light vehicle builds were up approximately 3% during the first quarter of 2005 compared to the same period last year, and demand from heavy duty truck customers continues to grow, with overall production up approximately 60% over the first quarter of 2004. All three of the Company's

engineered steel bar operations produced at very high utilization rates. Segment operating income for the first quarter of 2005, compared to the same period last year, benefited from new customer programs, cost improvements, higher selling prices, falling scrap costs and the acquisition of MACSTEEL Monroe.

Excluding the impact of MACSTEEL Monroe, net sales for the first quarter of 2005 were higher than the first quarter of 2004 by 52.5%. The increase in net sales was primarily a result of the 55.7% increase in average selling prices, excluding MACSTEEL Monroe. While base prices increased, the change is largely attributable to higher steel scrap surcharges in the first quarter of fiscal 2005.

Operating income was higher than the first quarter of 2004 due to two additional months of MACSTEEL Monroe coupled with higher average selling prices and scrap surcharges. Cost of sales and selling, general and administrative expenses increased 38.9% and 19.9%, respectively, while depreciation and amortization was flat, all exclusive of MACSTEEL Monroe. The higher average selling prices and scrap surcharges combined to more than offset the higher selling, general and administrative costs and sharp increase in material scrap prices when comparing the first quarter of 2005 to the first quarter of 2004.

The increase in the operating income margin in the first quarter of 2005 compared to the first quarter of 2004 is a result of the segment's trailing surcharge mechanism being in place during a period when the Company experiences a decrease in raw material prices. As raw material prices increase, margins are initially squeezed because of the surcharge lag. The opposite occurs as raw material prices decline, which is a primary contributor to the increase in the operating income margin percentage (See Commodity Price Risk in Item 3 "Quantitative and Qualitative Disclosure about Market Risk" for further explanation).

Building Products

	Three Months Ended January 31,			
	2005(2)	2004(1)	Change	%
	(In millions)			
Net sales	\$ 195.6	\$ 121.0	\$ 74.6	61.7%
Cost of sales	156.7	106.6	50.1	47.0
Selling, general and administrative	10.2	5.2	5.0	96.2
Depreciation and amortization	6.6	4.2	2.4	57.1
Operating income	\$ 22.1	\$ 5.0	\$ 17.1	342.0%
Operating income margin	11.3%	4.1%	7.2%	

(1) Fiscal 2004 includes TruSeal as of January 1, 2004.

(2) Fiscal 2005 includes Mikron as of December 10, 2004.

Housing starts and remodeling activity during the first quarter of 2005 remained at surprisingly good levels considering the adverse impact winter weather always brings. Order rates at the Company's window and door components business remained healthy. Additionally, the Company's aluminum sheet business had an especially strong first quarter of 2005. Shipments to traditional building and construction customers remained excellent, while sales to capital equipment, service center, and transportation customers remained above first quarter 2004 levels. This strong demand allowed for higher selling prices during the quarter.

Excluding the impact of revenues from TruSeal and Mikron, net sales for the first quarter of 2005 were higher than the first quarter of 2004 by 32.9%. The increase in net sales was a result of the increased volume across the entire segment, combined with a 29.5% increase in aluminum sheet prices.

Operating income for the first quarter of 2005 was higher than the first quarter of 2004 due mainly to increased volume and higher average selling prices, that more than offset the impact from the higher raw material costs. Excluding TruSeal and Mikron, cost of sales and selling, general and administrative expenses increased 21.1% and 12.1%, respectively, in the first quarter of 2005 compared to the first quarter of 2004. The increased cost of sales is primarily a result of a 15.1% increase in aluminum raw material prices. The increased selling, general and administrative expenses is a result of increased incentives earned as a result of the solid operating results, coupled with backfill costs associated with the Company's Sarbanes-Oxley implementation project.

The increase in the operating income margin in the first quarter of 2005, compared to the first quarter of 2004, is a result of increased spreads realized during the quarter from the segment's aluminum sheet products. Demand was also strong, which allowed the segment to more effectively leverage its fixed costs. The Company's acquisition of TruSeal in the first quarter of 2004 also contributed favorably to the increase in operating income margin, as demand for the additional products and services available as a result of the acquisition continued to grow.

Corporate and Other

	Three Months Ended January 31,			
	2005	2004	Change	%
	(In millions)			
Cost of sales	\$ 0.1	\$ 0.7	\$ (0.6)	(85.7)%
Selling, general and administrative	7.0	3.1	3.9	125.8
Depreciation and amortization	0.1	0.1	—	—
Gain on sale of land	—	(0.4)	0.4	(100.0)
Operating loss	\$ (7.2)	\$ (3.5)	\$ (3.7)	105.7%

Corporate and other operating expenses, which are not in the two operating segments mentioned above, include the consolidated LIFO inventory adjustments (calculated on a combined pool basis), corporate office expenses and inter-segment eliminations. The primary cause for the increase is a combination of increased professional fees incurred as part of the Company's Sarbanes-Oxley implementation project coupled with increased incentives earned as a result of the solid operating results.

Interest expense (on the income statement) for the three months ended January 31, 2005 was \$2.4 million compared to \$0.9 million from the same period a year ago. The increase is a result of the average debt outstanding for the comparative quarters. The first quarter of 2005 had a full quarter of interest associated with the Debentures along with interest on the \$200 million of borrowings on the Bank Agreement to fund the Mikron acquisition.

Other, net (on the income statement) for the three months ended January 31, 2005 was an expense of \$1.9 million compared to income of \$0.4 million in the first quarter of 2004. During the first quarter of 2005, the Company expensed \$2.1 million associated with its Deferred Compensation Plan. Each quarter, the Company values its liability for the Deferred Compensation Plan based upon the value of the underlying investment units. At January 31, 2005, the liability related to the Deferred Compensation Plan was \$2.1 million higher than at October 31, 2004, primarily due to a 56.0% increase in the Company's common stock price from October 31, 2004 to January 31, 2005.

Loss from discontinued operations, net of taxes (on the income statement) for the three months ended January 31, 2005 was \$5.5 million compared to \$0.2 million for the same period a year ago. The first quarter of 2005 includes Piper Impact's \$1.8 million operating loss for the quarter coupled with the losses on the sale of the business and the write-down of the remaining property (see Item 1 "Financial Statements" Note 15).

Outlook

Overall customer demand in the Company's two target markets, vehicular products and building products, is expected to remain robust through fiscal 2005.

Vehicular Products segment – Light vehicle build rates for the second fiscal quarter are expected to remain at healthy levels, albeit down from a year ago, particularly for the domestic producers. However, new programs, ongoing excellent heavy truck demand and the strength in secondary markets including farm and construction equipment, capital goods and defense will keep the segment at high operating rates throughout the second quarter.

Building Products segment – The drivers within the segment remain positive, supported by favorable interest rates and an improving job outlook. The segment will also benefit from very strong organic growth, a more balanced supply/demand aluminum marketplace and the Mikron acquisition.

Taken together, Quanex expects to report record fiscal 2005 diluted earnings per share from continuing operations in the range of \$5.00 per share to \$5.40 per share, a significant improvement over \$2.30 per share for fiscal 2004. For the second quarter, the Company expects diluted earnings per share from continuing operations to be in the range of \$1.40 per share to \$1.50 per share, up from the \$0.43 per share reported in the second quarter of 2004. The Company expects diluted earnings per share to be reduced by about \$0.05 associated with the Debentures premium, which is reflected in the second quarter guidance. The Company estimates that for each \$3.00 increase in its stock price, diluted earnings per share will be reduced by \$0.01 per quarter. Quanex cautions that the combination of short cycle businesses and volatile raw material input costs makes forecasting problematic.

Liquidity and Capital Resources

Sources of Funds

The Company's principal sources of funds are cash on hand, cash flow from operations, and borrowings under its secured Revolving Credit Agreement ("Bank Agreement"). On December 19, 2003, the Company executed an agreement with our credit facility banks to increase the Bank Agreement revolver from \$200 million to \$310 million to provide the funds necessary for acquisitions. On April 9, 2004, the Company requested and received consent from its credit facility bank group to extend the maturity date of its Revolving Credit Agreement from November 15, 2005 to February 28, 2007.

At January 31, 2005, the Company had \$170.0 million borrowed under the Bank Agreement and \$125.0 million outstanding 2.50% Senior Convertible Debentures due May 15, 2034 (the "Debentures"). This represents a \$170.0 million increase from October 31, 2004 borrowing levels, resulting from the Mikron acquisition, completed during the first quarter of 2005.

The Company believes that it has sufficient funds and adequate financial resources available to meet its anticipated liquidity needs. The Company also believes that cash flow from operations, cash balances and available borrowings will be sufficient in the foreseeable future to finance anticipated working capital requirements, capital expenditures, debt service requirements, environmental expenditures, dividends and the stock purchase program.

The Company's working capital was \$159.7 million at January 31, 2005 compared to \$140.1 million at October 31, 2004. The change in working capital was largely a result of having to fund an 87% increase in sales coupled with higher raw material prices. Excluding the addition of Mikron, the strong sales during the quarter resulted in an increase in accounts receivable of \$6.4 million in addition to a \$17.8 million increase in inventory. Accounts payable and accrued liabilities, combined, declined \$17.5 million leading to an additional increase in working capital. Approximately \$12.0 million of the accounts payable decrease is related to the timing of certain payments in relation to the particular day the quarter ended.

Operating Activities

Cash provided by operating activities during the three months ended January 31, 2005 was \$10.4 million compared to \$10.9 million for the same three-month period of 2004. The cash generated by the increase in operating income in the first quarter of 2005 was offset by a reduction of the amount of cash required by working capital accounts compared to the same period of 2004.

Investment Activities

Net cash used for investment activities during the three months ended January 31, 2005 was \$195.1 million compared to \$236.0 million for the same period of 2004. Investment activities for the three months ended January 31, 2005 included the acquisition and related costs for Mikron of \$197.4 million, net of cash acquired. Capital expenditures increased \$4.8 million to \$8.8 million in the three months ended January 31, 2005 from \$4.0 million in the same period of the previous year. This increase was all related to the Building Products segment, primarily due to \$2.5 million of capital expenditures at the recently

acquired Mikron operation coupled with \$0.9 million of increases at the aluminum sheet business and \$1.3 million of additional spending at the Company's window and door component businesses. The Company estimates that fiscal 2005 capital expenditures will be in line with depreciation of approximately \$60 million. At January 31, 2005, the Company had commitments of approximately \$13.8 million for the purchase or construction of capital assets. The Company plans to fund these capital expenditures through cash flow from operations.

Financing Activities

Net cash provided by financing activities for the three months ended January 31, 2005 was \$171.2 million compared to \$213.2 million during the same prior year period. The Company made net borrowings of \$170.0 million on the bank revolver in the first quarter of 2005 compared to borrowings of \$210.0 million against the bank revolver during the same three months of fiscal 2004. Additionally, Quanex received \$4.4 million in the three months ended January 31, 2005 for the issuance of common stock related to the exercise of options, versus \$6.7 million in the same period last year.

The Board of Directors of the Company authorized quarterly dividend increases of \$0.0133 per share and \$0.0083 per share in August 2004 and December 2004, respectively. The dividend increases resulted in dividend payments of \$3.5 million in the first quarter of 2005 compared to \$2.8 million of dividend payments in the same period last year.

Critical Accounting Estimates

The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying footnotes. Estimates and assumptions about future events and their effects cannot be perceived with certainty. Estimates may change as new events occur, as more experience is acquired, as additional information becomes available and as the Company's operating environment changes. Actual results could differ from estimates.

The Company believes the following are the most critical accounting estimates used in the preparation of the Company's consolidated financial statements as well as the significant judgments and uncertainties affecting the application of these estimates.

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Revenue Recognition and Allowance for Doubtful Accounts

The Company recognizes revenue when the products are shipped and the title and risk of ownership pass to the customer. Selling prices are fixed based on purchase orders or contractual agreements. Inherent in the Company's revenue recognition policy is the determination of collectibility. This requires management to make frequent judgments and estimates in order to determine the appropriate amount of allowance needed for doubtful accounts. The Company's allowance for doubtful accounts is estimated to cover the risk of loss related to accounts receivable. This allowance is maintained at a level the Company considers appropriate based on historical and other factors that affect collectibility. These factors include historical trends of write-offs, recoveries and credit losses, the careful monitoring of portfolio credit quality, and projected economic and market conditions. Different assumptions or changes in economic circumstances could result in changes to the allowance.

Inventory

The Company records inventory valued at the lower of cost or market value. Inventory quantities are regularly reviewed and provisions for excess or obsolete inventory are recorded primarily based on the Company's forecast of future demand and market conditions. Significant unanticipated changes to the Company's forecasts could require a change in the provision for excess or obsolete inventory.

Environmental Contingencies

Quanex is subject to extensive laws and regulations concerning the discharge of materials into the environment and the remediation of chemical contamination. To satisfy such requirements, Quanex must make capital and other expenditures on an ongoing basis. The Company accrues its best estimates of its remediation obligations and adjusts such accruals as further information and circumstances develop. Those estimates may change substantially depending on information about the nature and extent of contamination, appropriate remediation technologies, and regulatory approvals. Costs of future expenditures for environmental remediation are not discounted to their present value, unless the amount and timing of the expenditures are fixed or reliably determinable. When environmental laws might be deemed to impose joint and several liability for the costs of responding to contamination, the Company accrues its allocable share of liability taking into account the number of parties participating, their ability to pay their shares, the volumes and nature of the wastes involved, the nature of anticipated response actions, and the nature of the Company's alleged connections. Discovery in future assessments of unanticipated conditions or the establishment of new legal requirements could result in an increase in actual cash required to remediate contamination and in expenses being incurred in future periods.

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Long-Lived Assets

Property, Plant and Equipment

The Company makes judgments and estimates in conjunction with the carrying value of property, plant and equipment, other intangibles, and other assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. Additionally, carrying values of these assets are periodically reviewed for impairment and further reviewed whenever events or changes in circumstances indicate that carrying value may be impaired. The carrying values are compared with the fair value of such assets calculated based on the anticipated future cash flows related to those assets. If the carrying value of a long-lived asset exceeds its fair value, an impairment charge is recorded in the period in which such review is performed. This requires the Company to make long-term forecasts of its future revenues and costs related to the assets subject to review. Forecasts require assumptions about demand for the Company's products and future market conditions. Future events and unanticipated changes to assumptions could require a provision for impairment in a future period.

Goodwill

The purchase method of accounting for business combinations requires the Company to make use of estimates and judgments to allocate the purchase price paid for acquisitions to the fair value of the net tangible and identifiable intangible assets. The Company performs a goodwill impairment test annually as of August 31. In addition, goodwill would be tested more frequently if changes in circumstances or the occurrence of events indicates that a potential impairment exists. The impairment test requires the Company to compare the fair value of business reporting units to carrying value including assigned goodwill. The Company primarily uses the present value of future cash flows to determine fair value and validates the result against the cost and market approaches. Future cash flows are typically based upon a five-year future period for the businesses and an estimated residual value. Management judgment is required in the estimation of future operating results and to determine the appropriate residual values. The residual values are determined from comparable industry transactions. Future operating results and residual values could reasonably differ from the estimates and could require a provision for impairment in a future period.

Income Taxes

The Company records the estimated future tax effects of temporary differences between the tax basis of assets and liabilities and the amounts reported in the Company's consolidated balance sheet, as well as operating loss and tax credit carry forwards. The carrying value of the net deferred tax liability reflects the Company's assumption that the Company will be able to generate sufficient future taxable income in certain jurisdictions to realize its deferred tax assets. If the estimates and assumptions change in the future, the Company may be required to record a valuation allowance against a portion of its deferred tax assets. This could result in additional income tax expense in a future period in the consolidated statement of income.

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Insurance

The Company manages its costs for portions of workers' compensation, group medical, general liability and vehicle liability exposure through a combination of retentions and insurance coverage. The amounts in excess of the retention levels are fully insured by third party insurers. Liabilities associated with the Company's portion of these exposures are estimated in part by considering historical claims experience, severity factors and other assumptions. Projections of future loss expenses are inherently uncertain because of the random nature of insurance claims occurrences and could be significantly affected if future occurrences and claims differ from these assumptions and historical trends.

Retirement and Pension Plans

The Company sponsors a number of defined benefit pension plans and an unfunded postretirement plan that provides health care and life insurance benefits for eligible retirees and dependents. The measurement of liabilities related to these plans is based on management's assumptions related to future events, including expected return on plan assets, rate of compensation increases and health care cost trend rates. The discount rate, which is determined using a model that matches corporate bond securities, is applied against the projected pension and postretirement disbursements. Actual pension plan asset investment performance will either reduce or increase unamortized pension losses at the end of any fiscal year, which ultimately affects future pension costs.

Discontinued Operations

In accordance with Statements of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company presents the results of operations, financial position and cash flows of operations that have either been sold or that meet the criteria for "held for sale accounting" as discontinued operations. At the time an operation qualifies for held for sale accounting, the operation is evaluated to determine whether or not the carrying value exceeds its fair value less cost to sell. Any loss as a result of carrying value in excess of fair value less cost to sell is recorded in the period the operation meets held for sale accounting. Management judgment is required to (1) assess the criteria required to meet held for sale accounting, and (2) estimate fair value. Changes to the operation could cause it to no longer qualify for held for sale accounting and changes to fair value could result in an increase or decrease to previously recognized losses.

New Accounting Pronouncements

In September 2004, the Emerging Issues Task Force ("EITF") reached a consensus on Issue 04-8, "Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effects on Diluted Earnings Per Share," that was then ratified by the Financial Accounting Standards Board ("FASB") in October 2004. The consensus that was reached requires that all instruments that have embedded conversion features that are contingent on market conditions indexed to an issuer's share price should be included in diluted earnings per share computations (if dilutive) regardless of whether the market conditions have been met. The consensus should be applied to reporting periods ending after December 15, 2004. The consensus reached should be applied retroactively to instruments outstanding at the date of adoption of this consensus. The Company adopted the consensus reached by the EITF on Issue 04-8 on January 31, 2005. The adoption of the consensus is not expected to have a material impact on the Company's consolidated financial position or results of operations. See Item 1 "Financial Statements" Note 7 for further discussion of the impact of such adoption.

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In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123R requires companies to measure all employee stock-based compensation awards using a fair value method and record such expense in the Company's consolidated financial statements. The provisions of SFAS No. 123R are effective for the first interim or annual reporting period that begins after June 15, 2005; therefore, Quanex will adopt the new requirements no later than the beginning of the fourth quarter of fiscal 2005. Adoption of the expensing requirements will reduce the Company's reported earnings. Management is currently evaluating the specific impacts of adoption, which include whether the Company should adopt the requirements on a retrospective basis and which valuation model is most appropriate.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The following discussion of the Company and its subsidiaries' exposure to various market risks contains "forward looking statements" that involve risks and uncertainties. These projected results have been prepared utilizing certain assumptions considered reasonable in light of information currently available to the Company. Nevertheless, because of the inherent unpredictability of interest rates, foreign currency rates and metal commodity prices as well as

other factors, actual results could differ materially from those projected in such forward looking information. The Company does not use derivative financial instruments for speculative or trading purposes.

Interest Rate Risk

The Company and its subsidiaries have a Bank Agreement and other long-term debt which subject the Company to the risk of loss associated with movements in market interest rates. The Company and certain of its subsidiaries' floating-rate obligations total \$179.1 million or 58.1% of total debt at January 31, 2005.

At January 31, 2005, the Company had fixed-rate debt totaling \$129.0 million or 41.9% of total debt, which does not expose the Company to the risk of earnings loss due to changes in market interest rates. The aggregate availability under the Bank Agreement was \$124.2 million at January 31, 2005, which is net of \$15.8 million of outstanding letters of credit. Based on the outstanding balance of the Bank Agreement of \$170.0 million at January 31, 2005, a one percent increase or decrease in the average interest rate would result in a change to pre-tax interest expense of approximately \$1.7 million on an annualized basis.

Commodity Price Risk

The Vehicular Products segment has a scrap surcharge program in place, which is a practice that is well established within the engineered steel bar industry. The scrap surcharge is based on a three city, three month trailing average of #1 bundle scrap prices. The Company's long-term exposure to changes in scrap prices is significantly reduced because of the surcharge program. Over time, the Company recovers the majority of its scrap cost increases, though there is a level of exposure to short-term volatility because of the three month lag.

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Within the Building Products segment, the Company uses various grades of aluminum scrap as well as minimal amounts of prime aluminum ingot as raw materials for its manufacturing process. The price of this aluminum raw material is subject to fluctuations due to many factors in the aluminum market. In the normal course of business, Nichols Aluminum enters into firm price sales commitments with its customers. In an effort to reduce the risk of fluctuating raw material prices, the Company enters into firm price raw material purchase commitments (which are designated as "normal purchases" under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities") as well as option contracts on the London Metal Exchange ("LME"). The Company's risk management policy as it relates to these LME contracts is to enter into contracts to cover the raw material needs of the Company's committed sales orders, net of fixed price purchase commitments.

Through the use of firm price raw material purchase commitments and LME contracts, the Company intends to protect cost of sales from the effects of changing prices of aluminum. To the extent that the raw material costs factored into the firm price sales commitments are matched with firm price raw material purchase commitments, changes in aluminum prices should have no effect. During the first quarter of 2005, the Company primarily relied upon firm price raw material purchase commitments to protect cost of sales tied to firm price sales commitments. There were no outstanding LME hedges as of January 31, 2005.

Item 4. Controls and Procedures

As of the end of the period covered by this report, Quanex management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this quarterly report has been made known to them in a timely fashion. There have been no significant changes in internal controls, or in factors that could significantly affect internal controls, subsequent to the date the Chief Executive Officer and Chief Financial Officer completed their evaluation.

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PART II. OTHER INFORMATION

Item 6. Exhibits

Exhibit Number	Description Of Exhibits
3.1	Restated Certificate of Incorporation of the Registrant dated as of November 10, 1995, filed as Exhibit 3.1 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1995 and incorporated herein by reference.
3.2	Certificate of Amendment to Restated Certificate of Incorporation of the Registrant dated as of February 27, 1997, filed as Exhibit 3.2 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1999 and incorporated herein by reference.
3.3	Amendment to Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Registrant dated as of April 15, 1999, filed as Exhibit 3.3 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1999 and incorporated herein by reference.
3.4	Certificate of Correction of Amendment to Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock dated as of April 16, 1999, filed as Exhibit 3.4 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1999 and incorporated herein by reference.
3.5	Amended and Restated Bylaws of the Registrant, as amended through August 26, 1999 filed as Exhibit 3 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the fiscal quarter ended July 31, 1999, and incorporated herein by reference.

- 4.1 Form of Registrant's Common Stock certificate, filed as Exhibit 4.1 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended April 30, 1987, and incorporated herein by reference.
- 4.2 Revolving Credit Agreement dated as of November 26, 2002, by and among Quanex Corporation, the financial institutions from time to time signatory thereto and Comerica Bank, as agent for the banks filed as Exhibit 4.4 to the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) dated October 31, 2002. Certain schedules and exhibits to this Revolving Credit Agreement were not filed with this exhibit. The Company agrees to furnish supplementally any omitted schedule or exhibit to the SEC upon request.
- 4.3 First Amendment to Security Agreement, dated February 17, 2003, effective November 26, 2002, filed as Exhibit 4.5 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) dated April 30, 2003.
- 4.4 Consent and First Amendment to Revolving Credit Agreement dated December 19, 2003, by and among Quanex Corporation, the financial institutions from time to time signatory thereto and Comerica Bank, as agent for the banks filed as Exhibit 4.5 to the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) dated October 31, 2003. Certain schedules and exhibits to this Consent and First Amendment to Revolving Credit Agreement have not been filed with this exhibit. The Company agrees to furnish supplementally any omitted schedule or exhibit to the SEC upon request.

Exhibit Number	Description Of Exhibits
4.5	Waiver and Second Amendment to Revolving Credit Agreement dated March 11, 2004, by and among Quanex Corporation, the financial institutions from time to time signatory thereto and Comerica Bank, as agent for the banks filed as Exhibit 4.6 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) dated January 31, 2004.
4.6	Form of Consent to Requested Extension to Revolving Credit Maturity Date under the Quanex Corporation Revolving Credit Agreement dated April 7, 2004, filed as Exhibit 4.7 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) dated April 30, 2004.
4.7	Form of Consent and Third Amendment to Revolving Credit Agreement dated April 9, 2004, by and among Quanex Corporation, the financial institutions from time to time signatory thereto and Comerica Bank, as agent for the banks, filed as Exhibit 4.8 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) dated April 30, 2004.
4.8	Indenture dated as of May 5, 2004 between Quanex Corporation and Union Bank of California, N.A. as trustee relating to the Company's 2.50% Convertible Senior Debentures due May 15, 2034, filed as Exhibit 4.9 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) dated April 30, 2004.
4.9	Registration Rights Agreement dated as of May 5, 2004 among Quanex Corporation, Credit Suisse First Boston LLC, Bear, Stearns & Co. Inc., Robert W. Baird & Co. Incorporated, and KeyBanc Capital Markets relating to the Company's 2.50% Convertible Senior Debentures due May 15, 2034, filed as Exhibit 4.10 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) dated April 30, 2004.
4.10	Third Amended and Restated Rights Agreement dated as of September 15, 2004, between the Registrant and Wells Fargo Bank, N.A. as Rights Agent, filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K (Reg. No. 001-05725) dated September 17, 2004, and incorporated herein by reference.
4.11	Form of Consent and Fourth Amendment to Revolving Credit Agreement dated November 18, 2004 by and among Quanex Corporation, the financial institutions from time to time signatory thereto and Comerica Bank, as agent for the banks, filed as Exhibit 4.11 to the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) dated December 21, 2004.
* 4.12	Fifth Amendment to Revolving Credit Agreement dated March 11, 2005 by and among Quanex Corporation, the financial institutions from time to time signatory thereto and Comerica Bank, as agent for the banks.
*† 10.1	Amendment to Letter Agreement between Quanex Corporation and Raymond A. Jean, dated December 1, 2004.
*† 10.2	Amended and Restated Quanex Corporation Executive Incentive Compensation Plan, effective December 2, 2004.
*† 10.3	Quanex Corporation Long Term Incentive Plan, as amended December 2, 2004.
* 10.4	Third Amendment to the Piper Impact 401(k) Plan, effective January 24, 2005.
*† 10.5	Form of Restricted Stock Award Agreement for Directors under the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan.
*† 10.6	Form of Restricted Stock Award Agreement for Officers under the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan.
*† 10.7	Form of Nonqualified Stock Option Agreement for Officers under the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan.
*† 10.8	Form of Nonqualified Stock Option Agreement for New Directors under the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan.

Exhibit Number	Description Of Exhibits
*† 10.9	Form of Nonqualified Stock Option Agreement for annual grants to Directors under the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan.
* 31.1	Certification by chief executive officer pursuant to Rule 13a-14(a)/15d-14(a).
* 31.2	Certification by chief financial officer pursuant to Rule 13a-14(a)/15d-14(a).
* 32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

† Management Compensation or Incentive Plan
* Filed herewith

As permitted by Item 601(b)(4)(iii)(A) of Regulation S-K, the Registrant has not filed with this Quarterly Report on Form 10-Q certain instruments defining the rights of holders of long-term debt of the Registrant and its subsidiaries because the total amount of securities authorized under any of such instruments does not exceed 10% of the total assets of the Registrant and its subsidiaries on a consolidated basis. The Registrant agrees to furnish a copy of any such agreements to the Securities and Exchange Commission upon request.

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.

QUANEX CORPORATION

Date: March 11, 2005

/s/ Terry M. Murphy
Terry M. Murphy
Vice President – Finance and Chief Financial Officer
(Principal Financial Officer)

Date: March 11, 2005

/s/ Brent L. Korb
Brent L. Korb
Vice President – Corporate Controller
(Principal Accounting Officer)

March 11, 2005

QUANEX CORPORATION
Suite 1500
1900 West Loop South
Houston, Texas 77027

Re: Fifth Amendment ("Fifth Amendment") under the Quanex Corporation Revolving Credit Agreement dated as of November 26, 2002 (as amended, the "Credit Agreement") by and among Quanex Corporation ("Company"), Comerica Bank and such other financial institutions which are or may from time to time become parties to the Credit Agreement (the "Banks"), and Comerica Bank in its capacity as Agent for the Banks ("Agent")

Ladies and Gentlemen:

Reference is made to the Credit Agreement. Except as specifically defined to the contrary herein, capitalized terms used in this Fifth Amendment shall have the meanings given them in the Credit Agreement. This Fifth Amendment shall not become effective unless and until countersigned by the Company and returned to the Agent.

Based on the Agent's receipt of the approval of the requisite Banks and subject to the terms and conditions of this letter, this letter will confirm that the Banks hereby consent to the amendment of the definition of Net Income Adjustment by deleting the definition of "Net Income Adjustment" as it is set forth therein and inserting the following language in its place:

"Net Income Adjustment" shall mean that amount to be added to the minimum Consolidated Tangible Net Worth required to be maintained under Section 6.10 hereof for any fiscal quarter, consisting of an amount equal to fifty percent (50%) of the Consolidated Net Income of the Company and its Subsidiaries (but only if a positive number) for any fiscal quarter without any deductions or adjustments for losses, commencing with the fiscal quarter ending January 31, 2005."

Except as set forth in this Fifth Amendment, this Fifth Amendment shall not be deemed to amend or alter in any respect the terms and conditions of the Credit Agreement, any of the Notes issued thereunder, or any of the other Loan Documents, or to constitute a waiver by Agent or any Bank of any right or remedy under the Credit Agreement, any of the Notes issued thereunder or any of the other Loan Documents. Nor shall this Fifth Amendment constitute an undertaking or agreement by any Bank to increase the stated dollar amount of its existing commitment under the Credit Agreement. By accepting and acknowledging this Fifth Amendment, the Company shall be deemed to have ratified and reaffirmed all the terms, conditions, covenants and agreement contained in the Credit Agreement, as amended (including by this Fifth Amendment) and each of the other Loan Documents. Simultaneously with its execution and delivery of this Fifth Amendment, the Company agrees to provide the Banks with a closing certificate in form and substance acceptable to Agent and an Acknowledgment of Guarantors in the form attached hereto as Exhibit A.

By signing and returning a counterpart of this letter to the Agent, the Company acknowledges its acceptance of the terms of this letter.

Very truly yours,

COMERICA BANK, as Agent

By: _____

Its: _____

Acknowledged and Accepted
as of March 11, 2005

QUANEX CORPORATION

By: _____

Its: _____

AUTHORIZATION AND CONSENT

The undersigned Bank hereby consents to the amendment of Section 1 of the Credit Agreement on the terms and conditions set forth above, and authorizes the Agent to issue the foregoing Fifth Amendment to the Company.

[BANK]

By: _____
Name:

Its: _____

Date: March 11, 2005

Exhibit A

ACKNOWLEDGMENT OF GUARANTORS

Being a duly authorized officer of each of the undersigned (each a "Guarantor" and collectively, the "Guarantors"), the undersigned hereby acknowledge that (a) the Guarantors executed or joined into that certain Guaranty dated as of December 10, 2002 ("Guaranty") pursuant to which Guarantors guaranteed the obligations of Quanax Corporation (the "Company") under that certain Quanax Corporation Revolving Credit Agreement dated as of November 26, 2002 (as amended, the "Credit Agreement") by and among the Company, the certain financial institutions party from time to time thereto ("Banks") and Comerica Bank as agent for the Banks (the "Agent") and (b) the Company, the Banks and the Agent have executed the Fifth Amendment to the Credit Agreement dated as of date hereof (the "Amendment"). The undersigned hereby ratifies and confirms its obligations under the Guaranty and agrees that the Guaranty remains in full force and effect after giving effect to the Amendment. Capitalized terms not otherwise defined herein will have the meanings given in the Credit Agreement. This acknowledgment shall be governed by and construed in accordance with the laws of, and be enforceable in, the State of Michigan.

Dated as of the 11th day of March, 2005

IN WITNESS WHEREOF, each of the undersigned Guarantors has executed this Acknowledgment as of the date first above written.

NICHOLS ALUMINUM ALABAMA, INC.

By: _____

Its: _____

Tax Id No.: 63-1105530

IMPERIAL PRODUCTS, INC.

By: _____

Its: _____

Tax Id No.: 35-2028183

TEMROC METALS, INC.

By: _____

Its: _____

Tax Id No.: 41-0875485

COLONIAL CRAFT, INC.

By: _____

Its: _____

Tax Id No.: 76-0589066

QUANEX BAR, INC.

By: _____

Its: _____

Tax Id No.: 76-0331473

TRUSEAL TECHNOLOGIES, INC.

By: _____

Its: _____

Tax Id No.: 31-1534702

MACSTEEL MONROE, INC.

By: _____

Its: _____

Tax Id. No.: 76-0589069



December 1, 2004

Mr. Raymond A. Jean
5014 Cedar Creek
Houston TX 77056

Dear Ray:

The purpose of this letter is to amend the severance provision of your Employment Agreement dated February 14, 2001. Section 14 of your Employment Agreement outlines the severance terms in the event of your termination for a reason other than an "Event of Termination for Cause" as defined in your Change in Control Agreement. For the sole purpose of determining your qualifications for severance from Quanex Corporation, the following is added to the definitional terms for "Event of Termination for Cause" as outlined in Section 4 of your Change in Control Agreement:

(vi) a material violation of the Company's Code of Business Conduct & Ethics.

All other terms and conditions of your Employment Agreement remain the same.

Best regards,

/s/ Vincent R. Scorsone

Vincent R. Scorsone, Chairman
Compensation & Management Development Committee
Quanex Corporation Board of Directors

ACCEPTANCE OF TERMS OF AMENDED EMPLOYMENT AGREEMENT

/s/ Raymond A. Jean
Raymond A. Jean

12/10/04
Date

Quanex Corporation
1900 West Loop South, Suite 1500 • Houston, Texas 77027
713/961-4600 • 713/629-0113 Fax
www.quanex.com

QUANEX CORPORATION

EXECUTIVE INCENTIVE COMPENSATION PLAN

Amended and Restated
Effective December 2, 2004

ARTICLE I
ESTABLISHMENT AND PURPOSE

1.1 Establishment of the Plan. Quanex Corporation previously established an incentive compensation plan for executives as herein set forth, which shall be known as the Quanex Corporation Executive Incentive Compensation Plan (the "Plan") effective as of November 1, 1981. The Board of Directors of Quanex Corporation amended the Plan effective for Awards granted under the Plan on and after December 2, 2004.

1.2 Purpose. The purpose of the Plan is to provide executives of the Company with competitive levels of total compensation and incentive earning opportunities commensurate with results achieved and individual performance.

ARTICLE II
DEFINITIONS

2.1 Company. "Company" means Quanex Corporation and any successor. In addition, the term "Company" shall include any other corporation in which Quanex Corporation owns more than 50% of the outstanding voting stock and adopts this Plan.

2.2 Committee. "Committee" means those directors appointed by the Board of Directors to administer this Plan.

2.3 Consolidated Financial Statements. "Consolidated Financial Statements" means for each year, the consolidated balance sheet, statement of earnings, and shareholders' equity prepared by the independent certified public accountants engaged by the Company's Board of Directors to audit the financial statements of the Company, as set forth and certified in the annual report to stockholders of the Company.

2.4 Corporate Performance Goal. "Corporate Performance Goal" means the level of EBITDA/Sales, Group EBITDA/Sales, Group Return on Controllable Investment, Return on Equity and Return on Investment for the Plan Year, approved annually by the Committee. The Committee, in its discretion, may select other Corporate Performance Goals provided such goals are set forth in writing and approved no later than 60 days after the beginning of the Plan Year for which such goals are to apply.

2.5 EBITDA/Sales. "EBITDA/Sales" for any Plan Year means the Company's annual operating income plus depreciation and amortization divided by net sales for such year.

2.6 Group EBITDA/Sales. "Group EBITDA/Sales" for any Plan Year for a business group of the Company selected by the Committee means the annual operating income of such business group plus depreciation and amortization for such group divided by net sales for such group for such year.

2.7 Group Return on Controllable Investment. "Group Return on Controllable Investment" for a business group of the Company selected by the Committee for any Plan Year means Group annual operating income plus depreciation and amortization less the capital use charge on working capital imposed by the Company on the group, less taxes thereon at the effective tax rate for such Group for such Plan Year, divided by equity and non-current liabilities attributable to such group.

2.8 Incentive Award. "Incentive Award" means the amount due a Participant in accordance with Article IV of this Plan.

2.9 Individual Incentive Target. "Individual Incentive Target" means the anticipated Incentive Award to be paid to a Participant in the event the Corporate Performance Goals assigned to such Participant are met and the individual performance of the Participant is fully proficient and satisfactory. Individual Incentive Targets shall be a percentage of Salary as determined by the Committee and the Committee may assign such weight to each of a Participant's Corporate Performance Goals for purposes of determining whether an Individual Incentive Target is met as the Committee, in its sole discretion, shall determine.

2.10 Participant. "Participant" means an employee of the Company selected by the Committee to be considered for an Incentive Award under this Plan. The mere selection as a Participant shall not convey any rights as to the eventual receipt of an award.

2.11 Plan. "Plan" means the Quanex Corporation Executive Incentive Compensation Plan.

2.12 Plan Year. "Plan Year" means the period from November 1 to October 31 each year.

2.13 Return on Equity. "Return on Equity" for any Plan Year means the annual net income of the Company less preferred dividends divided by average common shareholders' equity. For purposes hereof average common shareholders' equity shall be the sum of common equity as of the beginning of each fiscal quarter of the Plan Year and as of the end of the Plan Year divided by five.

2.14 Return on Investment. "Return on Investment" for any Plan Year means the annual net income of the Company plus interest expense (net of the income tax benefit thereof at the effective tax rate of the Company for such Plan Year) divided by total investment. For purposes hereof total investment shall be the sum of shareholders' equity plus long term debt as of the beginning of each fiscal quarter of the Plan Year and as of the end of the Plan Year divided by five.

2.15 Salary. "Salary" means the amounts paid by the Company to a Participant during the Plan Year as regular compensation for services, exclusive of bonuses, awards, reimbursement

of expenses and all indirect payments or other additional amounts paid or credited to or on behalf of the Participant by the Company.

In determining any Corporate Performance Goal, the Committee, in its sole discretion, may exclude from long-term debt that part of the debt which the Committee considers not available for production of earnings and may adjust annual operating income and expenses for those items the Committee deems extraordinary, unusual or infrequent and for changes in accounting standards. In addition, the Committee, in its discretion, may determine that portions of long-term debt and additional equity arising from a public offering of the capital stock of the Company are to be phased into the debt and equity accounts over a period of time, not exceeding 36 months, as the Committee shall determine appropriate, giving consideration to the fact that the debt and equity may not be available, or may be only partially available for production of earnings.

ARTICLE III ELIGIBILITY AND PARTICIPATION

3.1 Eligibility and Participation. Eligibility for participation in the Plan will be limited to those key executive personnel who, by the nature and scope of their position, regularly and directly make or influence policy decisions which significantly impact the overall results or success of the Company.

3.2 Participation. Participants will be selected by the Committee not later than the beginning of each Plan Year. Each person selected to be a Participant will be notified in writing. The notice shall inform the Participant of his selection and of the Corporate Performance Goals established for the Plan Year and the Individual Incentive Targets for the Participant.

3.3 Cessation of Participants. The Committee may withdraw its approval of an executive's participation at any time during the Plan Year.

ARTICLE IV AWARD DETERMINATION

4.1 Assignment of Individual Incentive Targets. Each year the Committee will assign an Individual Incentive Target for each Participant. This Individual Incentive Target will be expressed as a percentage of the Participant's Salary. The Committee shall have the power to adjust Individual Incentive Targets at any time during the Plan Year.

4.2 Corporate Performance Goals. Prior to the beginning of each Plan Year the Committee will establish Corporate Performance Goals for each Participant that, if no adjustment were made for individual Participant's performance, would result in 100% of the Individual Incentive Target being earned. In addition, the Committee will establish for each Plan Year levels of Corporate Performance Goals for each Participant that, if no adjustment were made for individual Participant's performance, would result in amounts greater or lesser than the Individual Incentive Target being earned.

To establish the Corporate Performance Goals for each Participant for each Plan Year, the Committee will use any information it considers relevant regarding the likely

performance of the Company. The Corporate Performance Goals, together with related schedules, will be communicated to Participants as soon as practicable following its determination by the Committee.

4.3 Award Determination. As soon as possible after the end of the Plan Year, the Committee shall determine the Incentive Award payable to each Participant on the basis of the Corporate Performance Goals achieved based on the Consolidated Financial Statements for the Plan Year. The Incentive Award so determined shall be subject to adjustment to reflect individual performance in accordance with Section 4.4.

4.4 Individual Performance Adjustments. The Committee shall have the power to adjust awards as determined under Section 4.3, to reflect the individual performance of the Participant or to better relate the Incentive Award to the performance of the Company or to one of the business groups. In making adjustments to reflect excellent or superior individual performance the Committee is only limited by the maximum Incentive Award that can be earned by the Participant.

4.5 Participation in Other Incentive Plans. Notwithstanding the preceding, for each Participant who is also a Participant under another incentive compensation plan of the Company, the Committee may specify that incentive compensation shall be based on the compensation payable under the other plan to the maximum amount payable under that plan and additional incentive compensation shall be payable to the Participant under the provisions of this Plan only to the extent that compensation under this Plan would exceed compensation under the other plan.

4.6 Maximum Individual Awards. The Committee shall determine for each Participant a maximum Incentive Award that can be earned for each Plan Year, expressed as a percentage of the Participant's Salary. The maximum Incentive Award cannot be exceeded regardless of the level of corporate and individual performance achieved.

ARTICLE V FORM AND TIMING OF AWARDS

5.1 Payment of Individual Awards. Except as provided in Section 5.2, Incentive Awards to be paid to Participants in accordance with the provisions of Article IV shall be paid in cash as soon as practicable following the release of the Company's Consolidated Financial Statements for the Plan Year.

5.2 Participant Election to Defer Payments. For each Plan Year, a Participant may elect to defer all or any part of the Incentive Award which may be earned under this Plan, and otherwise become payable to the Participant. That election to defer shall be made in accordance with the Quanex Corporation Deferred Compensation Plan. If the Participant fails to make an election to defer a part or all of his Incentive Award and the payment of a part or all of the Incentive Award would cause the Company to lose a part or all of its deduction because of Section 162(m) of the Code, the payment of the Incentive

**ARTICLE VI
TERMINATION OF EMPLOYMENT**

In the event that the Company finds, after full consideration of the facts presented on behalf of both the Company and a Participant, that the Participant was discharged by the Company for a material violation of the Company's Code of Business Conduct & Ethics, fraud, embezzlement, theft, commission of a felony, proven dishonesty in the course of his/her employment by the Company, for any other reason for cause, or for disclosing trade secrets of the Company, the right of the Participant to receive an Incentive Award under the Plan with respect to the Plan Year during which the termination occurred shall be forfeited. Further, if the Company finds, after full consideration of the facts presented on behalf of both the Company and a Participant, that a Participant had actual and direct knowledge of a material violation of the Company's Code of Business Conduct & Ethics and failed to report it, a portion or the entire amount of his/her Incentive Award may be forfeited. The decision of the Company as to the cause of a Participant's discharge and/or forfeiture for cause of any award may be appealed to the Nominating and Governance Committee of the Board for consideration and final determination. In the event the employment of a Participant is terminated for any reason other than for cause, the Participant or his or her other beneficiaries shall be entitled to receive a prorated Incentive Award for the portion of the Plan Year prior to his or her termination of employment

**ARTICLE VII
DESIGNATION OF BENEFICIARIES**

A Participant shall designate a Beneficiary or Beneficiaries who are to receive upon his death the distributions that otherwise would have been paid to the Participant. All designations shall be in writing and shall be effective only if and when delivered to the Committee during the lifetime of the Participant. If a Participant designates a Beneficiary without providing in the designation that the Beneficiary must be living at the time of each distribution, the designation shall vest in the Beneficiary all of the distributions whether payable before or after the Beneficiary's death, and any distributions remaining upon the Beneficiary's death shall be made to the Beneficiary's estate. A Participant may, from time to time, during his lifetime, change his Beneficiary or Beneficiaries by a written instrument delivered to the Committee. In the event a Participant does not designate a Beneficiary or Beneficiaries, or if for any reason the designation is ineffective, in whole or in part, the distribution that otherwise would have been paid to the Participant shall be paid to his estate and in that event the term "Beneficiary" shall include his estate.

Once an Incentive Award is held under the terms of the Quanex Corporation Deferred Compensation, the designation of Beneficiaries shall become controlled by its terms and any designation of a Beneficiary under this Plan will become ineffective.

**ARTICLE VIII
ADMINISTRATION**

8.1 Committee Appointment. The Committee will be appointed by the Board of Directors from their members who are not salaried officers of the Company and are not eligible

to participate in the Plan. Each Committee member will serve until his or her resignation or removal. The Board of Directors will have the sole discretion to remove any one or more Committee members and appoint one or more replacement or additional Committee members from time to time.

8.2 Committee Organization and Voting. The Committee will select from among its members a chairman who will preside at all of its meetings and will elect a secretary without regard to whether that person is a member of the Committee. The secretary will keep all records, documents and data pertaining to the Committee's supervision and administration of the Plan. A majority of the members of the Committee will constitute a quorum for the transaction of business and the vote of a majority of the members present at any meeting will decide any question brought before the meeting. In addition, the Committee may decide any question by vote, taken without a meeting, of a majority of its members.

8.3 Powers of the Committee. The Committee will have the exclusive responsibility for the general administration of the Plan according to the terms and provisions of the Plan and will have all powers necessary to accomplish those purposes, including but not by way of limitation the right, power and authority:

- (a) to make rules and regulations for the administration of the Plan;
- (b) to construe all terms, provisions, conditions and limitations of the Plan;
- (c) to correct any defect, supply any omission or reconcile any inconsistency that may appear in the Plan;
- (d) to designate the persons eligible to become Participants and to establish the Corporate Performance Goal, and the Individual Incentive Target for each Participant, a maximum for each Incentive Award, and all other matters necessary to make this Plan operative;
- (e) to determine all controversies relating to the administration of the Plan, including but not limited to:
 - (i) differences of opinion arising between the Company and a Participant; and
 - (ii) any question it deems advisable to determine in order to administer the Plan; and
- (f) to delegate by written notice those clerical and recordation duties of the Committee, as it deems necessary or advisable for the proper and efficient administration of the Plan.

8.4 Committee Discretion. The Committee in exercising any power or authority granted under this Plan or in making any determination under this Plan shall perform or refrain from performing those acts using its sole discretion and judgment. Any decision made by the

Committee or any refraining to act or any act taken by the Committee in good faith shall be final and binding on all parties. The Committee's decision shall never be subject to de novo review.

8.5 Reimbursement of Expenses. The Committee will serve without compensation for their services but will be reimbursed by the Company for all expenses properly and actually incurred in the performance of their duties under the Plan.

ARTICLE IX ADOPTION BY SUBSIDIARIES

9.1 Procedure for and Status After Adoption. Any subsidiary corporation in which Quanex Corporation owns more than 50% of the outstanding voting stock may, with the approval of the Committee, adopt this Plan by appropriate action of its board of directors. The terms of the Plan will apply separately to each Company adopting the Plan and its Participants in the same manner as is expressly provided for Quanex Corporation and its Participants except that the powers of the Board of Directors and the Committee under the Plan will be exercised by the Board of Directors of Quanex Corporation alone. Each Company will bear the cost of providing Plan benefits for its own Participants. It is intended that the obligation of each Company with respect to its Participants will be the sole obligation of the Company that is employing the Participant and will not bind any other Company.

9.2 Termination of Participation By Adopting Company. Any Company adopting the Plan may, by appropriate action of its board of directors, terminate its participation in the Plan. The Committee may, in its discretion, also terminate a Company's participation in the Plan at any time.

ARTICLE X AMENDMENT AND/OR TERMINATION

10.1 Amendment and/or Termination. The Committee, in its sole discretion, without notice, at any time and from time to time, may modify or amend, in whole or in part, any or all of the provisions of this Plan, or suspend or terminate it entirely.

10.2 No Retroactive Effect. No modification, amendment, suspension, or termination, may without the consent of a Participant (or his Beneficiary in the case of the death of the Participant) reduce the right of a Participant (or his Beneficiary as the case may be) to a payment or distribution under this Plan to which he is entitled in accordance with the provisions contained in Article IV of this Plan.

ARTICLE XI MERGER, CONSOLIDATION, AND SALE OF ASSETS

Notwithstanding anything in this Plan to the contrary, in the event that the Company consolidates with, merges into, or transfers all or substantially all of its assets to another corporation, the obligations of the Company under this Plan shall be binding on that corporation or other entity.

ARTICLE XII MISCELLANEOUS

12.1 Limitation of Rights. Nothing in this Plan will be construed:

- (a) to give any employee of any Company any right to be designated a Participant in the Plan;
- (b) to give a Participant any right with respect to the Incentive Award except in accordance with the terms of this Plan;
- (c) to limit in any way the right of the Company to terminate a Participant's employment with the Company at any time;
- (d) to evidence any agreement or understanding, expressed or implied, that the Company will employ a Participant in any particular position or for any particular remuneration; or
- (e) to give a Participant or any other person claiming through him any interest or right under this Plan other than that of any unsecured general creditor of the Company.

12.2 Distributions to Incompetents or Minors. Should a Participant become incompetent or should a Participant designate a Beneficiary who is a minor or incompetent, the Committee is authorized to pay the funds due to the parent of the minor or to the guardian of the minor or incompetent or directly to the minor or to apply those funds for the benefit of the minor or incompetent in any manner the Committee determines in its sole discretion.

12.3 Nonalienation of Benefits. No right or benefit provided in this Plan will be transferable by the Participant except, upon his death, to a named Beneficiary as provided in this Plan. No right or benefit under this Plan will be subject to anticipation, alienation, sale, assignment, pledge, encumbrance or charge, and any attempt to anticipate, alienate, sell, assign, pledge, encumber, or charge the same will be void. No right or benefit under this Plan will in any manner be liable for or subject to any debts, contracts, liabilities or torts of the person entitled to such benefits. If any Participant or any Beneficiary becomes bankrupt or attempts to anticipate, alienate, sell, assign, pledge, encumber or charge any right or benefit under this Plan, that right or benefit will, in the discretion of the Committee, cease. In that event, the Committee may have the Company hold or apply the right or benefit or any part of it to the benefit of the Participant or Beneficiary, his or her spouse, children or other dependents or any of them in any manner and in any proportion the Committee believes to be proper in its sole and absolute discretion, but is not required to do so.

12.4 Reliance Upon Information. The Committee will not be liable for any decision or action taken or not taken in good faith in connection with the administration of this Plan. Without limiting the generality of the foregoing, any decision or action taken or not taken by the Committee when it relies upon information supplied it by any officer of the Company, the Company's legal counsel, the Company's independent accountants or other advisors in connection with the administration of this Plan will be deemed to have been taken in good faith.

12.5 Severability. If any term, provision, covenant or condition of the Plan is held to be invalid, void or otherwise unenforceable, the rest of the Plan will remain in full force and effect and will in no way be affected, impaired or invalidated.

12.6 Notice. Any notice or filing required or permitted to be given to the Committee or a Participant will be sufficient if in writing and hand delivered or sent by U.S. mail to the principal office of the Company or to the residential mailing address of the Participant. Notice will be deemed to be given as of the date of hand delivery or if delivery is by mail, as of the date shown on the postmark.

12.7 Gender and Number. If the context requires it, words of one gender when used in this Plan will include the other genders, and words used in the singular or plural will include the other.

12.8 Governing Law. The Plan will be construed, administered and governed in all respects by the laws of the State of Texas.

12.9 Effective Date. This amendment and restatement of the Plan will be operative and effective on December 2, 2004.

QUANEX CORPORATION
LONG-TERM INCENTIVE PLAN

Amended December 2, 2004

QUANEX CORPORATION
LONG-TERM INCENTIVE PLAN

WHEREAS, Quanex Corporation, A Delaware corporation (“Quanex”), desires to establish the Quanex Corporation Long-Term Incentive Plan (the “Plan”) to advance the best interests of Quanex by providing key executives of Quanex who have substantial responsibility for the management and growth of Quanex an additional incentive to remain in the employ of Quanex and to contribute materially to the continued growth, development and financial success of Quanex; and

WHEREAS, it is intended that the Plan shall constitute a bonus program within the meaning of Department of Labor Regulation section 2510.3-2(c) that is exempt from coverage under the Employee Retirement Income Security Act of 1974, as amended; and

WHEREAS, the Board of Directors of Quanex desires to amend the Plan;

NOW, THEREFORE, the Plan is amended with respect to Performance Awards granted under the Plan on and after December 2, 2004 as follows:

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ARTICLE I

PLAN PURPOSE AND TERM

1.1 **Purpose.** The Plan is intended to provide those executives who have substantial responsibility for the management and growth of Quanex with additional incentives to remain in the employ of Quanex and to contribute materially to the continued growth, development and financial success of Quanex.

1.2 **Term of Plan.** The Plan is effective November 1, 2001. The Plan shall remain in effect until all amounts due under the terms of the Plan have been paid.

ARTICLE II

DEFINITIONS

The words and phrases defined in this Article shall have the meaning set out in these definitions throughout the Plan, unless the context in which any such word or phrase appears reasonably requires a broader, narrower, or different meaning.

2.1 **“Affiliate”** means an entity that is treated as a single employer together with Quanex for certain employee benefit purposes under section 414 of the Code.

2.2 **“Award Agreement”** means the written agreement between Quanex and a Grantee that sets forth the terms of a Performance Award.

2.3 **“Board”** means the board of directors of Quanex.

2.4 **“Cause”** means (a) the willful and continued failure by the Grantee to substantially perform his duties with Quanex or its Affiliates (other than such failure resulting from his incapacity due to physical or mental illness) after demand for substantial performance is delivered to him by Quanex which specifically identifies the manner in which Quanex believes the Grantee has not substantially performed his duties; (b) the willful engaging by the Grantee in gross misconduct materially and demonstrably injurious to the property or business of Quanex or any of its Affiliates; or (c) the willful material violation of any Quanex policies regarding the protection of confidential and/or proprietary information or the material violation of any non-compete agreement between the Grantee and Quanex. For purposes of this definition, no act or failure to act on the Grantee’s part will be considered willful unless done or omitted to be done, by him not in good faith and without reasonable belief that his action or omission was in the best interests of Quanex or its Affiliates or not opposed to the interests of Quanex or its Affiliates.

2.5 **“Change of Control”** means the occurrence of one or more of the following events after November 1, 2001:

(a) the acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act) (a “Covered Person”) of beneficial ownership (within the meaning of rule 13d-3 promulgated under the Exchange Act) of 20 percent or more of either

(i) the then outstanding shares of the common stock of Quanex (the “Outstanding Quanex Common Stock”), or (ii) the combined voting power of the then outstanding voting securities of Quanex entitled to vote generally in the election of directors (the “Outstanding Quanex Voting Securities”); *provided, however*, that for purposes of this subsection (a) of this Section, the following acquisitions shall not constitute a Change of Control of Quanex: (i) any acquisition directly from Quanex, (ii) any acquisition by Quanex, (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by Quanex or any entity controlled by Quanex, or (iv) any acquisition by any corporation pursuant to a transaction which complies with clauses (i), (ii) and (iii) of subsection (c) of this Section;

(b) individuals who, as of November 1, 2001, constitute the Board (the “Incumbent Board”) cease for any reason to constitute at least a majority of the Board; *provided, however*, that any individual becoming a director subsequent to June 1, 1999, whose election, or nomination for election by Quanex’s stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Covered Person other than the Board;

(c) the consummation of (xx) a reorganization, merger or consolidation or sale of Quanex or (yy) a disposition of all or substantially all of the assets of the Company (a “Business Combination”), in each case, unless, following such Business Combination, (i) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Quanex Common Stock and Outstanding Quanex Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80 percent of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns Quanex or all or substantially all of Quanex’s assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership immediately prior to such Business Combination of the Outstanding Quanex Common Stock and Outstanding Quanex Voting Securities, as the case may be, (ii) no Covered Person (excluding any employee benefit plan (or related trust) of Quanex or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20 percent or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation, except to the extent that such ownership existed prior to the Business Combination, and (iii) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination, were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board of Directors, providing for such Business Combination; or

(d) the approval of the stockholders of Quanex of a complete liquidation or dissolution of Quanex.

2.6 **“Code”** means the Internal Revenue Code of 1986, as amended.

2.7 **“Committee”** means members of the Compensation Committee of the Board.

2.8 **“Common Stock”** means Quanex’s common stock, \$.50 par value.

2.9 **“Disability”** means the Separation From Service of a Grantee due to a medically determinable mental or physical impairment which, in the opinion of a physician selected by the Committee, shall prevent the Grantee from engaging in any substantial gainful activity and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months and which (a) was not contracted, suffered or incurred while the Grantee was engaged in, or did not result from having engaged in, a felonious criminal enterprise; (b) did not result from addiction to narcotics; (c) did not result from an injury incurred while a member of the Armed Forces of the United States for which the Grantee receives a military pension; and (d) did not result from an intentionally self-inflicted injury.

2.10 **“Fiscal Year”** means November 1 through October 31.

2.11 **“Grantee”** means a person who has been granted a Performance Award under the Plan.

- 2.12 **“Maximum Performance Level”** means the most stringent Performance Standard established by the Committee with respect to a Performance Award.
- 2.13 **“Performance Award”** means an incentive compensation opportunity granted under the Plan.
- 2.14 **“Performance Objectives”** means the criteria established by the Committee for a Fiscal year as the basis for determining the amount payable to a Grantee under a Performance Award.
- 2.15 **“Performance Objective Percentage”** has the meaning specified in Section 4.2.
- 2.16 **“Performance Period”** means the period that commences on the first day of a Fiscal Year and ends on the day before the third anniversary of such first day of a Fiscal Year.
- 2.17 **“Performance Standard”** means a level of performance established by the Committee with respect to a Performance Award.
- 2.18 **“Performance Unit”** means a unit that is awarded under the Plan pursuant to an Award Agreement for the purpose of determining the incentive compensation payable under the Plan.
- 2.19 **“Performance Unit Value”** means, with respect to any Performance Objective, \$0 if the Threshold Performance Level is not attained; \$75.00 if the Threshold Performance Level is attained but the Target Performance Level is not attained; \$100.00 if the Target

Performance Level is attained but the Maximum Performance Level is not attained; and \$200.00 if the Maximum Performance Level is attained.

- 2.20 **“Plan”** means the Quanex Corporation Long-Term Incentive Plan, as set forth in this document and as it may be amended from time to time.
- 2.21 **“Quanex”** means Quanex Corporation, a Delaware Corporation.
- 2.22 **“Retirement”** means the Grantee’s Separation From Service at a time when he is eligible to commence receiving retirement benefits under either the Quanex Corporation Salaried Employees’ Pension Plan or the Quanex Corporation Supplemental Benefit Plan.
- 2.23 **“Separation From Service”** means the termination of the employment relationship between the Grantee and Quanex and all Affiliates.
- 2.24 **“Spouse”** means the person to whom the Grantee is married under applicable local law.
- 2.25 **“Target Performance Level”** means the normal Performance Standard established by the Committee with respect to a Performance Award.
- 2.26 **“Threshold Performance Level”** means the least stringent Performance Standard established by the Committee with respect to a Performance Award.
- 2.27 **“Vested Interest”** means a Grantee’s nonforfeitable interest in the benefits payable under his Performance Award pursuant to Article IV determined under the terms of Article VI.

ARTICLE III

ELIGIBILITY

The individuals who shall be eligible to receive Performance Awards under the Plan during a Fiscal Year shall be those Quanex executives as the Committee shall determine.

ARTICLE IV

PERFORMANCE AWARDS

4.1 **Grants of Performance Awards.** Quanex may grant a Performance Award to each Grantee selected by the Committee. The potential amount payable under a Performance Award shall be based upon the attainment of Performance Objectives established by the Committee. Performance Awards may vary among Grantees. The terms of a Performance Award that are established by the Committee shall be specified in an Award Agreement. The fact that a Grantee is granted a Performance Award during a Fiscal Year shall not entitle him to have another Performance Award granted to him during any other Fiscal Year. The Committee

shall retain documentation relating to all Performance Awards and the applicable Performance Objectives.

4.2 **Establishment of Performance Objectives and Performance Standards.** The Committee shall establish the Performance Objectives that apply to a Performance Award. The Committee shall assign a percentage weight of importance (a “Performance Objective Percentage”) for each Performance Objective taken into account under a Performance Award. The total of the Performance Objective Percentages for all of the Performance Objectives applicable to a Performance Award shall be 100 percent. For each Performance Objective that the Committee establishes under a Performance Award, the Committee shall specify three Performance Standards which shall be referred to as the Threshold Performance Level, the Target Performance Level and the Maximum Performance Level.

4.3 **Special Ledger.** The Committee shall establish or cause to be established an appropriate record that will reflect the name of each Grantee and all other information necessary to properly reflect each Grantee’s Performance Awards made by the Committee.

ARTICLE V

CALCULATION AND PAYMENT OF BENEFITS

5.1 **Determination of Amounts Payable Under Performance Awards.** As soon as administratively practicable after the end of a Fiscal Year, the Committee shall ascertain the extent to which the Performance Objectives applicable to Performance Awards made for that Fiscal Year have been achieved. The Committee shall retain with the records of the Committee documentation of its conclusions, and the basis for its conclusions, concerning the extent to which Performance Objectives were achieved. Subject to Sections 5.2 and 5.3, if a Grantee achieves a performance standard (Maximum Performance Level, Target Performance Level or Threshold Performance Level) for a Performance Objective the Grantee shall be entitled to receive, and Quanex shall pay the Grantee (or the Grantee's Spouse or estate, if applicable), an incentive payment with respect to such Performance Objective in an amount equal to the product of (1) the Grantee's Vested Interest, (2) the number of Performance Units awarded to the Grantee under the Performance Award, (3) the applicable Performance Objective Percentage for such Performance Objective and (4) the applicable Performance Unit Value (\$75.00 for achieving the Threshold Performance Level; \$100.00 for achieving the Target Performance Level; and \$200.00 for achieving the Maximum Performance Level). If the performance standard achieved with respect to a particular Performance Objective is between the Threshold Performance Level and the Target Performance Level or between the Target Performance Level and the Maximum Performance Level, the applicable Performance Unit Value for the Performance Objective shall be determined by interpolation. If a Grantee fails to achieve at least the Threshold Performance Level for a Performance Objective he shall not be entitled to receive an incentive payment with respect to such Performance Objective. Exhibit A attached hereto contains an example that illustrates the manner in which the amount payable under a Performance Award is to be determined.

5.2 **Amounts Payable Upon the Death, Disability or Retirement of the Grantee.** If a Grantee incurs a Separation From Service due to his death, Disability or Retirement during the Performance Period for which a Performance Award was granted to him, he shall be entitled to receive, and Quanex shall pay him (or his Spouse or estate, if applicable), with respect to each Performance Objective, an amount equal to the amount determined under Section 5.1 above multiplied by a fraction, the numerator of which is the number of days during the Performance Period that have elapsed prior to his Separation From Service and the denominator of which is 1095.

5.3 **Amount Payable Upon a Change of Control.** Notwithstanding any other provisions of the Plan, if a Change of Control occurs (a) prior to the expiration of the applicable Performance Period and (b) either prior to a Grantee's Separation From Service or within 120 days after a Grantee's Separation From Service, he shall be entitled to receive, and Quanex shall pay him (or his Spouse or estate, if applicable), with respect to each Performance Objective, an amount equal to the product of (1) the number of Performance Units awarded to the Grantee under the Performance Award, (2) \$100.00, and (3) a fraction, the numerator of which is the number of days during the Performance Period that will have elapsed prior to the first day of the second Fiscal Year immediately following the Fiscal Year in which the Change of Control occurs and the denominator of which is 1095.

5.4 **No Interest on Performance Awards.** No interest shall be credited with respect to amounts payable under any Performance Awards.

5.5 **Time of Payment.** Unless a Change of Control occurs during the Performance Period, Quanex shall pay a Grantee the aggregate amount due to the Grantee under the Plan with respect to such Performance Period as soon as administratively practicable after the end of the Performance Period and in any event no later than 90 days after the end of the Performance Period.

If during a Performance Period a Change of Control occurs either prior to the date of a Grantee's Separation From Service or within 120 days after the Grantee's Separation From Service, Quanex shall pay the Grantee the aggregate amount due the Grantee under the Plan with respect to such Performance Period as soon as administratively practicable after the date of the Change of Control and in any event no later than 120 days after the date of the Change of Control.

Notwithstanding any other provision of the Plan to the contrary, if the Company determines that as a result of the application of section 162(m) of the Code the Company would not be entitled to take a deduction for part or all of the compensation payable to a Grantee under an Award, then, unless a Change of Control has occurred, the payment of the compensation, to the extent not currently deductible, will be delayed until December 1 of the second Fiscal Year that commences after the expiration of the applicable Performance Period.

5.6 **Form of Payment.** The payment under a Performance Award shall be in the form of cash, shares of Common Stock, or in a combination of cash and shares of Common Stock, as determined by the Committee in its sole discretion.

5.7 **Payment on Death of Grantee.** Upon the death of a Grantee before he has been paid his benefit under his Performance Award, his benefit under his Performance Award shall be paid to the Grantee's Spouse if the Spouse survives the Grantee, or to the Grantee's estate if the Grantee's Spouse does not survive the Grantee. Any payment under this Section 5.7 shall be made at the same time the payment would have been made to the Grantee.

ARTICLE VI

VESTING AND FORFEITURES

6.1 **Determination of Vested Interest.** Subject to Section 6.3, if the Grantee does not incur a Separation From Service prior to the expiration of the Performance Period applicable to his Performance Award, his Vested Interest shall be 100 percent. Further, if the Grantee dies, Retires or becomes Disabled before he has been paid his benefit under his Performance Award, his Vested Interest shall be 100 percent.

6.2 **Forfeiture Upon Separation From Service.** Subject to Section 6.4, if a Grantee incurs a Separation From Service prior to the expiration of the applicable Performance Period for any reason other than death, Retirement or Disability, his Vested Interest shall be zero and his Performance Award shall be immediately forfeited.

6.3 **Complete Forfeiture for Cause.** Notwithstanding Section 6.1 of the Plan, if prior to the date that is 120 days prior to the occurrence of a Change in Control, the Committee finds by a majority vote after full consideration of the facts, that a Grantee was discharged from the employ of Quanex, or an Affiliate, for Cause or for a material violation of the Company's Code of Business Conduct & Ethics, the Grantee shall immediately forfeit his Performance

Award to the extent he has not yet been paid benefits pursuant to the Performance Award. The decision of the Committee as to cause of the Grantee's discharge shall be final. No decision of the Committee shall affect the finality of the discharge of the Grantee. No Plan benefits shall be forfeited pursuant to this Section 6.3 after the date that is 120 days prior to the occurrence of a Change of Control. Further, if the Committee finds, by a majority vote after full consideration of the facts, that a Grantee possessed direct and actual knowledge of a material violation of the Company's Code of Business Conduct and Ethics and failed to report, a portion or the entire amount of any benefits yet to be paid pursuant to the Performance Award may be forfeited as is decided by the Committee.

6.4 **Accelerated Vesting Upon Change of Control.** Notwithstanding any other provisions of the Plan, if a Change of Control occurs prior to the expiration of the Performance Period applicable to a Grantee's Performance Award and prior to a Grantee's Separation From Service, such Grantee's Vested Interest shall be 100 percent. Further, notwithstanding any other provisions of the Plan, if a Change of Control occurs prior to the expiration of the Performance Period applicable to a Grantee's Performance Award and no later than the date that is 120 days after a Grantee's Separation From Service, such Grantee's Vested Interest shall be 100 percent.

6.5 **Treatment of Forfeited Interest in Performance Award.** If a Grantee's interest in a Performance Award is fully or partially forfeited for any reason, his forfeited interest in the

Performance Award shall *not* be applied to increase the Long Term Incentive Percentages of, or to otherwise increase the amounts payable under the Plan for any remaining Grantee who has not incurred a Separation From Service on or prior to the date of the forfeiture.

ARTICLE VII

ADMINISTRATION

7.1 **General.** The Plan shall be administered by the Committee. All questions of interpretation and application of the Plan and Performance Awards shall be subject to the determination of the Committee. A majority of the members of the Committee shall constitute a quorum. All determinations of the Committee shall be made by a majority of its members. Any decision or determination reduced to writing and signed by a majority of the members shall be as effective as if it had been made by a majority vote at a meeting properly called and held.

7.2 **Powers of Committee.** The Committee shall have the exclusive responsibility for the general administration of the Plan according to the terms and provisions of the Plan and will have all the powers necessary to accomplish those purposes, including but not by way of limitation the right, power and authority:

- (a) to make rules, regulations and administrative guidelines for the administration of the Plan;
 - (b) to construe all terms, provisions, conditions and limitations of the Plan;
 - (c) to correct any defect, supply any omission or reconcile any inconsistency that may appear in the Plan in the manner and to the extent it deems expedient to carry the Plan into effect for the greatest benefit of all parties at interest;
 - (d) to determine all controversies relating to the administration of the Plan, including but not limited to:
 - (1) differences of opinion arising between Quanex and a Grantee; and
 - (2) any question it deems advisable to determine in order to promote the uniform administration of the Plan for the benefit of all parties at interest;
 - (e) to determine the terms and conditions, if any, not inconsistent with the terms of the Plan that are to be placed upon the Performance Award given to a particular Grantee; and
 - (f) to determine the extent to which the applicable Performance Objectives have been achieved.
-

7.3 **Committee Discretion.** The Committee in exercising any power or authority granted under the Plan or in making any determination under the Plan shall perform or refrain from performing those acts in its sole discretion and judgment. Any decision made by the Committee or any refraining to act or any act taken by the Committee in good faith shall be final and binding on all parties. The Committee's decisions shall never be subject to de novo review, but instead shall only be overturned if found to be arbitrary or capricious by an arbitrator or a court of law.

7.4 **Disqualification of Committee Member.** A member of the Committee shall not vote or act on any Plan matter relating solely to himself.

ARTICLE VIII

AMENDMENT OR TERMINATION OF PLAN

The Board may terminate the Plan at any time, in its sole and absolute discretion, provided that any termination of the Plan prior to the expiration of the Performance Period shall be deemed to be a Change of Control for all purposes under the Plan. The Board may amend the Plan only with the written consent of each Grantee who has not either been paid the entire amount due him under his Performance Award or forfeited his entire interest in his Performance Award pursuant to the terms of the Plan.

ARTICLE IX

FUNDING

9.1 **Payments Under the Plan Are the Obligation of Quanex.** Benefits due under the Plan will be paid by Quanex.

9.2 **Grantees Must Rely Solely on the General Credit of Quanex.** The Plan is only a general corporate commitment of Quanex and each Grantee must rely solely upon the general credit of Quanex for the fulfillment of its obligations hereunder. Under all circumstances the rights of the Grantee to any asset held by Quanex will be no greater than the rights expressed in the Plan. Nothing contained in the Plan or a Performance Award will constitute a guarantee by Quanex that the assets of Quanex will be sufficient to pay any benefits under the Plan or would place the Grantee in a secured position ahead of general creditors of Quanex; the Grantees are only unsecured creditors of Quanex with respect to their Plan benefits and the Plan constitutes a mere promise by Quanex to make benefit payments in the future. No specific assets of Quanex have been or will be set aside, or will be pledged in any way for the performance of Quanex's obligations under the Plan which would remove such assets from being subject to the general creditors of Quanex.

9.3 **Unfunded Arrangement.** It is intended that the Plan shall be unfunded for tax purposes and for purposes of Title of the Employee Retirement Income Security Act of 1974, as amended.

ARTICLE X

MISCELLANEOUS

10.1 **No Employment Obligation.** The granting of any Performance Award shall not constitute an employment contract, express or implied, nor impose upon Quanex or any Affiliate any obligation to employ or continue to employ the Grantee. The right of Quanex or any Affiliate to terminate the employment of any person shall not be diminished or affected by reason of the fact that a Performance Award has been granted to him.

10.2 **Tax Withholding.** Quanex shall be entitled to deduct from the Performance Award or other compensation payable to each Grantee any sums required by federal, state, or local tax law to be withheld with respect to payments under a Performance Award.

10.3 **Indemnification of the Committee.** Quanex shall indemnify each present and future member of the Committee against, and each member of the Committee shall be entitled without further act on his part to indemnify from Quanex for, all expenses (including attorneys' fees, the amount of judgments and the amount of approved settlements made with a view to the curtailment of costs of litigation, other than amounts paid to Quanex itself) reasonably incurred by him in connection with or arising out of any action, suit, or proceeding in which he may be involved by reason of his being or having been a member of the Committee, whether or not he continues to be a member of the Committee at the time of incurring the expenses — including, without limitation, matters as to which he shall be finally adjudged in any action, suit or proceeding to have been found to have been negligent in the performance of his duty as a member of the Committee. However, this indemnity shall not include any expenses incurred by any member of the Committee in respect of matters as to which he shall be finally adjudged in any action, suit or proceeding to have been guilty of gross negligence or willful misconduct in the performance of his duty as a member of the Committee. In addition, no right of indemnification under the Plan shall be available to or enforceable by any member of the Committee unless, within 60 days after institution of any action, suit or proceeding, he shall have offered Quanex, in writing, the opportunity to handle and defend same at its own expense. This right of indemnification shall inure to the benefit of the heirs, executors or administrators of each member of the Committee and shall be in addition to all other rights to which a member of the Committee may be entitled as a matter of law, contract, or otherwise.

10.4 **Indemnification of the Board.** Quanex shall indemnify each present and future member of the Board against, and each member of the Board shall be entitled without further act on his part to indemnify from Quanex for, all expenses (including attorneys' fees, the amount of judgments and the amount of approved settlements made with a view to the curtailment of costs of litigation, other than amounts paid to Quanex itself) reasonably incurred by him in connection with or arising out of any action, suit, or proceeding relating to the Plan in which he may be involved by reason of his being or having been a member of the Board, whether or not he continues to be a member of the Board at the time of incurring the expenses — including, without limitation, matters as to which he shall be finally adjudged in any action, suit or proceeding to have been found to have been negligent in the performance of his duty as a member of the Board. However, this indemnity shall not include any expenses incurred by any

member of the Board in respect of matters as to which he shall be finally adjudged in any action, suit or proceeding to have been guilty of gross negligence or willful misconduct in the performance of his duty as a member of the Board. In addition, no right of indemnification under the Plan shall be available to or enforceable by any member of the Board unless, within 60 days after institution of any action, suit or proceeding, he shall have offered Quanex, in writing, the opportunity to handle and defend same at its own expense. This right of indemnification shall inure to the benefit of the heirs, executors or administrators of each member of the Board and shall be in addition to all other rights to which a member of the Board may be entitled as a matter of law, contract, or otherwise.

10.5 **Gender and Number.** If the context requires, words of one gender when used in the Plan shall include the other and words used in the singular or plural shall include the other.

10.6 **Headings.** Headings of Articles and Sections are included for convenience of reference only and do not constitute part of the Plan and shall not be used in construing the terms of the Plan.

10.7 **Other Compensation Plans.** The adoption and maintenance of the Plan shall not affect any other stock option, incentive or other compensation or benefit plans in effect for Quanex or any Affiliate or preclude Quanex from establishing any other forms of incentive or other compensation for employees of Quanex or any Affiliate.

10.8 **Rights of Quanex and Affiliates.** The existence of Performance Awards shall not affect in any way the right or power of Quanex or an Affiliate to (a) make or authorize any or all adjustments, recapitalizations, reorganizations or other changes in Quanex's or an Affiliate's structure or business, (b) approve and consummate any merger or consolidation of Quanex or an Affiliate with or into any entity, (c) issue any bonds, debentures or interests in Quanex or an Affiliate of any nature whatsoever to any person, (d) approve and consummate the dissolution or liquidation of Quanex or an Affiliate or any sale or transfer of all or any part of Quanex's or an Affiliate's assets or business or (e) approve and consummate any other act or proceeding whether of a similar character or otherwise.

10.9 **Nonalienation of Benefits.** No benefit provided under the Plan shall be transferable by the Grantee except pursuant to a state domestic relations order. No right or benefit under the Plan shall be subject to anticipation, alienation, sale, assignment, pledge, encumbrance or charge. Any attempt to anticipate, alienate, sell, assign, pledge, encumber or charge any right or benefit under the Plan shall be void. No right or benefit under the Plan shall, in any

manner, be liable for or subject to any debts, contracts, liabilities or torts of the person entitled to the right or benefit. If any Grantee becomes bankrupt or attempts to anticipate, alienate, assign, pledge, sell, encumber or charge any right or benefit under the Plan, then the right or benefit shall, in the discretion of the Committee, cease. In that event, Quanex and/or one or more Affiliates may hold or apply the right or benefit or any part of the right or benefit for the benefit of the Grantee, the Grantee's Spouse, children or other dependents or any of them in the manner and in the proportion that the Committee shall deem proper, in its sole discretion, but is not required to do so. The restrictions in this Section 10.9 shall not apply to state domestic relations' orders.

10.10 **Plan and Award Agreements Binding Upon Quanex's Successor.** The Plan and all Award Agreements shall be binding upon Quanex's successor. Further, the Board shall not authorize a Change of Control unless the purchaser agrees to take such actions as are necessary to cause all Grantees to be paid amounts due under the terms of the Plan as in effect prior to the Change of Control.

10.11 **Governing Law.** Except to the extent such laws are preempted by federal law, the validity, interpretation, construction and enforceability of the Plan shall be governed by the laws of the State of Texas.

EXHIBIT A

Example of Performance Compensation Calculation Under the Quanex Corporation Long-Term Incentive Plan

Assume that the Committee grants an executive a performance based compensation award under the Plan that is contingent upon achieving two performance goals, Performance Objective A and Performance Objective B. The Committee assigns weights of importance Performance Objective Percentages in the amounts of 40% and 60% for Performance Objective A and Performance Objective B, respectively.

Assume that for both of Performance Objectives A and B the Committee establishes threshold, target and maximum performance standards. The per performance unit dollar values ("Performance Unit Value") assigned for achieving the threshold, target and maximum performance standards are \$75, \$100 and \$200, respectively.

Assume that the performance based compensation award provides that the executive is awarded 2000 units ("Performance Units") for purposes of determining the amount payable under the award.

Assume that the executive achieves the maximum performance standard for Performance Objective A, and precisely halfway between the target and maximum performance standards for Performance Objective B. Finally, assume that the executive is continuously employed by Quanex throughout the performance period.

The amount payable to the executive with respect to Performance Objective A is \$160,000, determined as follows:

$.40$ (Performance Objective Percentage) X 2000 (Performance Units) X \$200 (Performance Unit Value) = \$160,000.

The amount payable to the executive with respect to Performance Objective B is \$180,000, determined as follows:

$.60$ (Performance Objective Percentage) X 2000 (Performance Units) X \$150 (Performance Unit Value) = \$180,000.

The total amount payable to the executive under the award is \$340,000.

**THIRD AMENDMENT TO
THE PIPER IMPACT 401(K) PLAN**

THIS AGREEMENT by Quanex Corporation, a Delaware corporation (the "*Sponsor*"),

WITNESSETH:

WHEREAS, the Sponsor maintains the Piper Impact 401(k) Plan (the "*Plan*");

WHEREAS, pursuant to Section 13.01 of the Plan, the Sponsor has the right to amend the Plan; and

WHEREAS, the Sponsor desires to amend the Plan;

NOW, THEREFORE, the Sponsor agrees that, effective as of January , 2005, Section (k) of Article VII of the Plan is amended and restated in its entirety to provide as follows::

(k) Except as otherwise provided below, if a Participant or former Participant has an outstanding loan from the Plan at the time of his Separation From Service, the outstanding loan principal balance and any accrued but unpaid interest will become immediately due in full. The Participant or former Participant will have the right to immediately pay the Trustee that amount. If the Participant or former Participant fails to repay the loan, the Trustee will foreclose on the loan and the Participant will be deemed to have received a Plan distribution of the amount foreclosed upon. The Trustee will not foreclose upon a Participant's or former Participant's Salary Deferral Contribution Account, Catch-up Salary Deferral Contribution Account or QNEC Account until the Participant's Separation From Service. Notwithstanding any other provision of this Section (k) or Section (i) to the contrary, a Participant, who on the day the Sponsor disposes of substantially all of the assets or the stock of Piper Impact, Inc. (i) has an outstanding loan from the Plan and (ii) incurs a Separation From Service as a result of such disposition, will be allowed to repay to the Trustee the outstanding loan principal balance and any accrued but unpaid interest over the remaining term of the loan in accordance with the amortization schedule provided in the loan agreement as if the Participant had not incurred a Separation From Service, such payments to be made by coupons or similar form under a procedure to be established by the Loan Committee.

IN WITNESS WHEREOF, the Sponsor has executed this Amendment this day of January, 2005.

QUANEX CORPORATION

By: _____
Title: _____

RESTRICTED STOCK AWARD AGREEMENT
Quanex Corporation
1996 Employee Stock Option and Restricted Stock Plan

This **RESTRICTED STOCK AWARD AGREEMENT** (the “*Agreement*”) is made by and between Quanex Corporation, a Delaware corporation, (the “*Company*”) and _____ (the “*Director*”) effective as of the _____ day of _____, 20____ (the “*Grant Date*”), pursuant to the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan (the “*Plan*”), which is incorporated by reference herein in its entirety.

WHEREAS, the Company desires to grant to the Director the shares of equity securities specified herein (the “*Shares*”), subject to the terms and conditions of this Agreement; and

WHEREAS, the Director desires to have the opportunity to hold Shares subject to the terms and conditions of this Agreement;

NOW, THEREFORE, in consideration of the premises, mutual covenants and agreements contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto, intending to be legally bound hereby, agree as follows:

1. **Definitions.** For purposes of this Agreement, the following terms shall have the meanings indicated:

(a) “*Transfer Restrictions*” shall mean any prohibitions and restrictions set forth herein with respect to the sale or other disposition of Shares issued to the Director hereunder.

(b) “*Restricted Shares*” shall mean the Shares that are subject to the Transfer Restrictions under this Agreement.

Capitalized terms not otherwise defined in this Agreement shall have the meanings given to such terms in the Plan.

2. **Grant of Restricted Shares.** Effective as of the Grant Date, the Company shall cause to be issued in the Director’s name the following Shares as Restricted Shares: _____ shares of the Company’s Common Stock, \$.50 par value. The Company shall cause certificates evidencing the Restricted Shares to be issued in the Director’s name, pursuant to which the Director shall have, except for the Transfer Restrictions, all of the rights of a stockholder with respect to such Restricted Shares, including, without limitation, the right to receive any dividends or distributions allocable thereto and all voting rights appurtenant thereto. Upon issuance the certificates shall be delivered to the Secretary of the Company or to such other depository as may be designated by the Committee under the Plan as a depository for safekeeping until the Transfer Restrictions lapse. Effective as of the date of this Agreement, the Director shall deliver to the Company all stock powers, endorsed in blank, relating to the Restricted Shares. In accepting this award of Shares the Director accepts and agrees to be bound by all the terms and conditions of the Plan.

3. **Transfer Restrictions.** The Shares granted hereby may not be sold, assigned, pledged, exchanged, hypothecated or otherwise transferred, encumbered or disposed of (other than by will or the applicable laws of descent and distribution) until after the cessation of the Director’s services as a director of the Company. Further, the Shares granted hereby may not be sold or otherwise disposed of in any manner which would constitute a violation of any applicable federal or state securities laws. Any attempted sale, assignment, pledge, exchange, hypothecation, transfer, encumbrance or disposition in violation of this Agreement shall be void and the Company shall not be bound thereby. The Director also agrees (i) that the Company may refuse to cause the transfer of the Shares to be registered on the applicable stock transfer records if such proposed transfer would, in the opinion of counsel satisfactory to the Company, constitute a violation of any applicable securities law and (ii) that the Company may give related instructions to the transfer agent, if any, to stop registration of the transfer of the Shares.

4. **Vesting.** The Shares that are granted hereby shall not be subject to any forfeiture restrictions.

5. **Capital Adjustments and Reorganizations.** The existence of the Restricted Shares shall not affect in any way the right or power of the Company to make or authorize any adjustment, recapitalization, reorganization or other change in its capital structure or its business, engage in any merger or consolidation, issue any debt or equity securities, dissolve or liquidate, or sell, lease, exchange or otherwise dispose of all or any part of its assets or business, or engage in any other corporate act or proceeding.

6. **Tax Withholding.** To the extent that the receipt of the Restricted Shares results in income to the Director for federal, state or local income or employment tax purposes with respect to which the Company has a withholding obligation, the Director shall deliver to the Company at the time of such receipt or lapse, as the case may be, such amount of money as the Company may require to meet its obligation under applicable tax laws or regulations, and, if the Director fails to do so, the Company is authorized to withhold from the Shares granted hereby or from any cash or stock remuneration then or thereafter payable to the Director in any capacity any tax required to be withheld by reason of such resulting income.

7. **No Fractional Shares.** All provisions of this Agreement concern whole Shares. If the application of any provision hereunder would yield a fractional share, such fractional share shall be rounded down to the next whole share if it is less than 0.5 and rounded up to the next whole share if it is 0.5 or more.

8. **Not an Employment Agreement.** This Agreement is not an employment agreement, and no provision of this Agreement shall be construed or interpreted to create an employment relationship between the Director and the Company or guarantee the right to remain a member of the Board of Directors of the Company for any specified term.

9. **Legend.** The Director consents to the placing on the certificate for the Shares of an appropriate legend restricting resale or other transfer of the Shares except in accordance with such Act and all applicable rules thereunder.

10. **Notices.** Any notice, instruction, authorization, request or demand required hereunder shall be in writing, and shall be delivered either by personal delivery, by telegram, telex, telecopy or similar facsimile means, by certified or registered mail, return receipt requested, or by courier or delivery service, addressed to the Company at the address indicated beneath its signature on the execution page of this Agreement, and to the Director at the Director's residential address indicated beneath the Director's signature on the execution page of this Agreement, or at such other address and number as a party shall have previously designated by written notice given to the other party in the manner hereinabove set forth. Notices shall be deemed given when received, if sent by facsimile means (confirmation of such receipt by confirmed facsimile transmission being deemed receipt of communications sent by facsimile means); and when delivered (or upon the date of attempted delivery where delivery is refused), if hand-delivered, sent by express courier or delivery service, or sent by certified or registered mail, return receipt requested.

11. **Amendment and Waiver.** This Agreement may be amended, modified or superseded only by written instrument executed by the Company and the Director. Only a written instrument executed and delivered by the party waiving compliance hereof shall make any waiver of the terms or conditions. Any waiver granted by the Company shall be effective only if executed and delivered by a duly authorized executive officer of the Company. The failure of any party at any time or times to require performance of any provisions hereof shall in no manner effect the right to enforce the same. No waiver by any party of any term or condition, or the breach of any term or condition contained in this Agreement, in one or more instances, shall be construed as a continuing waiver of any such condition or breach, a waiver of any other condition, or the breach of any other term or condition.

12. **Governing Law and Severability.** This Agreement shall be governed by the laws of the State of Texas without regard to its conflicts of law provisions. The invalidity of any provision of this Agreement shall not affect any other provision of this Agreement, which shall remain in full force and effect.

13. **Successors and Assigns.** Subject to the limitations which this Agreement imposes upon the transferability of the Shares granted hereby, this Agreement shall bind, be enforceable by and inure to the benefit of the Company and its successors and assigns, and to the Director, the Director's permitted assigns and upon the Director's death, the Director's estate and beneficiaries thereof (whether by will or the laws of descent and distribution), executors, administrators, agents, legal and personal representatives.

14. **Counterparts.** This Agreement may be executed in two or more counterparts, each of which shall be an original for all purposes but all of which taken together shall constitute but one and the same instrument.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by an officer thereunto duly authorized, and the Director has executed this Agreement, all as of the date first above written.

QUANEX CORPORATION

By: _____
Title: _____

DIRECTOR:

IRREVOCABLE STOCK POWER

KNOW ALL MEN BY THESE PRESENTS, That the undersigned, **For Value Received**, has bargained, sold, assigned and transferred and by these presents does bargain, sell, assign and transfer unto Quanex Corporation, a Delaware corporation (the "*Company*"), the Shares transferred pursuant to the Restricted Stock Award Agreement dated _____ between the Company and the undersigned; **and** subject to and in accordance with such Restricted Stock Award Agreement the undersigned does hereby constitute and appoint _____ the undersigned's true and lawful attorney, IRREVOCABLY, to sell assign, transfer, hypothecate, pledge and make over all or any part of such Shares and for that purpose to make and execute all necessary acts of assignment and transfer thereof, and to substitute one or more persons with like full power, hereby ratifying and confirming all that said attorney or his substitutes shall lawfully do by virtue hereof.

In Witness Whereof, the undersigned has executed this Irrevocable Stock Power effective the _____ day of _____, 20__.

RESTRICTED STOCK AWARD AGREEMENT
Quanex Corporation
1996 Employee Stock Option and Restricted Stock Plan

This **RESTRICTED STOCK AWARD AGREEMENT** (the “*Agreement*”) is made by and between Quanex Corporation, a Delaware corporation, (the “*Company*”) and (the “*Executive*”) on this day of , 200 (the “*Grant Date*”) pursuant to the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan (the “*Plan*”), which is incorporated by reference herein in its entirety.

WHEREAS, the Company desires to grant to the Executive the shares of equity securities specified herein (the “*Shares*”), subject to the terms and conditions of this Agreement; and

WHEREAS, the Executive desires to have the opportunity to hold Shares subject to the terms and conditions of this Agreement;

NOW, THEREFORE, in consideration of the premises, mutual covenants and agreements contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto, intending to be legally bound hereby, agree as follows:

1. Definitions. For purposes of this Agreement, the following terms shall have the meanings indicated:

(a) “*Forfeiture Restrictions*” shall mean any prohibitions and restrictions set forth herein with respect to the sale or other disposition of Shares issued to the Executive hereunder and the obligation to forfeit and surrender such shares to the Company.

(b) “*Restricted Shares*” shall mean Shares that are subject to the Forfeiture Restrictions under this Agreement.

Capitalized terms not otherwise defined in this Agreement shall have the meanings given to such terms in the Plan.

2. Grant of Restricted Shares. On the date of this Agreement, the Company shall cause to be issued in the Executive’s name the following Shares as Restricted Shares: shares of the Company’s Common Stock, \$.50 par value. The Company shall cause certificates evidencing the Restricted Shares to be issued in the Executive’s name, pursuant to which the Executive shall have, except for the Forfeiture Restrictions, all of the rights of a stockholder with respect to such Restricted Shares, including, without limitation, the right to receive any dividends or distributions allocable thereto and all voting rights appurtenant thereto. Upon issuance the certificates shall be delivered to the Secretary of the Company or to such other depository as may be designated by the Committee under the Plan as a depository for safekeeping until the forfeiture of such Restricted Shares occurs or the Forfeiture Restrictions lapse. On the date of this Agreement, the Executive shall deliver to the Company all stock powers, endorsed in blank, relating to the Restricted Shares. In accepting this award of Shares the Executive accepts and agrees to be bound by all the terms and conditions of the Plan.

3. Transfer Restrictions. The Shares granted hereby may not be sold, assigned, pledged, exchanged, hypothecated or otherwise transferred, encumbered or disposed of (other than by will or the applicable laws of descent and distribution) to the extent then subject to the Forfeiture Restrictions. Any such attempted sale, assignment, pledge, exchange, hypothecation, transfer, encumbrance or disposition in violation of this Agreement shall be void and no company shall be bound thereby. Further, the Shares granted hereby that are no longer subject to Forfeiture Restrictions may not be sold or otherwise disposed of in any manner which would constitute a violation of any applicable federal or state securities laws. The Executive also agrees (i) that the Company may refuse to cause the transfer of the Restricted Shares to be registered on the applicable stock transfer records if such proposed transfer would in the opinion of counsel satisfactory to the Company constitute a violation of any applicable securities law and (ii) that the Company may give related instructions to the transfer agent, if any, to stop registration of the transfer of the Restricted Shares.

4. Vesting. The Shares that are granted hereby shall be subject to Forfeiture Restrictions. The Forfeiture Restrictions shall lapse as to the Shares that are granted hereby on the earlier of (a) the third anniversary of the Grant Date or (b) the date a Change in Control of the Company occurs, provided that the Executive’s employment with the Company has not terminated prior to such date. However, in the event the Executive’s employment relationship with the Company is terminated due to the death, Disability or Retirement of the Executive prior to the earlier of the third anniversary of the Grant Date or the date a Change in Control of the Company occurs, the Forfeiture Restrictions shall lapse as to the Shares that are granted hereby on the date the Executive’s employment relationship with the Company is terminated due to the death, Disability or Retirement of the Executive. If the Executive’s employment relationship with the Company terminates before the earlier of the third anniversary of the Grant Date or the date a Change in Control of the Company occurs, except as specified in the preceding sentence, the Forfeiture Restrictions then applicable to the Restricted Shares shall not lapse and all the Restricted Shares shall be forfeited to the Company. For purposes of this Section 4, the term “*Change in Control*” shall have the meaning ascribed to that term in the individual change in control agreement between the Company and the Executive in effect on the Grant Date. Upon the lapse of the Forfeiture Restrictions with respect to Shares granted hereby the Company shall cause to be delivered to the Executive a stock certificate representing such Shares, and such Shares shall be transferable by the Executive (except to the extent that any proposed transfer would, in the opinion of counsel satisfactory to the Company, constitute a violation of applicable securities law). Notwithstanding any other provision of this Agreement, in no event will the Forfeiture Restrictions expire prior to the satisfaction by the Executive of any liability arising under Section 6 of this Agreement.

5. Capital Adjustments and Reorganizations. The existence of the Restricted Shares shall not affect in any way the right or power of the Company or any company the stock of which is awarded pursuant to this Agreement to make or authorize any adjustment, recapitalization, reorganization or other change in its capital structure or its business, engage in any merger or consolidation, issue any debt or equity securities, dissolve or liquidate, or sell, lease, exchange or otherwise dispose of all or any part of its assets or business, or engage in any other corporate act or proceeding.

6. Tax Withholding. To the extent that the receipt of the Restricted Shares or the lapse of any Forfeiture Restrictions results in income to the Executive for federal, state or local income or employment tax purposes with respect to which the Company has a withholding obligation, the Executive shall deliver to the Company at the time of such receipt or lapse, as the case may be, such amount of money as the Company may require to meet its obligation under applicable tax laws or regulations, and, if the Executive fails to do so, the Company is authorized to withhold from the Shares granted hereby or from any cash or stock remuneration then or thereafter payable to the Executive any tax required to be withheld by reason of such resulting income.

7. **Employment Relationship.** For purposes of this Agreement, the Executive shall be considered to be in the employment of the Company as long as the Executive has an employment relationship with the Company. The Committee shall determine any questions as to whether and when there has been a termination of such employment relationship, and the cause of such termination, under the Plan and the Committee's determination shall be final and binding on all persons.
8. **Section 83(b) Election.** The Executive shall not exercise the election permitted under section 83(b) of the Internal Revenue Code of 1986, as amended, with respect to the Restricted Shares without the written approval of the Chief Financial Officer of the Company. If the Chief Financial Officer of the Company permits the election, the Executive shall timely pay the Company the amount necessary to satisfy the Company's attendant tax withholding obligations, if any.
9. **No Fractional Shares.** All provisions of this Agreement concern whole Shares. If the application of any provision hereunder would yield a fractional share, such fractional share shall be rounded down to the next whole share if it is less than 0.5 and rounded up to the next whole share if it is 0.5 or more.
10. **Not an Employment Agreement.** This Agreement is not an employment agreement, and no provision of this Agreement shall be construed or interpreted to create an employment relationship between the Executive and the Company or guarantee the right to remain employed by the Company for any specified term.
11. **Legend.** If the Executive is an officer or affiliate of the Corporation under the Securities Act of 1933, the Executive consents to the placing on the certificate for the Shares of an appropriate legend restricting resale or other transfer of the Shares except in accordance with such Act and all applicable rules thereunder.
12. **Notices.** Any notice, instruction, authorization, request or demand required hereunder shall be in writing, and shall be delivered either by personal delivery, by telegram, telex, telecopy or similar facsimile means, by certified or registered mail, return receipt requested, or by courier or delivery service, addressed to the Company at the address indicated beneath its signature on the execution page of this Agreement, and to the Executive at the Executive's residential address indicated beneath the Executive's signature on the execution page of this Agreement, or at such other address and number as a party shall have previously designated by written notice given to the other party in the manner hereinabove set forth. Notices shall be deemed given when received, if sent by facsimile means (confirmation of such receipt by

confirmed facsimile transmission being deemed receipt of communications sent by facsimile means); and when delivered (or upon the date of attempted delivery where delivery is refused), if hand-delivered, sent by express courier or delivery service, or sent by certified or registered mail, return receipt requested.

13. **Amendment and Waiver.** This Agreement may be amended, modified or superseded only by written instrument executed by the Company and the Executive. Only a written instrument executed and delivered by the party waiving compliance hereof shall make any waiver of the terms or conditions. Any waiver granted by the Company shall be effective only if executed and delivered by a duly authorized executive officer of the Company other than the Executive. The failure of any party at any time or times to require performance of any provisions hereof shall in no manner effect the right to enforce the same. No waiver by any party of any term or condition, or the breach of any term or condition contained in this Agreement, in one or more instances, shall be construed as a continuing waiver of any such condition or breach, a waiver of any other condition, or the breach of any other term or condition.
14. **Governing Law and Severability.** This Agreement shall be governed by the laws of the State of Texas without regard to its conflicts of law provisions. The invalidity of any provision of this Agreement shall not affect any other provision of this Agreement, which shall remain in full force and effect.
15. **Successors and Assigns.** Subject to the limitations which this Agreement imposes upon the transferability of the Shares granted hereby, this Agreement shall bind, be enforceable by and inure to the benefit of the Company and its successors and assigns, and to the Executive, the Executive's permitted assigns and upon the Executive's death, the Executive's estate and beneficiaries thereof (whether by will or the laws of descent and distribution), executors, administrators, agents, legal and personal representatives.
16. **Counterparts.** This Agreement may be executed in two or more counterparts, each of which shall be an original for all purposes but all of which taken together shall constitute but one and the same instrument.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by an officer thereunto duly authorized, and the Executive has executed this Agreement, all as of the date first above written.

QUANEX CORPORATION

By: _____
 Title: _____

EXECUTIVE:

IRREVOCABLE STOCK POWER

KNOW ALL MEN BY THESE PRESENTS, That the undersigned, **For Value Received**, has bargained, sold, assigned and transferred and by these presents does bargain, sell, assign and transfer unto Quanex Corporation, a Delaware corporation (the “*Company*”), the Shares transferred pursuant to the Restricted Stock Agreement dated _____ between the Company and the undersigned ; **and** subject to and in accordance with such Restricted Stock Agreement the undersigned does hereby constitute and appoint _____ the undersigned’s true and lawful attorney, IRREVOCABLY, to sell assign, transfer, hypothecate, pledge and make over all or any part of such Shares and for that purpose to make and execute all necessary acts of assignment and transfer thereof, and to substitute one or more persons with like full power, hereby ratifying and confirming all that said attorney or his substitutes shall lawfully do by virtue hereof.

In Witness Whereof, the undersigned has executed this Irrevocable Stock Power on this _____ day of _____ .

NONQUALIFIED STOCK OPTION AGREEMENT
Quanex Corporation
1996 Employee Stock Option and Restricted Stock Plan

This **STOCK OPTION AGREEMENT** (the "Agreement") is made between **QUANEX CORPORATION**, a Delaware corporation (the "Company"), and _____ (the "Optionee"). The Board of Directors of the Company has adopted the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan (the "Plan"), which is incorporated by reference herein. The Company considers that its interests will be served by granting the Optionee an option to purchase shares of common stock of the Company as an inducement for [his] [her] continued and effective performance of services for the Company or an Affiliate. Any term used in this Agreement that is not specifically defined herein shall have the meaning specified in the Plan.

IT IS AGREED:

1. Subject to the terms of the Plan and this Agreement, on _____, 200__ (the "Date of Grant"), the Company hereby grants to the Optionee a nonqualified stock option (the "Option") to purchase _____ shares of the common stock of the Company, \$.50 par value per share, at a price of \$ _____ per share, subject to adjustment as provided in the Plan. The Option is exercisable in accordance with the following schedule:

(a) _____ on the day after the first anniversary of the Date of Grant, the Option may be exercised with respect to up to 1/3 of the shares subject to the Option;

(b) _____ after each succeeding anniversary of the Date of Grant, the Option may be exercised with respect to up to an additional 1/3 of the shares subject to the Option, so that after the expiration of the third anniversary of the Date of Grant the Option shall be exercisable in full; and

(c) _____ to the extent not exercised, installments shall be cumulative and may be exercised in whole or in part.

However, the Option shall be exercisable in full on the date a Change in Control occurs, provided that the Optionee's employment with the Company has not terminated prior to such date. For purposes of this Section 1, the term "*Change in Control*" shall have the meaning ascribed to that term in the individual change in control agreement between the Company and the Optionee in effect on the Date of Grant.

2. Except as specified below, the Option granted to the Optionee under this Agreement shall not be transferable or assignable by the Optionee other than by will or the laws of descent and distribution, and shall be exercisable during the Optionee's lifetime only by [him] [her]. The Optionee may transfer this Option to a member or members of [his] [her] immediate family, a trust under which [his] [her] immediate family members are the only beneficiaries and a partnership of which [his] [her] immediate family members are the only partners. For this purpose, "immediate family" means the Optionee's spouse, children, stepchildren, grandchildren,

parents, grandparents, siblings (including half brothers and sisters), and individuals who are family members by adoption. Notwithstanding any other provision of this Agreement, such a transferee of the Option granted under this Agreement may exercise the Option during the Optionee's lifetime. None of the Company, its employees or directors makes any representations or guarantees concerning the tax consequences associated with the inclusion of this provision in this Agreement, the Optionee's transfer of the Option granted under this Agreement or transferee's exercise of the Option. It is the sole responsibility of the Optionee to seek advice from [his] [her] own tax advisors concerning those tax consequences. The Optionee is entitled to rely upon only the tax advice of his own tax advisors.

3. The Option shall terminate and become null and void on the earliest of (a) the last day of the ten year period commencing on the Date of Grant, (b) the last day of the three-month period commencing on the date of the severance of the employment relationship between the Optionee and the Company and all Affiliates for any reason other than death, Disability or Retirement, or (c) the last day of the three-year period commencing on the date of the severance of the employment relationship between the Optionee and the Company and all Affiliates due to death, Disability or Retirement. In the event of the Optionee's severance of the employment relationship between the Employee and the Company and all Affiliates for any reason other than death, Disability or Retirement, the Option shall not continue to vest after such severance of employment. In the event of the severance of the employment relationship between the Employee and all Affiliates due to the death, Disability or Retirement of the Optionee, the Option shall continue to vest after such severance of employment until the expiration of the Option.

Upon the death of the Optionee prior to the expiration of [his] [her] Option, [his] [her] executors, administrators or any person or persons to whom [his] [her] Option may be transferred by will or by the laws of descent and distribution, shall have the right, at any time prior to the expiration date of the Option to exercise the Option with respect to the number of shares that the Optionee would have been entitled to exercise if [he] [she] were still alive.

4. This Agreement may not be changed or terminated orally but only by an agreement in writing signed by the party against whom enforcement of any such change or termination is sought.

5. The Company shall not be deemed by the grant of the Option (as distinguished from a separate employment agreement or service contract, if any) to be required to retain the services of the Optionee for any period.

6. The Optionee shall not have any rights as a stockholder with respect to any shares covered by the Option until the date of the issuance of the stock certificate or certificates to [him] [her] for such shares following his exercise of the Option pursuant to its terms and conditions and payment for the shares. No adjustment shall be made for dividends or other rights for which the record date is prior to the date such certificate or certificates are issued.

7. The Optionee consents to the placing on the certificate for any shares covered by the Option of an appropriate legend restricting resale or other transfer of such shares except in accordance with the Securities Act of 1933 and all applicable rules thereunder.

8. In the event of any difference of opinion concerning the meaning or effect of the Plan or this Agreement, such difference shall be resolved by the committee referred to in the Plan.

9. The validity, construction and performance of this agreement shall be governed by the laws of the State of Texas. Any invalidity of any provision of this Agreement shall not affect the validity of any other provision.

10. All offers, notices, demands, requests, acceptances or other communications hereunder shall be in writing and shall be deemed to have been duly made or given if mailed by registered or certified mail, return receipt requested. Any such notice mailed to the Company shall be addressed to its principal office, and any notice mailed to the Optionee shall be addressed to the Optionee's residence address as it appears on the books and records of the Company or to such other address as either party may hereafter designate in writing to the other.

11. This Agreement shall, except as herein stated to the contrary, inure to the benefit of and bind the legal representatives, successors and assigns of the parties hereto.

12. This Option is a nonqualified stock option which is not intended to be governed by section 422 of the Internal Revenue Code of 1986, as amended.

13. In accepting this Option, the Optionee accepts and agrees to be bound by all the terms and conditions of the Plan which pertain to nonqualified stock options granted under the Plan.

IN WITNESS WHEREOF, this Agreement has been duly executed and delivered to be effective as of the day and year first above written.

QUANEX CORPORATION

By: _____
Raymond A. Jean
Chairman, President and CEO

Accepted:

Optionee

Date

NONQUALIFIED STOCK OPTION AGREEMENT
Quanex Corporation
1996 Employee Stock Option and Restricted Stock Plan

This **STOCK OPTION AGREEMENT** (the “*Agreement*”) is made between **QUANEX CORPORATION**, a Delaware corporation (the “*Company*”), and _____ (the “*Optionee*”). The Board of Directors of the Company has adopted the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan (the “*Plan*”), which is incorporated by reference herein. The Company considers that its interests will be served by granting the Optionee an option to purchase shares of common stock of the Company as an inducement for [his] [her] continued and effective performance of services for the Company. Any term used in this Agreement that is not specifically defined herein shall have the meaning specified in the Plan.

IT IS AGREED:

1. Subject to the terms of the Plan and this Agreement, on _____, 200____ (the “*Date of Grant*”), the Company hereby grants to the Optionee a nonqualified stock option (the “*Option*”) to purchase _____ shares of the common stock of the Company, \$.50 par value per share, at a price of \$ _____ per share, subject to adjustment as provided in the Plan. The Option is exercisable in accordance with the following schedule:

(a) on the day after the first anniversary of the Date of Grant, the Option may be exercised with respect to up to 1/3 of the shares subject to the Option;

(b) after each succeeding anniversary of the Date of Grant, the Option may be exercised with respect to up to an additional 1/3 of the shares subject to the Option, so that after the expiration of the third anniversary of the Date of Grant the Option shall be exercisable in full; and

(c) to the extent not exercised, installments shall be cumulative and may be exercised in whole or in part.

2. Except as specified below, the Option granted to the Optionee under this Agreement shall not be transferable or assignable by the Optionee other than by will or the laws of descent and distribution, and shall be exercisable during the Optionee’s lifetime only by [him] [her]. The Optionee may transfer this Option to a member or members of [his] [her] immediate family, a trust under which [his] [her] immediate family members are the only beneficiaries and a partnership of which [his] [her] immediate family members are the only partners. For this purpose, “immediate family” means the Optionee’s spouse, children, stepchildren, grandchildren, parents, grandparents, siblings (including half brothers and sisters), and individuals who are family members by adoption. Notwithstanding any other provision of this Agreement, such a transferee of the Option granted under this Agreement may exercise the Option during the Optionee’s lifetime. None of the Company, its employees or directors makes any representations or guarantees concerning the tax consequences associated with the inclusion of this provision in this Agreement, the Optionee’s transfer of the Option granted under this Agreement or

transferee’s exercise of the Option. It is the sole responsibility of the Optionee to seek advice from [his] [her] own tax advisors concerning those tax consequences. The Optionee is entitled to rely upon only the tax advice of his own tax advisors.

3. The Option shall terminate and become null and void on the earliest of (a) the last day of the ten-year period commencing on the Date of Grant, (b) the last day of the three-month period commencing on the date on which the Optionee ceases to be a member of the Board of Directors for any reason other than death, Disability or Retirement, or (c) the last day of the three-year period commencing on the date on which the Optionee ceases to be a member of the Board of Directors due to death, Disability or Retirement. If the Optionee ceases to be a director of the Company for any reason other than death, Disability or Retirement, the Option shall not continue to vest after such cessation of service as a director. If the Optionee ceases to be a director of the Company due to the death, Disability or Retirement of the Optionee, the Option shall continue to vest after such cessation of service as a director until the expiration of the Option.

Upon the death of the Optionee prior to the expiration of [his] [her] Option, [his] [her] executors, administrators or any person or persons to whom [his] [her] Option may be transferred by will or by the laws of descent and distribution, shall have the right, at any time prior to the expiration date of the Option to exercise the Option with respect to the number of shares that the Optionee would have been entitled to exercise if [he] [she] were still alive.

4. This Agreement may not be changed or terminated orally but only by an agreement in writing signed by the party against whom enforcement of any such change or termination is sought.

5. The Company shall not be deemed by the grant of the Option to be required to retain the services of the Optionee for any period.

6. The Optionee shall not have any rights as a stockholder with respect to any shares covered by the Option until the date of the issuance of the stock certificate or certificates to [him] [her] for such shares following his exercise of the Option pursuant to its terms and conditions and payment for the shares. No adjustment shall be made for dividends or other rights for which the record date is prior to the date such certificate or certificates are issued.

7. The Optionee consents to the placing on the certificate for any shares covered by the Option of an appropriate legend restricting resale or other transfer of such shares except in accordance with the Securities Act of 1933 and all applicable rules thereunder.

8. In the event of any difference of opinion concerning the meaning or effect of the Plan or this Agreement, such difference shall be resolved by the committee referred to in the Plan.

9. The validity, construction and performance of this agreement shall be governed by the laws of the State of Texas. Any invalidity of any provision of this Agreement shall not affect the validity of any other provision.

10. All offers, notices, demands, requests, acceptances or other communications hereunder shall be in writing and shall be deemed to have been duly made or given if mailed by registered or certified mail, return receipt requested. Any such notice mailed to the Company shall be addressed to its principal office, and any notice mailed to the Optionee shall be addressed to the Optionee's residence address as it appears on the books and records of the Company or to such other address as either party may hereafter designate in writing to the other.

11. This Agreement shall, except as herein stated to the contrary, inure to the benefit of and bind the legal representatives, successors and assigns of the parties hereto.

12. This Option is a nonqualified stock option which is not intended to be governed by section 422 of the Internal Revenue Code of 1986, as amended.

13. In accepting this Option, the Optionee accepts and agrees to be bound by all the terms and conditions of the Plan which pertain to nonqualified stock options granted under the Plan.

IN WITNESS WHEREOF, this Agreement has been duly executed and delivered to be effective as of the day and year first above written.

QUANEX CORPORATION

By: _____
Raymond A. Jean
Chairman, President and CEO

Accepted:

Optionee

Date

NONQUALIFIED STOCK OPTION AGREEMENT
Quanex Corporation
1996 Employee Stock Option and Restricted Stock Plan

This **STOCK OPTION AGREEMENT** (the "*Agreement*") is made between **QUANEX CORPORATION**, a Delaware corporation (the "Company"), and _____ (the "*Optionee*"). The Board of Directors of the Company has adopted the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan (the "*Plan*"), which is incorporated by reference herein. The Company considers that its interests will be served by granting the Optionee an option to purchase shares of common stock of the Company as an inducement for [his] [her] continued and effective performance of services for the Company. Any term used in this Agreement that is not specifically defined herein shall have the meaning specified in the Plan.

IT IS AGREED:

1. Subject to the terms of the Plan and this Agreement, on _____, 200 (the "*Date of Grant*"), the Company hereby grants to the Optionee a nonqualified stock option (the "*Option*") to purchase _____ shares of the common stock of the Company, \$.50 par value per share, at a price of \$ _____ per share, subject to adjustment as provided in the Plan. The Option is fully exercisable at all times until the expiration of the Option.
2. Except as specified below, the Option granted to the Optionee under this Agreement shall not be transferable or assignable by the Optionee other than by will or the laws of descent and distribution, and shall be exercisable during the Optionee's lifetime only by [him] [her]. The Optionee may transfer this Option to a member or members of [his] [her] immediate family, a trust under which [his] [her] immediate family members are the only beneficiaries and a partnership of which [his] [her] immediate family members are the only partners. For this purpose, "immediate family" means the Optionee's spouse, children, stepchildren, grandchildren, parents, grandparents, siblings (including half brothers and sisters), and individuals who are family members by adoption. Notwithstanding any other provision of this Agreement, such a transferee of the Option granted under this Agreement may exercise the Option during the Optionee's lifetime. None of the Company, its employees or directors makes any representations or guarantees concerning the tax consequences associated with the inclusion of this provision in this Agreement, the Optionee's transfer of the Option granted under this Agreement or transferee's exercise of the Option. It is the sole responsibility of the Optionee to seek advice from [his] [her] own tax advisors concerning those tax consequences. The Optionee is entitled to rely upon only the tax advice of his own tax advisors.
3. The Option shall terminate and become null and void on the earliest of (a) the last day of the ten-year period commencing on the Date of Grant, (b) the last day of the three-month period commencing on the date on which the Optionee ceases to be a member of the Board of Directors for any reason other than death, Disability or Retirement, or (c) the last day of the three-year period commencing on the date on which the Optionee ceases to be a member of the Board of Directors due to death, Disability or Retirement. Upon the death of the Optionee prior

to the expiration of [his] [her] Option, [his] [her] executors, administrators or any person or persons to whom [his] [her] Option may be transferred by will or by the laws of descent and distribution, shall have the right, at any time prior to the expiration date of the Option to exercise the Option with respect to the number of shares that the Optionee would have been entitled to exercise if [he] [she] were still alive.
4. This Agreement may not be changed or terminated orally but only by an agreement in writing signed by the party against whom enforcement of any such change or termination is sought.
5. The Company shall not be deemed by the grant of the Option to be required to retain the services of the Optionee for any period.
6. The Optionee shall not have any rights as a stockholder with respect to any shares covered by the Option until the date of the issuance of the stock certificate or certificates to [him] [her] for such shares following his exercise of the Option pursuant to its terms and conditions and payment for the shares. No adjustment shall be made for dividends or other rights for which the record date is prior to the date such certificate or certificates are issued.
7. The Optionee consents to the placing on the certificate for any shares covered by the Option of an appropriate legend restricting resale or other transfer of such shares except in accordance with the Securities Act of 1933 and all applicable rules thereunder.
8. In the event of any difference of opinion concerning the meaning or effect of the Plan or this Agreement, such difference shall be resolved by the committee referred to in the Plan.
9. The validity, construction and performance of this agreement shall be governed by the laws of the State of Texas. Any invalidity of any provision of this Agreement shall not affect the validity of any other provision.
10. All offers, notices, demands, requests, acceptances or other communications hereunder shall be in writing and shall be deemed to have been duly made or given if mailed by registered or certified mail, return receipt requested. Any such notice mailed to the Company shall be addressed to its principal office, and any notice mailed to the Optionee shall be addressed to the Optionee's residence address as it appears on the books and records of the Company or to such other address as either party may hereafter designate in writing to the other.
11. This Agreement shall, except as herein stated to the contrary, inure to the benefit of and bind the legal representatives, successors and assigns of the parties hereto.
12. This Option is a nonqualified stock option which is not intended to be governed by section 422 of the Internal Revenue Code of 1986, as amended.
13. In accepting this Option, the Optionee accepts and agrees to be bound by all the terms and conditions of the Plan which pertain to nonqualified stock options granted under the Plan.

IN WITNESS WHEREOF, this Agreement has been duly executed and delivered to be effective as of the day and year first above written.

QUANEX CORPORATION

By: _____
Raymond A. Jean
Chairman, President and CEO

Accepted:

Optionee

Date

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Raymond A. Jean, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Quanex Corporation (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures [as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)] and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c. Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

March 11, 2005

/s/ Raymond A. Jean

Raymond A. Jean

Chairman of the Board, President and
Chief Executive Officer
(Principal Executive Officer)

CHIEF FINANCIAL OFFICER CERTIFICATION

I, Terry M. Murphy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Quanex Corporation (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures [as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)] and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c. Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

March 11, 2005

/s/ Terry M. Murphy

Terry M. Murphy

Vice President – Finance and

Chief Financial Officer

(Principal Financial Officer)

**Certification Pursuant To Section 906
of the Sarbanes-Oxley Act of 2002**

We hereby certify that the accompanying Report of Quanex Corporation on Form 10-Q for the quarter ended January 31, 2005 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Report fairly presents, in all material respects, the financial condition and results of operations of Quanex Corporation.

March 11, 2005

/s/ Raymond A. Jean

Raymond A. Jean
*Chairman of the Board, President and
Chief Executive Officer*

/s/ Terry M. Murphy

Terry M. Murphy
*Vice President—Finance and
Chief Financial Officer*
