UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 31, 2001

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	38-1872178
(State or other jurisdiction of incorporation or organization)	(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 [X] 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 July 31, 2001
Common Stock, par value $0.50 per share	13,384,507

QUANEX CORPORATION
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

QUANEX CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands)

	July 31, 2001 (Unaudited)	October 31, 2000 (Audited)
ASSETS		
Current assets:		
Cash and equivalents	$ 31,805	$ 22,409
Accounts and notes receivable, net	97,999	98,465
Inventories	91,423	101,274
Deferred income taxes	12,657	12,771
Other current assets	5,349	1,027
Total current assets	239,233	235,946
Property, plant and equipment	729,274	681,992
Less accumulated depreciation and amortization	(374,531)	(343,744)
Property, plant and equipment, net	354,743	338,248
Goodwill, net	60,127	47,539
Other assets	44,865	24,126
	$ 698,968	$ 645,859
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 77,289	$ 77,339
Accrued expenses	48,222	50,189
Income taxes payable	3,740	3,218
Other current liabilities	3,582	--
Current maturities of long-term debt	420	256
Total current liabilities	133,253	131,002
Long-term debt	236,487	191,657
Deferred pension credits	5,158	7,026
Deferred postretirement welfare benefits	7,718	7,634
Deferred income taxes	25,301	27,620
Other liabilities	17,605	14,423
Total liabilities	425,522	379,362
Stockholders' equity:		
Preferred stock, no par value	--	--
Common stock, $.50 par value	7,043	7,110
Additional paid-in capital	108,152	111,061
Retained earnings	177,188	165,841
Unearned compensation	(1,227)	(467)
Accumulated other comprehensive income	(3,901)	(301)
	287,255	283,244
Less: Common stock held by rabbi trust	(851)	(3,349)
Less: Cost of shares of common stock in treasury	(12,958)	(13,398)
Total stockholders' equity	273,446	266,497
	$ 698,968	$ 645,859

QUANEX CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)

	Three Months Ended July 31, 2001	Three Months Ended July 31, 2000	Nine Months Ended July 31, 2001	Nine Months Ended July 31, 2000
	(Unaudited)		(Unaudited)	
Net sales	$ 240,332	$ 254,144	$ 647,915	$ 696,709
Cost and expenses:				
Cost of sales	197,792	208,874	540,220	575,172
Selling, general and administrative expense	13,492	14,113	38,188	40,251
Depreciation and amortization	10,695	12,310	33,116	37,381
Loss on sale of Piper Impact Europe	--	14,280	--	14,280
Operating income	18,353	4,567	36,391	29,625
Other income (expense):				
Interest expense	(4,129)	(4,149)	(12,412)	(11,499)
Capitalized interest	349	499	1,095	1,690
Other, net	208	289	1,975	1,598
Income before income taxes and extraordinary gain	14,781	1,206	27,049	21,414
Income tax expense	(5,173)	(491)	(9,467)	(7,495)
Income before extraordinary gain	9,608	715	17,582	13,919
Extraordinary gain - early extinguishment of debt (net of taxes)	--	--	372	358
Net income	$ 9,608	$ 715	$ 17,954	$ 14,277
Earnings per common share:				
Basic:				
Income before extraordinary gain	$ 0.72	$ 0.05	$ 1.31	$ 1.00
Extraordinary gain	--	--	0.03	0.03
Total basic net earnings	$ 0.72	$ 0.05	$ 1.34	$ 1.03
Diluted:				
Income before extraordinary gain	$ 0.67	$ 0.05	$ 1.28	$ 1.00
Extraordinary gain	--	--	0.02	0.02
Total diluted net earnings	$ 0.67	$ 0.05	$ 1.30	$ 1.02
Weighted average shares outstanding:				
Basic	13,377	13,534	13,397	13,827
Diluted	15,428	13,682	15,420	13,973
Common stock dividends per share	$ 0.16	$ 0.16	$ 0.48	$ 0.48

QUANEX CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOW
(In thousands)

	Nine Months Ended July 31,	
	2001	2000
	(Unaudited)	
Operating activities:		
Net income	$ 17,954	$ 14,277
Adjustments to reconcile net income to cash provided by operating activities:		
Extraordinary gain on early extinguishment of debt (net of taxes)	(372)	(358)
Loss on sale of Piper Impact Europe (net of taxes of $4,998)	--	9,282
Depreciation and amortization	33,454	37,777
Deferred income taxes	(2,596)	(2,877)
Deferred pension and postretirement benefits	(1,784)	158
Changes in assets and liabilities net of effects from acquisitions and dispositions:		
Decrease (increase) in accounts and notes receivable	3,790	(8,546)
Decrease (increase) in inventory	12,494	(7,878)
Increase (decrease) in accounts payable	(2,111)	7,666
Decrease in accrued expenses	(3,348)	(5,661)
Other, net (including income tax refund)	(1,394)	10,530
Cash provided by operating activities	56,087	54,370
Investment activities:		
Acquisition of Golden Aluminum, net of cash acquired	--	(20,148)
Acquisition of Imperial Products, Inc., net of cash acquired	--	(15,303)
Acquisition of Temroc Metals, Inc., net of cash acquired	(17,922)	--
Capital expenditures, net of retirements	(42,998)	(33,368)
Other, net	(3,523)	(569)
Cash used by investment activities	(64,443)	(69,388)
Cash used by operating and investment activities	(8,356)	(15,018)
Financing activities:		
Bank borrowings, net	47,000	53,193
Repayment of borrowings against insurance policies	(17,273)	--
Purchase of subordinated debentures	(3,942)	(9,586)
Purchase of Quanex common stock	(1,990)	(15,879)
Common dividends paid	(6,469)	(6,711)
Issuance of common stock, net	1,813	964
Other, net	(1,387)	(352)
Cash provided by financing activities	17,752	21,629
Effect of exchange rate changes on cash and equivalents	--	67
Increase in cash and equivalents	9,396	6,678
Cash and equivalents at beginning of period	22,409	25,874
Cash and equivalents at end of period	$ 31,805	$ 32,552
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 12,823	$ 11,224
Cash paid during the period for income taxes	$ 10,030	$ 10,524
Cash received during the period for income tax refunds	$ (210)	$ (7,000)

QUANEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Accounting Policies

The interim consolidated financial statements of Quanex Corporation and subsidiaries ("Quanex" or the "Company") are unaudited, but include all adjustments which the Company deems necessary for a fair presentation of its financial position and results of operations. All such adjustments are of a normal recurring nature. Results of operations for interim periods are not necessarily indicative of results to be expected for the full year. All significant accounting policies conform to those previously set forth in the Company's fiscal 2000 Annual Report on Form 10-K which is incorporated by reference. Certain amounts for prior periods have been reclassified in the accompanying consolidated financial statements to conform to 2001 classifications.

2. Inventories

Inventories consist of the following:

	July 31, 2001	October 31, 2000
	(In thousands)	
Raw materials	$24,108	$ 26,473
Finished goods and work in process	60,049	67,981
	84,157	94,454
Other	7,266	6,820
	$91,423	$101,274

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

LIFO	$63,067	$ 69,028
FIFO	28,356	32,246
	$91,423	$101,274

With respect to inventories valued using the LIFO method, replacement cost exceeded the LIFO value by approximately $8 million at July 31, 2001 and $10 million at October 31, 2000, respectively.

3. Acquisitions

On November 30, 2000, Quanex completed the purchase of all of the capital stock of Temroc Metals, Inc., ("Temroc"), a Minnesota corporation, for approximately $22 million in cash. Temroc, as a surviving corporation, became a wholly owned subsidiary of the Company. Goodwill associated with Temroc is approximately $14 million, based on preliminary purchase accounting. Temroc is a leading aluminum extrusion and fabrication company based in Hamel, Minnesota where it manufactures customized aluminum extrusions and fabricated metal products for recreational vehicles, architectural products, electronics and other markets. Temroc has become part of the Company's Engineered Products Group and will continue to operate as a manufacturer of aluminum extrusions and fabricated metal products. To finance the acquisition, the Company borrowed against its existing $250 million unsecured revolving credit and term loan facility with a group of six banks. 4

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4. 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 July 31, 2001 / For the Three Months Ended July 31, 2000

Income (Numerator) | Shares (Denominator) | Per-Share Amount | Income (Numerator) | Shares (Denominator) | Per-Share Amount

BASIC

EPS Income
before
extra. gain
$ 9,608
13,377 $0.72
$715 13,534
$0.05 Extra.
Gain - early
debt ext. -
- - - ------
-- ----- ---
- -----
Total basic
net earnings
$ 9,608
$0.72 $715
$0.05 EFFECT
OF DILUTIVE
SECURITIES
Effect of
common stock
equiv.
arising from
stock
options -
140 - 1
Effect of
common stock
held by
rabbi trust
- 46 - 147
Effect of
conversion
of
subordinated
debentures
(1) 691
1,865 - -
DILUTED EPS
Income
before
extra. gain
$ 10,299
15,428 $0.67
$715 13,682
$0.05 Extra.
Gain - early
debt ext. -
- - - ------
-- ----- ---
- -----
Total basic
net earnings
$ 10,299
$0.67 $715
$0.05
For the Nine
Months Ended
For the Nine
Months Ended
July 31,
2001 July
31, 2000
Income
Shares Per-
Share Income
Shares Per-
Share
(Numerator)
(Denominator)
Amount
(Numerator)
(Denominator)
Amount -----
------ -----
-------- ---
------ -----
------ -----
-------- ---
----- BASIC
EPS Income
before
extra. gain
$ 17,582
13,397 $1.31
$13,919
13,827 $1.00

Extra. Gain
- early debt
ext. 372
0.03 358 .03
-------- ---
-- ------- -
---- Total
basic net
earnings $
17,954 $1.34
$14,277
$1.03 EFFECT
OF DILUTIVE
SECURITIES
Effect of
common stock
equiv.
arising from
stock
options - 32
- 6 Effect
of common
stock held
by rabbi
trust - 86 -
140 Effect
of
conversion
of
subordinated
debentures
(1) 2,119
1,905 - -
DILUTED EPS
Income
before
extra. gain
$ 19,701
15,420 $1.28
$13,919
13,973 $1.00
Extra. Gain
- early debt
ext. 372
0.02 358 .02
-------- ---
-- ------- -
---- Total
basic net
earnings $
20,073 $1.30
$14,277
$1.02
- -------------- (1) Conversion of the Company's 6.88% convertible subordinated debentures into common stock is anti-dilutive for the three and nine month periods ended July 31, 2000 and, therefore, is not included in the calculation of diluted earnings per share. 5. Comprehensive Income ($ in thousands) Total comprehensive income for the three and nine months ended July 31, 2001 is $8,900 and $14,354, respectively. Total comprehensive income for the three and nine months ended July 31, 2000 is $963 and $14,580, respectively. Included in comprehensive income is net income, the change in the cumulative foreign currency translation adjustment balance (for fiscal 2000 only), the change in the adjustment for minimum pension liability balance and the effective portion of the gains and losses on derivative instruments designated as cash flow hedges. 5

6. Long-term Debt

Long-term debt consists of the following:

(In thousands)	July 31, 2001	October 31, 2000
Bank Agreement Revolver	$157,000	$110,000
Convertible subordinated debentures	58,727	63,337
Temroc Industrial Development Revenue Bonds	2,654	-
Industrial Revenue and Economic Development Bonds	3,275	3,275
State of Alabama Industrial Development Bonds	4,500	4,755
Scott County, Iowa Industrial Waste Recycling Revenue Bonds	2,600	2,800
Other	8,151	7,746
	$236,907	$191,913
Less maturities due within one year included in current liabilities	420	256
	$236,487	$191,657

The Temroc Industrial Development Revenue Bonds were obtained as part of the acquisition of Temroc. These bonds are due in annual installments through October 2012. Interest is payable semi-annually at fixed rates from 4.5% to 5.6% depending on maturity (average rate of 5.1% over the term of the bonds). These bonds are secured by a mortgage on Temroc's land and building. During the fiscal third quarter ended July 31, 2001, the Company borrowed on the Revolver to pay back $17.3 million of loans taken against the cash surrender value of various officer life insurance policies. These loans had previously been netted as an offset to the cash surrender value and classified as "Other assets" on the balance sheet.

```
9 7. Industry Segment Information (in thousands)
THREE
MONTHS
ENDED
Engineered
Aluminum
Engineered
Corporate
JULY 31,
2001 Steel
Mill Sheet
Products
Piper And
Bars
Products
(5) Impact
Other(1)
Consolidated
----------
----------
----------
-------- --
------- ---
---------
Net Sales:
To
unaffiliated
companies
$83,569
$92,935
$44,062
$19,766 $ -
- $240,332
Inter-
segment (2)
1,094 6,028
-- --
(7,122) --
------- ---
---- ------
- ------- -
------ ----
---- Total
$84,663
$98,963
$44,062
$19,766
$(7,122)
$240,332
=======
=======
=======
=======
=======
========
Operating
income
(loss)
$12,171 $
2,201 $
7,325 $ 700
$(4,044) $
18,353
=======
=======
=======
=======
=======
========
THREE
MONTHS
ENDED
Engineered
Aluminum
Engineered
Corporate
JULY 31,
2000 Steel
Mill Sheet
Products
Piper And
Bars
Products(3)
(4)
Impact(6)
Other(1)
```

Consolidated

--------- -
-------- --

Net Sales:
To
unaffiliated
companies
$88,911
$104,797
$32,263 $
28,173 $ --
$254,144
Inter-
segment (2)
1,027 6,046
-- --
(7,073) --
------- ---
----- -----
-- --------
------- ---
----- Total
$89,938
$110,843
$32,263 $
28,173
$(7,073)
$254,144
=======
========
=======
========
=======
========
Operating
income
(loss)
$14,481 $
6,591 $
4,863
$(18,136)
$(3,232) $
4,567
=======
========
=======
========
=======
========
NINE MONTHS
ENDED
Engineered
Aluminum
Engineered
Corporate
JULY 31,
2001 Steel
Mill Sheet
Products
Piper And
Bars
Products
(5) Impact
Other(1)
Consolidated

------- ---
------ ----

Net Sales:
To
unaffiliated
companies
$228,260
$254,212
$101,655
$63,788 $ -
- $647,915
Inter-
segment (2)
4,007

13,711 -- -
- (17,718)
-- --------
-------- --
------ ----
--- -------
- --------
Total
$232,267
$267,923
$101,655
$63,788
$(17,718)
$647,915
========
========
========
=======
========
========
Operating
income
(loss) $
28,171 $
3,625 $
12,325 $
2,772
$(10,502) $
36,391
========
========
========
=======
========
========
NINE MONTHS
ENDED
Engineered
Aluminum
Engineered
Corporate
JULY 31,
2000 Steel
Mill Sheet
Products
Piper And
Bars
Products(3)
(4)
Impact(6)
Other(1)
Consolidated

--------- -
-------- --

Net Sales:
To
unaffiliated
companies
$254,740
$287,201
$73,407 $
81,361 $ --
$696,709
Inter-
segment (2)
3,145
15,210 -- -
- (18,355)
-- --------
-------- --
----- -----
--- -------
- --------
Total
$257,885
$302,411
$73,407 $
81,361
$(18,355)
$696,709
========
========
=======

========
========
========
Operating
income
(loss) $
42,218 $
15,376 $
9,184
$(25,408)
$(11,745) $
29,625
========
========
=======
========
========
========

(1) Included in "Corporate and Other" are inter-segment eliminations and corporate expenses. (2) Inter-segment sales are conducted on an arm's length basis. (3) Results include Nichols Aluminum - Golden operations acquired January 25, 2000. (4) Results include Imperial Products operations acquired April 3, 2000. (5) Fiscal 2001 results include Temroc operations acquired November 30, 2000. (6) Fiscal 2000 results include Piper Europe operations, which was disposed of in July 2000. 7

10 8. Stock Repurchase Program - Treasury Stock In December 1999, Quanex announced that its board of directors approved a program to repurchase up to 2 million shares of the Company's common stock in the open market or in privately negotiated transactions. During the nine months ended July 31, 2001, the Company repurchased 107,800 shares at a cost of approximately $2.0 million. These shares were not canceled, but instead were treated as treasury stock of the Company. The cumulative cost of shares acquired as treasury shares, net of shares reissued, is $13.0 million as of July 31, 2001 and is reflected as a reduction of stockholders' equity in the balance sheet. 9. Extraordinary Item During the nine months ended July 31, 2001, the Company accepted unsolicited block offers to buy back $4.6 million principal amount of the 6.88% Convertible Subordinated Debentures for $3.9 million in cash. An after tax extraordinary gain of $372 thousand was recorded on this transaction. The principal amount of the convertible subordinated debentures outstanding as of July 31, 2001 was $58,727,300. 10. Financial Instruments and Risk Management Effective November 1, 2000, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS No. 138, which requires the Company to measure all derivatives at fair value and to recognize them in the balance sheet as an asset or liability, depending on the Company's rights or obligations under the applicable derivative contract. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. Metal Exchange Forward Contracts The Company's aluminum mill sheet products segment, Nichols Aluminum, uses various grades of aluminum scrap as well as prime aluminum ingot as a raw material 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) as well as forward 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 as well as a certain level of forecasted aluminum sales, net of fixed price purchase commitments. With the use of firm price raw material purchase commitments and LME contracts, the Company aims to protect the gross margins 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 on the Company. Where firm price sales commitments are matched with LME contracts, the Company is subject to the ineffectiveness of LME contracts to perfectly hedge raw material prices. The Company has grouped the LME contracts into two types: customer specific and non-customer specific. The customer specific contracts have been designated as cash flow hedges of forecasted aluminum raw material purchases in accordance with SFAS 8

11 No. 133. The non-customer specific LME contracts that are used to manage or balance the raw material needs have not been designated as hedges and, therefore, do not receive hedge accounting under SFAS No. 133. Both types of contracts are measured at fair market value on the balance sheet. As of July 31, 2001, open LME forward contracts have maturity dates extending through October 2003. At July 31, 2001, these contracts covered notional volumes of 37,037,619 pounds and had a fair value loss of approximately $1.3 million, which is recorded as part of other current and non-current liabilities in the financial statements. The effective portion of the gains and losses related to the customer specific forward LME contracts designated as hedges are reported in other comprehensive income. These gains and losses are reclassified into earnings in the periods in which the related inventory is sold. As of July 31, 2001, losses of approximately $856 thousand ($522 thousand net of taxes) are expected to be reclassified from other comprehensive income into earnings over the next twelve months. Gains and losses on these customer specific hedge contracts, including amounts related to hedge ineffectiveness, are reflected in "Cost of sales" in the income statement. For the three and nine months ended July 31, 2001, a net loss of $582 thousand and a net gain of $106 thousand, respectively, were recognized in "Cost of sales" representing the amount of the hedges' ineffectiveness. (No components of these gains and losses were excluded from the assessment of hedge effectiveness. Additionally, no hedge contracts were discontinued due to the determination that the original forecasted transaction would not occur. Therefore, there was no income statement impact related to that action.) The entire amount of gains and losses of the non-customer specific forward LME contracts not designated as hedges are reflected in "Cost of Sales" in the income statement in the period in which they occur. These gains and losses include the changes in fair market value during the period for all open and closed contracts. Interest Rate Swap Agreements In fiscal 1996, the Company entered into interest rate swap agreements, which effectively converted $100 million of its variable rate debt under the Bank Agreement Revolver to fixed rate. The Company's risk management policy related to these swap agreements is to hedge the exposure to interest rate movements on a portion of its long-term debt. Under the swap agreements, payments are made based on a fixed rate ($50 million at 7.025% and $50 million at 6.755%) and received on a LIBOR based variable rate (3.71% at July 31, 2001). Differentials to be paid or received under the agreements are recognized as interest expense. The agreements mature in 2003. The Company has designated the interest rate swap agreements as cash flow hedges of future interest payments on its variable rate long-term debt. On November 1, 2000, the Company recorded a derivative liability of $918 thousand, representing the fair value of the swaps as of that date. A corresponding amount, net of income taxes of $358 thousand, was recorded to other comprehensive income. The fair value of the swaps as of July 31, 2001 was a loss of $5.2 million, which is recorded as part of other current and non-current liabilities. Gains and losses related to the swap agreements will be reclassified into earnings in the periods in which the related hedged interest payments are made. As of July 31, 2001, losses of approximately $2.4 million ($1.5 million net of taxes) are expected to be reclassified into earnings over the next twelve months. Gains and losses on these agreements, including amounts recorded related to hedge ineffectiveness, are reflected in "Interest expense" in the income statement. A net loss of $157 and $466 thousand was recorded in interest expense in the three and nine months ended July 31, 2001 representing the amount of the hedge's ineffectiveness. (No components of the swap instruments' losses were excluded from the assessment of hedge effectiveness. Additionally, none of the swap agreements were discontinued due to the determination that the original forecasted transaction would not occur. Therefore, there was no income statement impact related to that action.) 9

12 If the floating rates were to change by 10% from July 31, 2001 levels, the fair market value of these swaps would change by approximately $700 thousand. In terms of the impact on cash flow to the Company, as floating interest rates decline, the market value of the swap agreement rises, thus increasing the quarterly cash settlement of the swaps paid by the Company. However, the interest paid on the floating rate debt balance decreases. The inverse situation occurs with rising interest rates. 11. Contingencies During the second quarter of fiscal 2001, Nichols Aluminum Casting had some of its aluminum reroll product damaged in a fire at a third-party offsite warehouse storage facility. The product was covered under casualty insurance policies and the Company's cost in the material has subsequently been recovered. No income statement impact has been recorded as a result of the loss or subsequent recovery of costs as they offset one another. The Company has also filed a claim under its business interruption insurance policy, to recover lost profit on the use of this damaged material, but at this time has not collected this portion of the claim and therefore has not recorded any potential gain associated with it. 10

13 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"'s) financial condition and results of operations should be read in conjunction with the July 31, 2001 and October 31, 2000 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 our 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, energy costs, interest rates, construction delays, market conditions for the Company's customers, any material changes in purchases by the Company's principal customers, 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, 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. 11

14 RESULTS OF OPERATIONS Summary Information as % of Sales: (Dollars in millions) THREE MONTHS ENDED JULY 31, NINE MONTHS ENDED JULY 31, ------------------------ -- 2001 2000 2001 2000 --- --------------------- Dollar % of Dollar % of Dollar % of Dollar % of Amount Sales Amount Sales Amount Sales Amount Sales --------- ------ ------ ----- ---- -- ----- ------ ----- Net Sales $ 240.3 100% $ 254.1 100% $ 647.9 100% $ 696.7 100% Cost of Sales 197.8 82 208.9 82 540.2 83 575.1 83 Sell., gen. and admin 13.4 6 14.1 5 38.2 6 40.3 6 Deprec. and amort 10.7 4 12.3 5 33.1 5 37.4 5 Loss on sale of Piper Impact Europe - - 14.3 6 - - 14.3 2 -------- ---- ------ ---- -------- ---- --------- --- Operating Income 18.4 8% 4.5 2% 36.4 6% 29.6 4% Interest Expense (4.1) (2) (4.1) (2) (12.4) (2) (11.5) (1) Capitalized Interest .3 0 .5 0 1.1 0 1.7 0 Other, net .2 0 .3 0 2.0 0 1.6 0 Income tax expense (5.2) (2) (.5) 0 (9.5) (1) (7.5) (1) -------- ---- ------ ---- -------- ---- --------- - --- Income from cont. oper $ 9.6 4% $ .7 0% $ 17.6 3% $ 13.9 2% ======== ====== ======= ===== ======== Overview Despite a slow business environment, Quanex achieved strong earnings for its fiscal third quarter ended July 31, 2001. Management of the Company is encouraged by the ongoing improvements in bookings and increased shipments to the vehicular and building products markets. Quanex's operating groups, MACSTEEL, Nichols Aluminum, and Engineered Products, again exceeded their previous quarter results in both sales and operating income. Piper Impact reported another quarter of positive operating income compared to last year's third quarter loss. Business Segments The following table sets forth selected operating data for the Company's four business segments:

Three Months Ended Nine Months Ended July 31, July 31, ---------------- ------------------------ ----- 2001 2000 2001 2000 ---- ---- ---- ---- (In thousands) (In thousands) Engineered Steel Bars: - --------------------- Net sales .... $ 84,663 $ 89,938 $ 232,267 $ 257,885 Operating income .... 12,171 14,481 28,171 42,218 Deprec. and amort .... 5,328 4,926 15,852 14,776 Identifiable assets .... $ 280,622 $ 260,317 $ 280,622 $ 260,317 Aluminum Mill Sheet Products:(1) Net sales .... $ 98,963 $ 110,843 $ 267,923 $ 302,411 Operating income.............. 2,201 6,591 3,625 15,376 Deprec. and amort............. 3,100 3,196 10,202 9,991 Identifiable assets........... $ 218,770 $ 229,944 $ 218,770 $ 229,944 Engineered Products: (2) (3) Net sales..................... $ 44,062 $ 32,263 $ 101,655 $ 73,407 Operating income.............. 7,325 4,863 12,325 9,184 Deprec. and amort............. 1,273 945 3,819 2,565 Identifiable assets........... $ 92,745 $ 64,917 $ 92,745 $ 64,917 Piper Impact: (4) Net sales..................... $ 19,766 $ 28,173 $ 63,788 $ 81,361 Operating income (loss)....... 700 (18,136) 2,772 (25,408) Deprec. and amort............. 848

3,116 2,816 9,795
Identifiable
assets........... $
45,210 $ 113,136 $ 45,210
$ 113,136

(1) Results include Nichols Aluminum - Golden operations acquired January 25, 2000. (2) Results include Imperial Products operations acquired April 3, 2000. (3) Fiscal 2001 results include Temroc operations acquired November 30, 2000. (4) Fiscal 2000 results include Piper Europe operations which was sold in July 2000. The engineered steel bar business, MACSTEEL, achieved strong shipments for the quarter at both steel plants. Aggressive sales efforts have resulted in new 12

15 accounts as well as increased orders from existing customers. Market share improvement at MACSTEEL is coming from the automotive, oil country and defense segments. MACSTEEL's ability to shift into secondary markets is part of its successful operating tactics. While these markets and products typically don't have as good of a mix as traditional markets, these sales do help in these difficult times. The increased production has enabled the mill to return to a 6-day schedule. Cost control initiatives have taken hold and scrap pricing remains good. The aluminum mill sheet products business, Nichols Aluminum, reported operating income nearly double the previous fiscal quarter's results. Although Nichols' distribution and trailer-truck markets remain weak, they have reduced fixed costs and gained share in the improving building and construction markets during the quarter. Nichols has also benefited from low scrap prices and more effective metal processing capability. The engineered products business achieved all-time quarterly records for sales and operating income during the third quarter. While somewhat softer than this time last year, attractive interest rates continue to draw buyers into the housing market, and remodeling spending has held up well. Results have benefited from the acquisitions of Imperial and Temroc as well as the impact of new product development initiatives. Piper Impact reported another profitable quarter compared to the operating loss of the same period last year. Piper has now delivered three consecutive quarters of profitability. Opportunities are currently being explored to use additional MACSTEEL bars in Piper's processes to manufacture lower cost, high performance components for auto markets. Piper is accelerating deployment of lean manufacturing practices, and remains focused on reaching closure on numerous business development opportunities. Fiscal Quarter and Nine Months ended July 31, 2001 vs. 2000 Net Sales - Consolidated net sales for the three and nine months ended July 31, 2001 were $240.3 million and $647.9 million, respectively, representing a decrease of $13.8 million, or 5%, and $48.8 million, or 7%, when compared to consolidated net sales for the same periods in 2000. All operating segments, with the exception of the engineered products group, experienced decreased net sales. Net sales from the Company's engineered steel bar business for the three and nine months ended July 31, 2001, were $84.7 million and $232.3 million, respectively, representing a decrease of $5.3 million, or 6%, and $25.6 million, or 10%, when compared to the same periods last year. For the three months ended July 31, 2001, compared to the prior year, the decrease was due to lower sales prices. For the nine months ended July 31, 2001 compared to the prior year, the decrease was due to lower sales volume resulting from weaker markets in the transportation and capital goods industry as well as lower sales prices. The business continued to experience pricing pressures; however, due to the increased proportion of MACPLUS volume, a value added product, the impact on overall average sales price was minimized. Net sales from the Company's aluminum mill sheet products business for the three and nine months ended July 31, 2001, were $99.0 million and $267.9 million, respectively, representing a decrease of $11.9 million, or 11%, and $34.5 million, or 11%, when compared to the same periods last year. The nine months ending July 31, 2001, included the results of Nichols Aluminum Golden which was acquired January 25, 2000. The decrease in net sales was due to lower sales volume as well as lower selling prices. Volume was affected by more severe winter weather during the first fiscal quarter than was experienced in the prior year, as well as a general economic slowdown. These factors negatively affected the building and construction and trailer-truck markets that Nichols Aluminum serves. The building and construction market did, however, show recovery during the fiscal quarter ended July 31, 2001 and is currently at its highest level this year. Sales prices were also negatively impacted by the extremely competitive 13

16 pricing environment and the fact that other mills are aggressively seeking available business during the economic slowdown. Net sales from the Company's engineered products business for the three and nine months ended July 31, 2001, were $44.1 million and $101.7 million, respectively, representing an increase of $11.8 million, or 37%, and $28.2 million, or 38%, when compared to the same periods last year. The increase was largely due to the contributions from Imperial Products, ("Imperial"), which was acquired in April 2000, and Temroc, acquired November 30, 2000. Additionally, the group's net sales improved at the other facilities, benefiting from the capital expansion project at AMSCO which was completed in November 2000 and new product development initiatives. Net sales from the Company's Piper Impact business for the three and nine months ended July 31, 2001, were $19.8 million and $63.8 million, respectively, representing a decrease of $8.4 million, or 30%, and $17.6 million, or 22%, when compared to the same periods last year. Net sales for the period ending July 31, 2000 included sales from Piper Impact Europe which was sold in July of 2000. Comparable net sales of Piper's operations, excluding Piper Europe, decreased 17% for the three months ended July 31, 2001 and remained flat for the nine month period ended July 31, 2001 over the same prior year periods. Operating income - Consolidated operating income for the three and nine months ended July 31, 2001 were $18.4 million and $36.4 million, respectively, representing an increase of $13.8 million, or 302%, and $6.8 million, or 23%, when compared to the same periods last year. The prior year's three and nine months ended July 31, 2000 included a $14.3 million loss on the sale of Piper Europe. Excluding that loss, operating income decreased 3% and 17% for the three and nine months ended July 31, 2001, respectively. Lower operating income at the Company's engineered steel bar and aluminum mill sheet businesses were partially offset by improved operating results at the engineered products and Piper Impact businesses. Operating income from the Company's engineered steel bar business for the three and nine months ended July 31, 2001, was $12.2 million and $28.2 million, respectively, representing a decrease of $2.3 million, or 16%, and $14.0 million, or 33%, when compared to the same periods last year. This decrease was due largely to lower net sales resulting from the sluggish demand in the transportation and capital goods markets as well as competitive pricing pressures. Lower material scrap prices helped offset some of the impact of reduced volume and lower selling price. The business experienced increased utility costs as energy prices rose and recognized higher depreciation expense with the completion of capital projects. Operating income from the Company's aluminum mill sheet products business for the three and nine months ended July 31, 2001, was $2.2 million, and $3.6 million, respectively, representing a decrease of $4.4 million, or 67%, and $11.8 million, or 76%, when compared to the same periods last year. The decline largely resulted from significantly lower net sales, lower spreads and higher energy costs. Operating income from the Company's engineered products business for the three and nine months ended July 31, 2001, was $7.3 million and $12.3 million, respectively, representing an increase of $2.5 million, or 51%, and $3.1 million, or 34%, when compared to the same periods last year. The increase was due in part to the acquisition of Imperial, acquired in April of 2000 and Temroc, acquired November 30, 2000. Additionally, operating income increased at the other facilities due largely to higher net sales. Operating income from the Company's Piper Impact business for the three and nine months ended July 31, 2001 was $0.7 million and $2.8 million, respectively, compared to operating losses of $18.1 million and $25.4 million for the same prior year periods. The prior year's results included the operating loss of Piper Impact Europe which was sold in July of 2000 as well as the $14.3 million loss 14

17 recorded upon its sale. Comparative operating income, excluding Piper Europe, improved 120% and 132% from the same prior year's results. This improvement is a result of lower costs realized from cellular manufacturing and cost cutting efforts. Additionally, depreciation expense declined with the reduced asset base, which resulted from the asset impairment charge recorded in the fourth quarter of fiscal 2000. In addition to the four operating segments mentioned above, corporate level operating expenses for the three and nine months ended July 31, 2001, were $4.0 million and $10.5 million, respectively, compared to $3.2 million and $11.7 million, for the same periods last year. Included in corporate and other are the corporate office expenses, impact of LIFO valuation method of inventory accounting and inter-segment eliminations as well as inter-company gains and losses from derivative instruments. (See Note 2 to the financial statements regarding LIFO valuation method of inventory accounting.) Selling, general and administrative expense was $13.5 million and $38.2 million, respectively, for the three and nine months ended July 31, 2001 representing a decrease of $0.6 million, or 4%, and a decrease of $2.1 million, or 5%, when compared to the same periods last year. The decrease in the nine months ended July 31, 2001 as compared to the same prior year period was largely due to the sale of Piper Europe in July of 2000, cost cutting measures at the remaining Piper Impact facilities and lower corporate level expenses. These decreases were partially offset, however, by the expenses of Imperial and Temroc, which were acquired in April 2000 and November 2000, respectively. Depreciation and amortization decreased by $1.6 million, or 13%, and $4.3 million, or 11%, respectively, for the three and nine months ended July 31, 2001, as compared to the same periods last year. The engineered steel bar and engineered products businesses experienced increased depreciation amounts due to recently completed capital projects as well as the acquisitions of Imperial and Temroc. This increase was more than offset, however, by the decreased depreciation at Piper Impact which resulted from the sale of Piper Impact Europe as well as the asset impairment charge taken in the fourth quarter of the prior fiscal year. Interest expense for the three months ended July 31, 2001 decreased by $20 thousand from the same period last year due largely to the lower outstanding debt balance as well as lower interest rates on a portion of the revolver balance. This was partially offset, however, by the ineffective portion of the loss on certain interest rate swap derivatives recognized during that period. (See Note 10 to the financial statements.) Interest expense increased $913 thousand, or 8%, respectively, for the nine months ended July 31, 2001, as compared to the same fiscal period of 2000. The increase was primarily due to 1) higher outstanding debt balance and 2) the ineffective portion of the loss on certain interest rate swap derivatives recognized during that period. (See Notes 3, 8 and 10 to the financial statements.) Capitalized interest decreased by $150 and $595 thousand, respectively, for the three and nine months ended July 31, 2001, as compared to the same periods of 2000, due to the completion of the Phase V expansion project at MACSTEEL in December 2000. Net income was $9.6 and $18.0 million, respectively, for the three and nine months ended July 31, 2001, compared to $0.7 and $14.3 million for the same periods of 2000. In addition to the items mentioned above, the nine month period ended July 31, 2001 included an extraordinary gain of $372 thousand on the purchase of subordinated debentures, compared to $358 thousand for the nine month period ended July 31, 2000. Additionally, the three and nine month periods ended July 31, 2000 included a $14.3 million ($9.3 million after tax) loss on the sale of Piper Impact Europe.

18 Outlook Overall, we believe that MACSTEEL continues to outperform their competitors in a tough market. MACSTEEL traditionally has better operating results in the second half of the year, and we expect this year will be no different with better results in the fourth quarter than the third. With the additional value adding capacity expected to come on-line by early fiscal 2002 at the completion of the Phase VI construction project, we expect MACSTEEL to do better next year. At Nichols Aluminum, we expect business conditions to continue to improve. They are now booked out through most of October, as the building and construction market has improved and is at its highest level this year. Customers are generally optimistic that business conditions will remain strong through the remainder of the fiscal year. However, sales to service centers remain a challenge as pricing is very competitive. We expect Nichols Aluminum to have a better second half and believe the fourth quarter will be their best quarter this fiscal year. Higher operating results are also anticipated at the engineered products group for the second half of fiscal year 2001, compared to the first half. These improvements are expected as a result of the acquisitions of Imperial and Temroc, new product initiatives, a strong housing market and cost reduction programs. While Piper Impact, excluding Piper Europe, showed a significant improvement in net sales and operating income for the nine months ended July 31, 2001 as compared to the same prior year period, the aluminum air bag component business is expected to continue its decline. Piper's fourth quarter outlook is flat compared to the third quarter. This is slightly better than original expectations as Piper has been able to "backfill" anticipated order declines from specific customers faster than originally expected. The Company has been evaluating strategic alternatives available regarding Piper Impact, including its possible sale. This business has been stable for several quarters and has been profitable throughout the year. These improvements, coupled with unrealistic valuations by potential purchasers, have led us to the decision to keep Piper Impact within the Quanex family for now. We believe assets have been written down to a level which is in line with its earnings potential. The Company typically experiences better operating results as the year progresses and we expect that will be the case this year. For the fourth quarter of fiscal 2001, operating results are expected to lag last year's comparable quarter but show some improvement from third quarter 2001. The Company previously indicated in its July 24, 2001 quarterly update that the fiscal year 2001 fully diluted earnings per share are expected to be between $1.75 and $2.00. Based on year-to-date results and slow, but steady improvement in the demand for Quanex's vehicular and building products, the Company expects to earn near the top of that range. LIQUIDITY AND CAPITAL RESOURCES The Company's principal sources of funds are cash on hand, cash flow from operations, and borrowings under its $250 million unsecured Revolving Credit and Term Loan Agreement ("Bank Agreement"). At July 31, 2001, the Company had $157 million borrowed under the Bank Agreement. This represents a $47 million increase over October 31, 2000 borrowing levels. The borrowings were primarily used to finance the acquisition of Temroc (see Note 3 to the financial statements), to repurchase $4.6 million principal amount of the Company's 6.88% Subordinated Debentures and to pay $17.3 million of insurance policy loans. (See Note 6 to the financial statements.) There have been no significant changes to the terms of the Company's debt structure during the three and nine month periods ended July 31, 2001. (See Note 6 to the financial statements for detail regarding the outstanding borrowings under the Company's various facilities.) At July 31, 2001, the Company had commitments of approximately $15 million for the purchase or construction of capital assets. The Company plans to fund 16

19 these capital expenditures through cash flow from operations and, if necessary, additional borrowings. During the first nine months of fiscal 2001, the Company accepted unsolicited block offers to buy back $4.6 million principal amount of the 6.88% Convertible Subordinated Debentures for $3.9 million in cash. The Company believes that it has sufficient funds and adequate financial sources available to meet its anticipated liquidity needs. The Company also believes that cash flow from operations, cash balances and available borrowings will be sufficient for the foreseeable future to finance anticipated working capital requirements, capital expenditures, debt service requirements, environmental expenditures and common stock dividends. Operating Activities Cash provided by operating activities during the nine months ended July 31, 2001 was $56.1 million compared to $54.4 million for the same nine month period of 2000. Net income, adding back depreciation and amortization and the net loss on the sale of Piper Impact Europe in fiscal 2000 provided $51.4 million compared to $61.3 million of cash for the same nine month period of 2000. The period ended July 31, 2001 included lower working capital requirements as compared to the same period of the prior year as a result of slowing business and a focused effort to improve this area. The period ended July 31, 2000 included a $7.0 million tax refund resulting from overpayment of estimated taxes in fiscal 1999, compared to a $210 thousand refund received in the same period of 2001. Investment Activities Net cash used by investment activities during the nine months ended July 31, 2001 was $64.4 million compared to $69.4 million for the same period of 2000. Fiscal 2001 cash used by investment activities included cash paid for the acquisition of Temroc totaling $17.9 million, net of cash acquired. Fiscal 2000 cash used by investing activities included cash paid for the acquisition of Nichols Aluminum Golden totaling $20.1 million, net of cash acquired and Imperial totaling $15.3 million, net of cash acquired. Capital expenditures and other investment activities increased $12.6 million in the nine month period ended July 31, 2001 as compared to the same periods of 2000. The Company estimates that fiscal 2001 capital expenditures will total approximately $50 to $55 million. Financing Activities Net cash provided by financing activities for the nine months ended July 31, 2001 was $17.8 million compared to $21.6 million for the same prior year period. The Company's net bank borrowings were $47.0 million during the first nine months of fiscal 2001, compared to $53.2 million during the same period last year. Quanex repaid $17.3 million of life insurance cash surrender value policy loans during the fiscal third quarter ended July 31, 2001 using bank borrowings. During the nine months ended July 31, 2001, the Company expended $3.9 million to purchase subordinated debentures compared to $9.6 million for the same prior year period. Also, during the nine months ended July 31, 2001, the Company paid $2.0 million to repurchase 107,800 shares of its own common stock; however, in the same period last year, it paid $15.9 million to repurchase approximately 762,700 shares. NEW ACCOUNTING PRONOUNCEMENTS In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101. SAB No. 101 provides the staff's views in applying Generally Accepted Accounting Principles ("GAAP") to revenue recognition in financial statements. It does not change any of the existing rules on revenue recognition. All registrants are expected to apply the accounting and disclosures described in this bulletin. The staff, however, will not object if registrants that have not applied this accounting do not restate prior financial statements provided they report a change in accounting principle in accordance with APB Opinion No. 20, Accounting Changes, no later than the first fiscal 17

20 quarter of the fiscal year beginning after December 15, 1999. However, SAB No. 101B delays the implementation of SAB No. 101 until no later than the fourth quarter of fiscal years beginning after December 15, 1999. The Company will be analyzing SAB No. 101 to determine what, if any, impact or additional disclosure requirements are necessary. Any such impact will be addressed and reflected in the fourth fiscal quarter of the Company's year ending October 31, 2001 in accordance with SAB No. 101B. In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141 "Business Combinations". SFAS No. 141 addresses financial accounting and reporting for business combinations. The provisions of this statement apply to all business combinations initiated after June 30, 2001. This statement also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001, or later. The Company will follow the guidance of this statement for any future acquisitions it may undertake. In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets". This statement addresses financial accounting and reporting for acquired goodwill and other intangible assets. It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. The provisions of this statement are required to be applied starting with fiscal years beginning after December 15, 2001 (Quanex's fiscal year beginning November 1, 2002). Early application is permitted for entities with fiscal years beginning after March 15, 2001 (Quanex's fiscal year beginning November 1, 2001). The Company is currently evaluating the impact of this statement.

21 Item 3. Quantitative and Qualitative Disclosures about Market Risk Effective November 1, 2000, the Company adopted SFAS No. 133, which requires the Company to measure all derivatives at fair value and to recognize them in the balance sheet as an asset or liability, depending on the Company's rights or obligations under the applicable derivative contract. The Company utilizes certain "derivative instruments" to manage its exposure to market risk. Prior to the adoption of SFAS No. 133, these derivative instruments were not recorded in the financial statements until their settlement. (See Note 10 for further discussion.) 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 and metal commodity prices as well as other factors, actual results could differ materially from those projected in such forward looking information. The Company holds certain floating-rate obligations. The exposure of these obligations to increases in short-term interest rates is limited by interest rate swap agreements entered into by the Company. These swap agreements effectively fix the interest rate on most of the Company's variable rate debt, thus limiting the potential impact that increasing interest rates would have on earnings. At October 31, 2000 (prior to the adoption of SFAS No. 133) the unrealized losses related to the interest rate swap agreements were $918 thousand. As of July 31, 2001, a liability of $5.2 million related to the interest rate swap agreements was recorded in the financial statements. If the floating rates were to change by 10% from July 31, 2001 levels, the fair market value of these swaps would change by approximately $700 thousand. It should be noted that any change in value of these contracts, real or hypothetical, would be significantly offset by an inverse change in the value of the underlying hedged item. In terms of the impact on cash flow to the Company, as floating interest rates decline, the market value of the swap agreement rises, thus increasing the quarterly cash settlement of the swaps paid by the Company. However, the interest paid on the floating rate debt balance decreases. The inverse situation occurs with rising interest rates. The Company uses futures contracts to hedge a portion of its exposure to price fluctuations of aluminum. The exposure is related to the Company's backlog of aluminum sales orders with committed prices as well as future aluminum sales for which a sales price increase would lag a raw material cost increase. Hedging gains and losses are included in "Cost of sales" in the income statement. Prior to the adoption of SFAS No. 133, gains and losses related to open contracts were unrealized and not reflected in the consolidated statements of income. At October 31, 2000, the Company had open futures contracts with unrealized losses of $372 thousand. As of July 31, 2001, (after the adoption of SFAS No. 133) the Company had open futures contracts with a fair value loss of approximately $1.3 million which was recorded as part of other current and other non-current liabilities. At October 31, 2000 and July 31, 2001, these contracts covered a notional volume of 25,738,940 and 37,037,619 pounds of aluminum, respectively. A hypothetical 10% change from the July 31, 2001 average London Metal Exchange ("LME") ingot price on these contracts of $.649 per pound would increase or decrease the unrealized pretax gains/losses related to these contracts by approximately $2.4 million. However, it should be noted that any change in the value of these contracts, real or hypothetical, would be substantially offset by an inverse change in the cost of purchased aluminum scrap. Other than the items mentioned above, there were no other material quantitative or qualitative changes during the first nine months of fiscal 2001 in the Company's market risk sensitive instruments. 19

 PART II. OTHER INFORMATION Item 1 - Legal Proceedings On or about July 16, 2001, the Company's MACSTEEL Michigan Division paid a civil penalty of $137,500 to resolve an EPA Region V administrative complaint that alleged past wastewater permit violations. Item 6 - Exhibits and Reports on Form 8-K. a) Exhibits Exhibit 10.1 Agreement for Adoption and Merger of the Temroc Metals, Inc. Bargaining Unit Employees 401(k) Plan into the Nichols 401(k) Savings Plan for Hourly Employees dated effective July 1, 2001 Exhibit 10.2 Agreement for Adoption and Merger of the Temroc Metals, Inc. Non-Bargaining Unit Employees 401(k) Plan into the Nichols 401(k) Savings Plan dated effective July 1, 2001 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 Registrants 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. b) Reports on Form 8-K No reports on Form 8-K were filed by the Company during the quarter for which this report is being filed.

23 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: September 7, 2001 /s/ Viren M. Parikh -------------------------------------- Viren M. Parikh Controller (Chief Accounting Officer) Date: September 7, 2001 /s/ Terry M. Murphy -------------------------------------- Terry M. Murphy Vice President - Finance and Chief Financial Officer 21

24 INDEX TO EXHIBITS Exhibit 10.1 Agreement for Adoption and Merger of the Temroc Metals, Inc. Bargaining Unit Employees 401(k) Plan into the Nichols 401(k) Savings Plan for Hourly Employees dated effective July 1, 2001 Exhibit 10.2 Agreement for Adoption and Merger of the Temroc Metals, Inc. Non-Bargaining Unit Employees 401(k) Plan into the Nichols 401(k) Savings Plan dated effective July 1, 2001 22

EXHIBIT 10.1

NICHOLS 401(k) SAVINGS PLAN FOR HOURLY EMPLOYEES

AGREEMENT FOR ADOPTION AND MERGER
OF THE TEMROC METALS, INC. BARGAINING UNIT EMPLOYEES 401(k) PLAN
INTO THE NICHOLS 401(k) SAVINGS PLAN FOR HOURLY EMPLOYEES

THIS AGREEMENT by and between Quanex Corporation, a corporation ("Quanex") and Temroc Metals, Inc., a corporation ("Temroc"),

W I T N E S S E T H:

WHEREAS, Temroc maintains the Temroc Metals, Inc. Bargaining Unit Employees 401(k) Plan (the "Prior Plan") and its related trust (the "Prior Trust") for the benefit of its employees and their beneficiaries;

WHEREAS, Quanex maintains the Nichols 401(k) Savings Plan for Hourly Employees (the "Plan") and its related trust (the "Trust");

WHEREAS, the Plan provides that any business organization may, with the approval of Quanex, adopt the Plan and Trust for all or any classification of its employees;

WHEREAS, Temroc desires to merge the Prior Plan into the Plan, and to merge the Prior Trust into the Trust, with Fidelity Management Trust Company, as trustee of the Trust (the "Trustee"), all effective as of the close of business on July 1, 2001;

WHEREAS, Temroc, in connection with the mergers, desires to adopt the Plan and Trust, and Quanex desires to consent to the adoptions; and

WHEREAS, as a result of the mergers, Temroc shall become an adopting employer of the Plan and Trust;

NOW, THEREFORE, the parties hereto agree as follows:

ADOPTION OF PLAN AND TRUST BY TEMROC

(1) ADOPTION. Temroc hereby adopts the Plan and Trust, effective as of July 1, 2001, for all of its employees who are included in a unit of employees covered by a collective bargaining agreement and who otherwise qualify as members therein under the terms and provisions of the Plan and Trust, and hereby agrees to be bound by all the terms, provisions, limitations, and conditions of the Plan and Trust with respect to the employees eligible for membership in the Plan to the same extent as if it had executed identical plan and trust documents, except that, effective July 1, 2001, the Plan shall be amended as follows:

(a) RETIREMENT AGE. Section 1.35 shall be amended to add the following sentence immediately following the second sentence of such section: In the case of a Member or former Member who was a participant in the Temroc Metals, Inc. Bargaining Unit Employees 401(k) Plan (the "Temroc Plan"), "Retirement Age" means the time he attains age 65 if that definition is more favorable for him than the definition in the first sentence of this Section 1.35.

(b) ELIGIBILITY. Section 3.01 of the Plan shall be amended to add the following two sentences immediately following the last sentence of such section: Each Employee who is employed by Temroc Metals, Inc. ("Temroc") and was a participant in the Temroc Plan on June 30, 2001 shall be eligible to participate in the Plan on July 1, 2001. Each other Employee who is employed by Temroc and included in a unit of employees covered by the collective bargaining agreement between Temroc and the United Automobile Workers (UAW), Local 125 (the "UAW Collective Bargaining Agreement") shall be eligible to participate in the Plan for all purposes beginning on the Entry Date that occurs with or next follows the date on which the Employee completes one quarter year of Active Service.

(c) GAINSHARING CONTRIBUTIONS. Section 4.02 of the Plan shall be amended to add the following two sentences immediately following the last sentence of such section: Temroc shall contribute to the Trust for each Plan Year a Supplemental Contribution for Members who are employed by Temroc in such amount as is required under the terms of the UAW Collective Bargaining Agreement. Each such Member's right to benefits derived from Supplemental Contributions made to the Plan on his behalf shall be nonforfeitable.

(d) IN-SERVICE AGE 59 1/2 WITHDRAWALS. Section 6.06 of the Plan shall be amended to add the following sentence immediately following the last sentence of such section: This Section 6.06 shall not apply to Members who are employed by Temroc.

(e) LOANS. Section 6.07 of the Plan shall be amended to add the following sentence immediately following the last sentence of such section: This Section 6.07 shall not apply to Members who are employed by Temroc.

(2) CONSENT. Quanex hereby consents to and approves the adoption of the Plan by Temroc, effective as of July 1, 2001.

(3) COMMINGLING OF FUNDS. Temroc further agrees that the Committee, in its sole discretion, may permit the funds contributed by it to be commingled for purposes of investment with other funds in the Trust or to be maintained separately.

(4) AGREEMENT TO FURNISH INFORMATION. Temroc agrees to promptly furnish all information required by the Committee and the Trustee with reference to its employees who are eligible for the Plan, and to pay its contribution to the Plan the first Plan Year and all subsequent

Plan Years in which it is an adopting employer of the Plan, in the amount and at the time required by the terms of the Plan.

MERGER OF THE PRIOR PLAN INTO THE PLAN

(1) MERGER OF PLAN. Effective July 1, 2001, the Prior Plan is merged into the Plan.

(2) ELIGIBILITY. No person who is not a participant in the Prior Plan on June 30, 2001, shall be eligible to become a participant in the Prior Plan.

(3) CONTRIBUTIONS. No contributions shall be made under the Prior Plan with respect to any period after June 30, 2001.

(4) QUALIFICATION A CONDITION PRECEDENT TO MERGER. The merger of the Prior Plan into the Plan is contingent upon and subject to the express condition precedent that the merger meets all statutory and regulatory requirements for qualification of the Plan and the Prior Plan and their related trusts have at all times in form and in operation maintained their qualified and exempt status. In the event that this condition precedent is not satisfied the merger shall fail retroactively for failure to meet the condition precedent and the portion of the Plan trust fund attributable to the Prior Plan assets shall be immediately returned to Temroc and the merger shall be void ab initio.

(5) COMPLIANCE WITH SECTIONS 411(d)(6) AND 414(l) OF THE INTERNAL REVENUE CODE OF 1986. The merger of the Prior Plan into the Plan will comply with sections 411(d)(6) and 414(l) of the Internal Revenue Code of 1986, as amended (the "Code"). The distribution options available under the Prior Plan shall be preserved in the Plan in accordance with section 411(d)(6) of the Code. Each participant in the Prior Plan would (if the Prior Plan then terminated) receive

a benefit immediately after the merger equal to or greater than the benefit he would have been entitled to receive immediately before the merger (if the Prior Plan had then terminated).

(6) SINGLE PLAN. Upon the merger of the Prior Plan into the Plan, the Prior Plan and the Plan will be a single plan within the meaning of section 414(l) of the Code. All Prior Plan and Plan assets will be available to pay the benefits of all participants in the Prior Plan and Plan.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed on this 26 day of June, 2001.

QUANEX CORPORATION

By /s/ Terry Murphy

Title Vice President - Finance & CFO

TEMROC METALS, INC.

By /s/ Terry Murphy

Title VP Finance

EXHIBIT 10.2

NICHOLS 401(k) SAVINGS PLAN

AGREEMENT FOR ADOPTION AND MERGER
OF THE TEMROC METALS, INC. NON-BARGAINING UNIT EMPLOYEES 401(k)
PLAN INTO THE NICHOLS 401(k) SAVINGS PLAN

THIS AGREEMENT by and between Quanex Corporation, a corporation ("Quanex") and Temroc Metals, Inc., a corporation ("Temroc"),

W I T N E S S E T H:

WHEREAS, Temroc maintains the Temroc Metals, Inc. Non-Bargaining Unit Employees 401(k) Plan (the "Prior Plan") and its related trust (the "Prior Trust") for the benefit of its employees and their beneficiaries;

WHEREAS, Quanex maintains the Nichols 401(k) Savings Plan (the "Plan") and its related trust (the "Trust");

WHEREAS, the Plan provides that any business organization may, with the approval of Quanex, adopt the Plan and Trust for all or any classification of its employees;

WHEREAS, Temroc desires to merge the Prior Plan into the Plan, and to merge the Prior Trust into the Trust, with Fidelity Management Trust Company, as trustee of the Trust (the "Trustee"), all effective as of the close of business on July 1, 2001;

WHEREAS, Temroc, in connection with the mergers, desires to adopt the Plan and Trust, and Quanex desires to consent to the adoptions; and

WHEREAS, as a result of the mergers, Temroc shall become an adopting employer of the Plan and Trust;

NOW, THEREFORE, the parties hereto agree as follows:

ADOPTION OF PLAN AND TRUST BY TEMROC

(1) ADOPTION. Temroc hereby adopts the Plan and Trust, effective as of July 1, 2001, for all of its employees who are not included in a unit of employees covered by a collective bargaining agreement and who otherwise qualify as members therein under the terms and provisions of the Plan and Trust, and hereby agrees to be bound by all the terms, provisions, limitations, and conditions of the Plan and Trust with respect to the employees eligible for membership in the Plan to the same extent as if it had executed identical plan and trust documents, except that, effective July 1, 2001, the Plan shall be amended as follows:

(a) RETIREMENT AGE. Section 1.39 shall be amended to add the following sentence immediately following the second sentence of such section: In the case of a Member or former Member who was a participant in the Temroc Metals, Inc. Non-Bargaining Unit Employees 401(k) Plan (the "Temroc Plan"), "Retirement Age" means the time he attains age 65 if that definition is more favorable for him than the definition in the first sentence of this Section 1.39.

(b) ELIGIBILITY. Section 3.01 of the Plan shall be amended to add the following sentence immediately following the last sentence of such section: Each Employee who is employed by Temroc Metals, Inc. ("Temroc") and was a participant in the Temroc Plan on June 30, 2001 shall be eligible to participate in the Plan on July 1, 2001.

(c) LOANS. Section 6.07 of the Plan shall be amended to add the following sentence immediately following the last sentence of such section: This Section 6.07 shall not be effective with respect to Members who are employed by Temroc until January1, 2002.

(2) CONSENT. Quanex hereby consents to and approves the adoption of the Plan by Temroc, effective as of July 1, 2001.

(3) COMMINGLING OF FUNDS. Temroc further agrees that the Committee, in its sole discretion, may permit the funds contributed by them to be commingled for purposes of investment with other funds in the Trust or to be maintained separately.

(4) AGREEMENT TO FURNISH INFORMATION. Temroc agrees to promptly furnish all information required by the Committee and the Trustee with reference to its employees who are eligible for the Plan, and to pay its contribution to the Plan the first Plan Year and all subsequent Plan Years in which it is an adopting employer of the Plan, in the amount and at the time required by the terms of the Plan.

MERGER OF THE PRIOR PLAN INTO THE PLAN

(1) MERGER OF PLAN. Effective July 1, 2001, the Prior Plan is merged into the Plan.

(2) ELIGIBILITY. No person who is not a participant in the Prior Plan on June 30, 2001, shall be eligible to become a participant in the Prior Plan.

(3) CONTRIBUTIONS. No contributions shall be made under the Prior Plan with respect to any period after June 30, 2001.

(4) QUALIFICATION A CONDITION PRECEDENT TO MERGER. The merger of the Prior Plan into the Plan is contingent upon and subject to the express condition precedent that the merger meets all statutory and regulatory requirements for qualification of the Plan and the Prior Plan and their related trusts have at all times in form and in operation maintained their qualified and exempt status. In the event that this condition precedent is not satisfied the merger shall fail retroactively for failure to meet the condition precedent and the portion of the Plan trust fund

attributable to the Prior Plan assets shall be immediately returned to Temroc and the merger shall be void ab initio.

(5) COMPLIANCE WITH SECTIONS 411(d)(6) AND 414(l) OF THE INTERNAL REVENUE CODE OF 1986. The merger of the Prior Plan into the Plan will comply with sections 411(d)(6) and 414(l) of the Internal Revenue Code of 1986, as amended (the "Code"). The distribution options available under the Prior Plan shall be preserved in the Plan in accordance with section 411(d)(6) of the Code. Each participant in the Prior Plan would (if the Prior Plan then terminated) receive a benefit immediately after the merger equal to or greater than the benefit he would have been entitled to receive immediately before the merger (if the Prior Plan had then terminated).

(6) SINGLE PLAN. Upon the merger of the Prior Plan into the Plan, the Prior Plan and the Plan will be a single plan within the meaning of section 414(l) of the Code. All Prior Plan and Plan assets will be available to pay the benefits of all participants in the Prior Plan and Plan.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed on this 26th day of June, 2001.

QUANEX CORPORATION

By /s/ Terry Murphy

Title VP Finance & CFO

TEMROC METALS, INC.

By /s/ Terry Murphy

Title VP Finance
