QUANEX CORP
Form 10-K/A
June 08, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

(Mark One)

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

For the fiscal year ended October 31, 2004

or

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

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 (Address of principal executive offices)	**77027** (Zip code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.50 par value	New York Stock Exchange, Inc.
Rights to Purchase Series A Junior Participating Preferred Stock	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act:

NONE

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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ý No o

The aggregate market value of the voting common equity held by non-affiliates as of April 30, 2004, computed by reference to the closing price for the Common Stock on the New York Stock Exchange, Inc. on that date, was $664,151,147. Such calculation assumes only the registrant s officers and directors were affiliates of the registrant.

At April 30, 2005, there were outstanding 25,228,278 shares of the registrant s Common Stock, $.50 par value.

EXPLANATORY NOTE

This amendment to Quanex Corporation s Annual Report on Form 10-K for the fiscal year ended October 31, 2004, as filed by Quanex Corporation on December 21, 2004, (the 2004 Form 10-K) is being filed for the sole purpose of revising the Report of Independent Registered Public Accounting Firm to include the financial statement schedule listed in the Index at Item 15 in the 2004 Form 10-K.

PART II

Item 8. ***Financial Statements and Supplementary Data***

RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements of Quanex Corporation and subsidiaries were prepared by management, which is responsible for their integrity and objectivity. The statements were prepared in accordance with accounting principles generally accepted in the United States of America and include amounts that are based on management s best judgments and estimates.

Quanex s system of internal controls is designed to provide reasonable assurance, at justifiable cost, as to the reliability of financial records and reporting and the protection of assets. The system of controls provides for appropriate division of responsibility and the application of policies and procedures that are consistent with high standards of accounting and administration. Internal controls are monitored through recurring internal audit programs and are updated as our businesses and business conditions change.

The Audit Committee, composed solely of outside, independent directors, determines that management is fulfilling its financial responsibilities by meeting periodically with management, the independent auditors, and Quanex s internal auditors, to review internal accounting controls and assess the effectiveness of our disclosure controls and procedures. The Audit Committee is responsible for appointing the independent auditors and reviewing the scope of all audits and the accounting principles applied in our financial reporting. Deloitte & Touche LLP has been engaged by the Audit Committee as independent auditors to audit the accompanying consolidated financial statements and issue the report thereon, which appears on the following page. Our internal auditors and Deloitte & Touche LLP have full and free access to meet with the Audit Committee, without management present, to discuss the results of their audits, the quality of our financial reporting and the adequacy of our internal controls and disclosure controls and procedures.

We believe that Quanex s system of internal controls, combined with the activities of the internal auditors and the Audit Committee, provides reasonable assurance of the integrity of our financial reporting.

/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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Quanex Corporation

Houston, Texas

We have audited the accompanying consolidated balance sheets of Quanex Corporation and subsidiaries (the Company) as of October 31, 2004 and 2003, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended October 31, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Quanex Corporation and subsidiaries as of October 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended October 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Deloitte & Touche LLP
Deloitte & Touche LLP

Houston, Texas
December 21, 2004

QUANEX CORPORATION

CONSOLIDATED BALANCE SHEETS

	October 31, 2004		October 31, 2003	
	(In thousands)			
ASSETS				
Current assets:				
Cash and equivalents	$	41,743	$	22,108
Accounts and notes receivable, net of allowance of $6,882 and $6,829		176,358		104,009
Inventories		115,367		68,626
Deferred income taxes		10,744		5,320
Other current assets		2,363		1,499
Current assets of discontinued operations		9,759		31,886
Total current assets		356,334		233,448
Property, plant and equipment, net		350,982		298,733
Goodwill, net		134,670		66,436
Cash surrender value insurance policies, net		24,439		24,536
Intangible assets, net		27,556		2,755
Other assets		9,391		3,517
Assets of discontinued operations		26,150		53,689
Total assets	$	929,522	$	683,114
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	161,674	$	80,791
Accrued liabilities		45,844		33,764
Income taxes payable		4,127		7,641
Current maturities of long-term debt		456		3,877
Current liabilities of discontinued operations		4,102		14,592
Total current liabilities		216,203		140,665
Long-term debt		130,496		15,893
Deferred pension credits		8,804		7,781
Deferred postretirement welfare benefits		7,745		7,845
Deferred income taxes		53,983		49,938
Non-current environmental reserves		8,188		13,517
Other liabilities		2,973		283
Liabilities of discontinued operations		423		2,033
Total liabilities		428,815		237,955
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 16,650,862 and 16,519,271		8,324		8,260
Additional paid-in-capital		191,675		187,114
Retained earnings		307,754		264,067
Unearned compensation		(824)		(164)
Accumulated other comprehensive income		(4,463)		(3,641)
		502,466		455,636
Less common stock held by Rabbi Trust - 58,139 and 47,507 shares		(1,759)		(1,317)
Less cost of shares of common stock in treasury 0 and 294,803				(9,160)
Total stockholders equity		500,707		445,159
Total liabilities & stockholders equity	$	929,522	$	683,114

See notes to consolidated financial statements.

QUANEX CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended October 31,		
	2004	**2003**	**2002**
	(In thousands, except per share amounts)		
Net sales	$ 1,460,268	$ 898,197	$ 853,430
Cost and expenses:			
Cost of sales	1,245,639	743,953	685,762
Selling, general and administrative	65,618	48,029	48,104
Depreciation and amortization	50,054	40,985	39,114
Gain on sale of land	(454)	(405)	
Operating income	99,411	65,635	80,450
Interest expense	(6,049)	(2,829)	(14,547)
Capitalized interest			1,879
Retired executive life insurance benefit		2,152	9,020
Other, net	282	2,695	1,962
Income from continuing operations before income taxes	93,644	67,653	78,764
Income tax expense	(36,045)	(23,650)	(25,020)
Income from continuing operations	57,599	44,003	53,744
Income (loss) from discontinued operations, net of taxes	(3,132)	(1,116)	1,738
Net income	$ 54,467	$ 42,887	$ 55,482
Basic earnings per common share(*):			
Earnings from continuing operations	$ 3.50	$ 2.72	$ 3.62
Income (loss) from discontinued operations	(0.19)	(0.07)	0.12
Basic earnings per share	$ 3.31	$ 2.65	$ 3.74
Diluted earning per common share(*):			
Earnings from continuing operations	$ 3.45	$ 2.69	$ 3.41
Income (loss) from discontinued operations	(0.19)	(0.07)	0.11
Diluted earnings per share	$ 3.26	$ 2.62	$ 3.52
Weighted average common shares outstanding(*):			
Basic	16,436	16,154	14,823
Diluted	16,698	16,384	16,237

(*) On December 2, 2004 the Board of Directors declared a three-for-two stock split in the form of a 50% stock dividend, payable on December 31 to holders of record on December 17. The amounts above are presented without giving effect to such stock split. See Note 5, Earnings Per Share, for a proforma presentation of the impact of this stock split.

See notes to consolidated financial statements.

QUANEX CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Years Ended October 31, 2004, 2003 and 2002	Comprehensive Income	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income Minimum Pension Liability	Accumulated Other Comprehensive Income Derivative Gain (Loss)	Treasury Stock & Other	Total Stockholders Equity
				(In thousands)				
Balance at October 31, 2001		$ 7,043	$ 108,314	$ 186,274	$ (1,809)	$ (5,403)	$ (14,442)	$ 279,977
Comprehensive income:								
Net income	$ 55,482			55,482				55,482
Adjustment for minimum pension liability (net of taxes of $798)	(1,247)				(1,247)			(1,247)
Derivative transactions:								
Current period hedging transactions (net of taxes of $511)	(798)					(798)		(798)
Reclassifications into earnings (net of taxes of $3,694)	5,778					5,778		5,778
Total comprehensive income	$ 59,215							
Common dividends ($0.64 per share)				(9,637)				(9,637)
Common stock held by Rabbi Trust							(108)	(108)
Cost of common stock in treasury							12,672	12,672
Other		1,184	77,658	(45)			479	79,276
Balance at October 31, 2002		$ 8,227	$ 185,972	$ 232,074	$ (3,056)	$ (423)	$ (1,399)	$ 421,395
Comprehensive income:								
Net income	$ 42,887			42,887				42,887
Adjustment for minimum pension liability (net of taxes of $372)	(583)				(583)			(583)
Derivative transactions:								
Current period hedging transactions (net of taxes of $1)	(2)					(2)		(2)
Reclassifications into earnings (net of taxes of $270)	423					423		423
Total comprehensive income	$ 42,725							
Common dividends ($0.68 per share)				(10,865)				(10,865)
Common stock held by Rabbi Trust							(336)	(336)
Cost of common stock in treasury							(9,160)	(9,160)
Other		33	1,142	(29)			254	1,400
Balance at October 31, 2003		$ 8,260	$ 187,114	$ 264,067	$ (3,639)	$ (2)	$ (10,641)	$ 445,159
Comprehensive income:								
Net income	$ 54,467			54,467				54,467
Adjustment for minimum pension liability (net of taxes of $563)	(880)				(880)			(880)
Derivative transactions:								
Foreign currency translation adjustment	56						56	56
Reclassifications into earnings (net of taxes of $1)	2					2		2
Total comprehensive income	$ 53,645							
				(11,530)				(11,530)

Common dividends ($0.70 per share)							
Common stock held by Rabbi Trust						(442)	(442)
Cost of common stock in treasury						9,160	9,160
Other	64	4,561	750			(660)	4,715
Balance at October 31, 2004	$ 8,324	$ 191,675	$ 307,754	$ (4,519)		$ (2,527)	$ 500,707

See notes to consolidated financial statements.

	Years Ended October 31, 2004, 2003 and 2002				
	Preferred Shares Issued	Common Shares			
		Issued	Treasury	Rabbi Trust	Net Outstanding
Balance at October 31, 2001		14,085,642	(633,935)	(42,484)	13,409,223
Stock issued options exercised (net of trade-ins)		562,926	597,284		1,160,210
Stock issued compensation plans		(1,902)	22,797		20,895
Stock issued conversion of subordinated debentures		1,822,594	173		1,822,767
Rabbi Trust		(13,627)	13,681	(54)	
Balance at October 31, 2002		16,455,633		(42,538)	16,413,095
Treasury shares purchased			(438,600)		(438,600)
Stock issued options exercised (net of trade-ins)		42,333	161,677		204,010
Stock issued compensation plans		1,000	(2,544)		(1,544)
Rabbi Trust		20,305	(15,336)	(4,969)	
Balance at October 31, 2003		16,519,271	(294,803)	(47,507)	16,176,961
Stock issued options exercised (net of trade-ins)		113,782	268,680		382,462
Stock issued compensation plans		9,500	23,800		33,300
Rabbi Trust		8,309	2,323	(10,632)	
Balance at October 31, 2004		16,650,862		(58,139)	16,592,723

See notes to consolidated financial statements.

QUANEX CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOW

	Years Ended October 31, 2004	2003 (In thousands)	2002
Operating Activities:			
Net income	$ 54,467	$ 42,887	$ 55,482
Loss (income) from discontinued operations	3,132	1,116	(1,738)
Adjustments to reconcile net income to cash provided by operating activities:			
Gain on sale of land	(454)	(405)	
Loss on early extinguishment of debt			922
Retired executive life insurance benefit		(2,152)	(9,020)
Depreciation and amortization	50,603	41,334	39,371
Deferred income taxes	551	3,477	(4,302)
Deferred pension and postretirement benefits	(499)	1,522	(4,766)
Changes in assets and liabilities, net of effects from acquisitions and dispositions:			
Increase in accounts and notes receivable	(46,776)	(6,514)	(5,057)
Decrease (increase) in inventory	(6,993)	9,058	(8,661)
Increase in accounts payable	57,623	10,733	2,517
Increase (decrease) in accrued liabilities	8,764	(7,869)	(1,431)
Increase (decrease) in income taxes payable	(6,242)	1,081	(213)
Other, net	1,965	(5,441)	201
Operating cash flow from discontinued operations	8,096	14,013	17,806
Cash provided by operating activities	124,237	102,840	81,111
Investing Activities:			
Acquisitions, net of cash acquired	(214,618)		(17,283)
Proceeds from sale of discontinued operations	23,310		
Proceeds from sale of land	637	2,832	
Capital expenditures, net of retirements	(19,542)	(25,371)	(31,378)
Retired executive life insurance proceeds		6,442	26,111
Other, net	172	(2,952)	(4,466)
Cash used for investing activities from discontinued operations	(3,049)	(3,451)	(2,792)
Cash used for investing activities	(213,090)	(22,500)	(29,808)
Financing Activities:			
Bank borrowings (repayments), net	(10,000)	(55,000)	(75,000)
Prepayment of note payable			(7,029)
Issuance (purchase) of debentures	125,000		(1,314)
Purchase of Quanex common stock		(13,515)	
Common stock dividends paid	(11,530)	(10,865)	(9,637)
Issuance of common stock, net	11,665	5,163	33,948
Other, net	(6,657)	(2,298)	(3,561)
Cash provided by (used for) financing activities	108,478	(76,515)	(62,593)
Effect of exchange rate changes on cash equivalents	10		
Increase (decrease) in cash and equivalents	19,635	3,825	(11,290)
Cash and equivalents at beginning of period	22,108	18,283	29,573
Cash and equivalents at end of period	$ 41,743	$ 22,108	$ 18,283

See notes to consolidated financial statements.

QUANEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Critical Accounting Policies

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 policies used in the preparation of the Company s consolidated financial statements as well as the significant judgments and uncertainties affecting the application of these policies.

Nature of Operations

The Company manufactures engineered carbon and alloy steel bars, aluminum flat-rolled products, flexible insulating glass spacer systems, and precision-formed metal and wood products which primarily serve the North American vehicular products and building products markets. See Note 12, Industry Segment Information.

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. Unanticipated changes of future assessments and/or regulatory laws could result in expenses being incurred in future periods in addition to an increase in actual cash required to remediate the contamination.

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.

Property, plant and equipment is stated at cost and is depreciated using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of certain categories are as follows:

	Years
Land improvements	10 to 25
Buildings	10 to 40
Machinery and equipment	3 to 20

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.

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 Statement 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.

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 Stock-Based Compensation Transition and Disclosure is disclosed below.

	Years Ended October 31, (In thousands)					
		2004		**2003**		**2002**
Net income, as reported	$	54,467	$	42,887	$	55,482
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		(1,997)		(1,673)		(1,407)
Pro forma net income	$	52,470	$	41,214	$	54,075
Earnings per common share:						
Basic as reported	$	3.31	$	2.65	$	3.74
Basic pro forma	$	3.19	$	2.55	$	3.65
Diluted as reported	$	3.26	$	2.62	$	3.52
Diluted pro forma	$	3.14	$	2.52	$	3.43

Fair value of the options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions.

	Years Ended October 31,		
	2004	**2003**	**2002**
Risk-free interest rate	3.41%	4.49%	3.58%
Dividend yield	2.06%	1.98%	2.01%
Volatility factor	42.07%	50.21%	44.14%
Weighted average expected life	5 years	9.5 years	5 years

Principles of Consolidation

The consolidated financial statements include the accounts of Quanex and its subsidiaries, all of which are wholly owned. All significant intercompany balances and transactions have been eliminated in consolidation.

Earnings per Share Data

Basic earnings per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Scope of Operations

The Company operates primarily in two industry segments: vehicular products and building products. The Company s products include engineered steel bars, coiled aluminum sheet (mill finish and coated), aluminum and steel fabricated products, impact extrusions and hardwood architectural moulding and window and door accessories. The Company s manufacturing operations are conducted primarily in the United States.

Statements of Cash Flows

The Company generally considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Similar investments with original maturities beyond three months are considered short-term investments. For fiscal years 2004, 2003, and 2002, cash paid for income taxes was $35.7 million, $10.9 million and $17.7 million, respectively. These amounts are before refunds of $0.4 million, $0.5 million and $0.1 million, respectively. Cash paid for interest for fiscal 2004, 2003, and 2002 was $4.0 million, $2.6 million and $13.1 million, respectively.

Reclassification

Certain reclassifications, none of which effected net income, have been made to prior period amounts to conform to the presentation of fiscal year 2004. Specifically, the Company reclassified amortization of debt issuance costs from other, net to interest expense.

In the third quarter of 2004, the Company committed to a plan to sell its Piper Impact business and in the fourth quarter of 2004, sold its Nichols Aluminum Golden business. Accordingly, the assets and liabilities of Piper Impact and Nichols Aluminum Golden 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 19).

New Accounting Pronouncements

In December 2003, the Financial Accounting Standards Board (FASB) issued the revised SFAS No. 132, Employers Disclosures about Pensions and Other Postretirement Benefits. The revised SFAS No. 132 retains the disclosures required by the original issuance of SFAS No. 132 and requires additional annual disclosures describing the types of plan assets, investment strategy, measurement date, plan obligations, and cash flows. The Company included the revised SFAS No. 132 annual disclosures in this Annual Report on Form 10-K for the fiscal year ending October 31, 2004. The revised SFAS No. 132 also requires additional interim period disclosures, including the components of net periodic benefit cost and changes in planned contributions. The Company included the required disclosures in the notes to the interim financial statements beginning with the second quarter of fiscal 2004.

In September 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue 04-08, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effects on Diluted Earnings Per Share, which was ratified by the FASB in October 2004. EITF Issue 04-08 becomes effective for periods after December 15, 2004, which will be the Company s first fiscal quarter of 2005. Under the consensus, companies will be required to retroactively restate diluted earnings per share numbers applying the if converted method of accounting from the issuance date of the contingently convertible bond. On May 5, 2004, the Company issued $125.0 million of 2.50% Convertible Senior Debentures due May 15, 2034 (the Debentures). As it relates to Quanex, EITF Issue 04-08 would mean an additional 2.2 million shares of earnings dilution and have an annualized earnings per share impact of approximately $0.30 - $0.35 per common share. However, the Company could elect to settle its convertible obligation with either common stock, cash or a combination of the two. If the Company elects to settle its entire convertible obligation with cash and can demonstrate its ability to do so, it would not be required to show the dilutive impact of the higher share count in the calculation of its earnings per share for periods after such election.

2. Acquisitions

Fiscal 2004 Acquisitions

During the first quarter of fiscal 2004, the Company acquired the stock of TruSeal Technologies, Inc. (TruSeal) and assets of North Star Steel Monroe (MACSTEEL Monroe). The acquisitions were 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 acquisitions and the results of operations were included in the Company s consolidated financial statements as of the respective effective dates of the acquisitions. There were no material differences between the Company s accounting policies and those of TruSeal and North Star Steel Monroe.

On December 31, 2003, the Company completed the acquisition of TruSeal, a manufacturer of patented and trademarked flexible insulating glass spacer systems and sealants for vinyl, aluminum, and wood windows. TruSeal has been integrated into the Building Products segment. The Company acquired TruSeal to further expand the broad range of high quality components and products currently supplied to existing customers and to provide a level of customer diversification. TruSeal has a broad presence in the vinyl and aluminum window markets, whereas the Company s niche had been primarily with the wood window OEM s. As consideration for the acquisition of all of the outstanding capital stock of TruSeal, the Company paid $111.2 million in cash, net of a $1.8 million working capital adjustment, and assumed $14.8 million of liabilities. The Company also incurred $1.4 million in transaction fees, including legal, valuation and accounting fees.

On December 31, 2003, the Company completed the asset purchase of MACSTEEL Monroe, a mini-mill steel facility that can produce over 500,000 tons of special bar quality and engineered steel bars in diameters from 0.5625 to 3.25 inches, which primarily serves the light vehicle and heavy-duty truck markets. MACSTEEL Monroe has been integrated into MACSTEEL within the Vehicular Products segment. The Company acquired MACSTEEL Monroe to support and benefit a core business, MACSTEEL, and to expand the range of high quality bar products available to the Company s customers. MACSTEEL Monroe s production of smaller diameter bars complements the Company s existing one to six inch size range and expands the customer base and product offerings. As consideration for the MACSTEEL Monroe acquisition, the Company paid $99.8 million in cash, net of a $15.7 million working capital adjustment, and assumed $18.3 million of liabilities. The working capital adjustment resulted in a reduction of property, plant and equipment in the second quarter of fiscal 2004. The Company also incurred $2.3 million in transaction fees, including legal, valuation and accounting fees.

The final allocations of the combined assets and liabilities of TruSeal and MACSTEEL Monroe acquired and assumed are summarized below. The final allocations were based on independent appraisals and management s estimates of fair values. The final determination of deferred taxes resulted in a reduction from the preliminary allocation to the final allocations of both goodwill and deferred income tax liabilities of approximately $4.4 million.

		As of Date of Opening Balance Sheets (In thousands)
Cash and equivalents	$	148
Accounts receivable, net of allowance for doubtful accounts		23,049
Inventories		39,711
Deferred income taxes		4,387
Other current assets		2,824
Total current assets		70,119
Property, plant and equipment, net		80,791
Goodwill, net		68,224
Intangible assets:		
Trade names and trademarks		8,230
Patents		14,834
Other intangibles		3,692
Total intangible assets		26,756
Other assets		1,959
Total assets	$	247,849
Accounts payable	$	21,923
Accrued liabilities		6,203
Total current liabilities		28,126
Deferred income taxes		2,668
Other liabilities		2,279
Total liabilities		33,073
Investment		214,776
Total liabilities and equity	$	247,849

The allocations resulted in goodwill of $68.2 million, of which $46.7 million is expected to be deductible for tax purposes. All $68.2 million of goodwill has been assigned to the Building Products segment. The 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 and trademarks are being amortized over an average estimated useful life of 16 years, the patents are being amortized over an average of 17 years and the other intangibles are being amortized over an average of 5 years. The weighted average useful life of intangible assets, excluding goodwill, created as a result of the acquisitions is 15 years. No residual value is estimated for the intangible assets.

The $68.2 million of goodwill associated with the TruSeal acquisition can be attributed to the value the Company expects to realize from expanding the product offerings to its current customers. The Company previously marketed and sold a wide range of products to similar customers as those of TruSeal. With the acquisition of TruSeal, the Company has expanded the product offerings it can market and sell to its entire base of customers in the Building Products segment. The reliability, service levels and synergies established with the Company s base of customers within this segment allow for the potential of increased performance from TruSeal. The ability to provide customers a suite of complimentary products is of considerable value to the Company.

The following table provides unaudited proforma results of operations for the twelve months ended October 31, 2004, 2003 and 2002, as if TruSeal and MACSTEEL Monroe 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 acquisitions and estimated depreciation and amortization of fixed and identifiable intangible assets. However, the proforma results presented do not include any anticipated cost savings or other synergies related to either of the acquisitions. 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 Twelve Months Ended October 31, (In thousands)		
	2004	**2003**	**2002**
Net sales	$ 1,505,008	$ 1,188,442	$ 1,105,474
Net income attributable to common stockholders	53,850	52,134	63,985
Diluted earnings per common share	$ 3.22	$ 3.18	$ 4.04

Fiscal 2002 Acquisitions

On February 12, 2002, Quanex completed the purchase of certain assets and assumption of certain liabilities of Ekamar, Inc., formerly known as Colonial Craft, Inc., a Minnesota corporation, through its wholly owned subsidiary, Quanex Windows, Inc., for approximately $17.3 million in cash. The acquired business operates as a wholly owned subsidiary of the Company and has been renamed Colonial Craft, Inc. (COLONIAL CRAFT). The acquisition was accounted for as a purchase transaction under SFAS No. 141, and accordingly the tangible assets acquired and liabilities assumed were recorded at their fair value at the date of the acquisition. The results of operations of COLONIAL CRAFT have been included in the consolidated financial statements of Quanex subsequent to the date of acquisition. Pro forma results of operations have not been presented because the effect of the acquisition was not material.

COLONIAL CRAFT is a manufacturer of value-added fenestration related wood products based in Mounds View, Minnesota and Luck, Wisconsin. COLONIAL CRAFT manufactures custom wood window accessories with two primary product lines: wood window grilles and hardwood architectural mouldings. COLONIAL CRAFT was integrated into the Building Products segment. COLONIAL CRAFT provides direct synergy with one of the Company s two core businesses.

3. Executive Life Insurance Benefit

During the fiscal year ended October 31, 2003, a former executive of the Company, on whose life the Company held life insurance policies, died. As a result, the Company received life insurance proceeds totaling $6.4 million. Estimates of the cash surrender value of these life insurance policies amounting to $4.3 million were previously recognized in Other assets on the financial statements. The excess of the proceeds over the previously recorded cash surrender value amounting to $2.2 million was recognized as a non-taxable benefit on the income statement during fiscal 2003. The impact to the fiscal year ended October 31, 2003 basic and diluted earnings per share of this benefit was $0.13.

During the fiscal year ended October 31, 2002, another of the Company s former executives, on whose life it held life insurance policies, died. As a result, the Company received life insurance proceeds totaling $26.1 million. Estimates of the cash surrender value of these life insurance policies amounting to $15.9 million were previously recognized in Other assets on the financial statements. The excess of the proceeds over the

previously recorded cash surrender value and the liability to the beneficiaries of the executive amounting to $9.0 million was recognized as a non-taxable benefit on the income statement during fiscal 2002. The impact on October 31, 2002 earnings per share of this benefit was $0.61 basic and $0.56 diluted.

4. Goodwill and Acquired Intangible Assets

As of November 1, 2001, the Company adopted SFAS No. 142 Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill is no longer amortized, but is reviewed for impairment annually or more frequently if certain indicators arise. In accordance with SFAS No. 142, the Company completed the transitional impairment test of goodwill during the second quarter ended April 30, 2002, which indicated that goodwill was not impaired. The Company again reviewed goodwill for impairment as of August 31, 2004, 2003 and 2002, which indicated that goodwill was not impaired. The Company performs this annual impairment test as of August 31 each year or more frequently if certain indicators arise.

The carrying amounts of goodwill as of October 31, 2004 and 2003 are as follows (in thousands):

	2004	2003
Vehicular Segment	$ 13,496	$ 13,496
Building Products Segment	121,174	52,940
Total	$ 134,670	$ 66,436

Intangible assets consist of the following (in thousands):

	As of October 31, 2004			As of October 31, 2003		
	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	$ 187	2 years	$ 313	$ 119	3 years
Patents	15,277	883	16	443	82	10
Trademarks	8,230	420	14			
Customer Relationships	2,491	416	5			
Other intangibles	1,201	250	3			
Total	$ 27,512	$ 2,156	13 years	$ 756	$ 201	8 years
Unamortized intangible assets:						
Trade Name	$ 2,200			$ 2,200		

The aggregate amortization expense for intangibles for the years ended October 31, 2004 and 2003 is $2.0 million and $0.1 million, respectively. Estimated amortization expense for the next five years follows (in thousands):

Fiscal Years Ending October 31,	Estimated Amortization

2005	$	2,303
2006		2,294
2007		2,252
2008		1,988
2009		1,521

5. 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 Year Ended October 31, 2004		
	Numerator (Income)	Denominator (Shares)	Per Share Amount
Basic earnings per share computation	$ 54,467	16,436	$ 3.31
Effect of dilutive securities:			
Effect of common stock equivalents arising from stock options		207	
Effect of common stock held by rabbi trust		55	
Diluted earnings per share computation	$ 54,467	16,698	$ 3.26

	For the Year Ended October 31, 2003		
	Numerator (Income)	Denominator (Shares)	Per Share Amount
Basic earnings per share computation	$ 42,887	16,154	$ 2.65
Effect of dilutive securities:			
Effect of common stock equivalents arising from stock options		166	
Effect of common stock held by rabbi trust		64	
Diluted earnings per share computation	$ 42,887	16,384	$ 2.62

	For the Year Ended October 31, 2002		
	Numerator (Income)	Denominator (Shares)	Per Share Amount
Basic earnings per share computation	$ 55,482	14,823	$ 3.74
Effect of dilutive securities:			
Effect of common stock equivalents arising from stock options		284	
Effect of common stock held by rabbi trust		40	
Effect of conversion of subordinated debentures	1,610	1,090	
Diluted earnings per share computation	$ 57,092	16,237	$ 3.52

In May 2004, the Company issued $125.0 million of the Debentures that, if converted in the future, would have a potentially dilutive effect on the Company s stock. Shares issuable upon conversion of the Debentures are excluded from the computation of earnings per share because the contingent conditions for their conversion have not been met (see Note 10).

33

In September 2004, the EITF reached a consensus on EITF Issue 04-08, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effects on Diluted Earnings Per Share, which was ratified by the FASB in October 2004. Issue 04-08 becomes effective for periods after December 15, 2004, which will be the Company s first fiscal quarter of 2005. Under the consensus, companies will be required to retroactively restate diluted earnings per share numbers applying the if converted method of accounting from the issuance date of the contingently convertible bond. On May 5, 2004, the Company issued $125.0 million of 2.50% Convertible Senior Debentures due May 15, 2034. As it relates to Quanex, EITF Issue 04-08 would mean an additional 2.2 million shares of earnings dilution and have an annualized earnings per share impact of approximately $0.30 - $0.35 per common share. However, the Company could elect to settle its convertible obligation with either common stock, cash or a combination of the two. If the Company elects to settle its entire convertible obligation with cash and can demonstrate its ability to do so, it would not be required to show the dilutive impact of the higher share count in the calculation of its earnings per share for periods after such election.

On December 2, 2004 the Board of Directors declared a three-for-two stock split in the form of a 50% stock dividend, payable on December 31, 2004 to holders of record on December 17, 2004. The following table presents the proforma effect of such stock split on earnings per share.

	Proforma Years Ended October 31, (In thousands, except per share amounts)					
		2004		2003		2002
Basic earnings per common share - Proforma:						
Proforma earnings from continuing operations	$	2.34	$	1.82	$	2.42
Proforma income (loss) from discontinued operations		(0.13)		(0.05)		0.08
Proforma basic earnings per share	$	2.21	$	1.77	$	2.50
Diluted earning per common share - Proforma:						
Proforma earnings from continuing operations	$	2.30	$	1.79	$	2.27
Proforma income (loss) from discontinued operations		(0.13)		(0.04)		0.07
Proforma diluted earnings per share	$	2.17	$	1.75	$	2.34
Weighted average common shares outstanding Proforma:						
Basic		24,654		24,231		22,235
Diluted		25,047		24,576		24,356

6. Inventories

Inventories consist of the following:

	October 31, (In thousands)			
		2004		2003
Raw materials	$	24,562	$	15,521
Finished goods and work in process		78,088		43,530
		102,650		59,051
Other		12,717		9,575
Total	$	115,367	$	68,626

The values of inventories are based on the following accounting methods:

	October 31, 2004	October 31, 2003
	(In thousands)	
LIFO	$ 50,382	$ 54,332
FIFO	64,985	14,294
Total	$ 115,367	$ 68,626

With respect to inventories valued using the LIFO method, replacement cost exceeded the LIFO value by approximately $34.4 million and $13.9 million at October 31, 2004 and 2003, respectively. During fiscal 2004 and fiscal 2003, there were LIFO liquidations that resulted in a reduction of the LIFO reserve of approximately $3.2 million (credit to cost of sales) and $1.4 million, respectively. The LIFO liquidations, which are included in the $34.4 million and $13.9 million LIFO reserve amounts discussed above, reduced the amount of expense recognized in the respective years compared to what would have been recognized had there been no liquidations.

LIFO reserve adjustments are treated as corporate expenses as this matches how management reviews the businesses. The LIFO reserve adjustments are calculated on a consolidated basis in a single pool using the link chain method. Upon completion of the consolidated calculation, the resulting reserve that is recorded to properly state inventories at their LIFO values are not allocated to the segments. Management believes LIFO reserves to be a corporate item and thus performs all reviews of segment operations on a FIFO basis.

Since the adoption of LIFO inventory valuation in 1973, the Company has completed multiple acquisitions. The acquisitions were integrated into the Company s operations with some valuing inventory on a LIFO basis and others on a FIFO basis. The selection of the inventory valuation treatment of each acquisition depends on the facts and circumstances and is applied on each transaction individually. As a result of this variability, management reviews all of the businesses on a FIFO basis for comparability, with the LIFO reserve treated as a corporate item.

7. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	October 31, 2004	October 31, 2003
	(In thousands)	
Land and land improvements	$ 24,073	$ 19,808
Buildings	136,769	116,585
Machinery and equipment	671,882	589,817
Construction in progress	9,423	16,392
	842,147	742,602
Less accumulated depreciation and amortization	(491,165)	(443,869)
Property, plant and equipment, net	$ 350,982	$ 298,733

The Company had commitments for the purchase or construction of capital assets amounting to approximately $5.2 million at October 31, 2004.

8. Accrued Liabilities

Accrued liabilities consist of the following:

	October 31, 2004	October 31, 2003
	(In thousands)	
Payroll, payroll taxes and employee benefits	$ 31,193	$ 22,795
Accrued contribution to pension funds	324	2,035
Interest	1,825	175
State and local taxes	1,179	1,564
Other	11,323	7,195
Accrued liabilities	$ 45,844	$ 33,764

9. Income Taxes

Income taxes are provided on taxable income at the statutory rates applicable to such income.

Income tax expense (benefit) consists of the following:

	Years Ended October 31, 2004	2003	2002
		(In thousands)	
Current:			
Federal	$ 26,379	$ 18,908	$ 19,145
State	3,039	1,412	1,238
Foreign	474		
	29,892	20,320	20,383
Deferred	6,153	3,330	4,637
Income tax expense	36,045	23,650	25,020
Income taxes from discontinued operations	(1,737)	(714)	1,112
	$ 34,308	$ 22,936	$ 26,132

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Significant components of the Company s net deferred tax liability are as follows:

	October 31, 2004	October 31, 2003
	(In thousands)	
Deferred tax liability:		
Property, plant and equipment	$ 50,678	$ 45,481
Intangibles	3,649	1,448
Inventory	1,649	1,703
Other	7,456	12,163
	63,432	60,795
Deferred tax assets:		
Postretirement benefit obligation	(3,257)	(3,328)
Other employee benefit obligations	(9,037)	(6,382)
Environmental accruals	(1,476)	(1,277)
Other	(6,423)	(5,190)
	(20,193)	(16,177)
Net deferred tax liability	$ 43,239	$ 44,618
Deferred income tax non-current liability	$ 53,983	$ 49,938
Deferred tax current assets	(10,744)	(5,320)
Net deferred tax liability	$ 43,239	$ 44,618

Income tax expense differs from the amount computed by applying the statutory federal income tax rate to income from continuing operations before income taxes for the following reasons:

	Years Ended October 31, 2004	2003	2002
		(In thousands)	
Income tax expense at statutory tax rate	$ 32,775	$ 23,677	$ 27,572
Increase (decrease) in taxes resulting from:			
State income taxes, net of federal effect	2,883	1,955	2,300
Amortization of intangibles	560		
Life insurance benefit		(753)	(3,157)
Other items, net	(173)	(1,229)	(1,695)
	$ 36,045	$ 23,650	$ 25,020

The Company s tax returns are not currently under audit. The Company has 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 operations.

10. Long-Term Debt and Financing Arrangements

Long-term debt consists of the following:

	October 31, 2004		2003 (In thousands)	
Bank Agreement Revolver	$		$	10,000
2.50% Convertible Senior Debentures due 2034		125,000		
Industrial Revenue and Economic Development Bonds, unsecured, principle due in the years 2005 and 2010, bearing interest ranging from 6.50% to 8.375%		1,665		1,665
State of Alabama Industrial Development Bonds				3,450
Scott County, Iowa Industrial Waste Recycling Revenue Bonds		2,000		2,200
Temroc Industrial Development Revenue Bonds		2,027		2,228
Other		260		227
	$	130,952	$	19,770
Less maturities due within one year included in current liabilities		456		3,877
	$	130,496	$	15,893

Bank Agreement

In November 2002, the Company entered into a secured $200.0 million Revolving Credit Agreement (Bank Agreement). The Bank Agreement is secured by all Company assets, excluding land and buildings. The current Bank Agreement expires November 2005 and provides for up to $25.0 million for standby letters of credit, limited to the undrawn amount available under the current Bank Agreement. All borrowings under the current 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 $200.0 million to $310.0 million to provide funds necessary for the TruSeal and MACSTEEL Monroe acquisitions, as detailed in Note 2. 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 October 31, 2004, the Company was in compliance with all current Bank Agreement covenants. As of October 31, 2004, nothing was outstanding under the Bank Agreement and all $310.0 million of the revolver was available.

Convertible Senior Debentures

On May 5, 2004, the Company issued $125.0 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.

On August 26, 2004, the Board of Directors of the Company authorized an annual dividend increase of $0.08 per common share outstanding. On December 2, 2004, the Board of Directors of the Company authorized an annual dividend increase of $0.05 per common share outstanding and declared in a separate action a three-for-two stock dividend, in the form of a 50% stock dividend. As a result of the dividend increases and stock split, it is estimated that the conversion rate will be adjusted to approximately 26.1113 shares of common stock per $1,000 principal amount of notes after taking into account the December 31, 2004 stock split. The estimated adjusted conversion rate is equivalent to an adjusted conversion price of $38.2976 per share of common stock, also after taking into account the December 31, 2004 stock split.

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.

The net proceeds from the offering, totaling approximately $122.0 million were used to repay a portion of the amounts outstanding under the revolving credit agreement.

Convertible Subordinated Debentures

On June 30, 1995, the Company exercised its right under the terms of its Cumulative Convertible Exchangeable Preferred Stock to exchange such stock for the 6.88% Convertible Subordinated Debentures due June 30, 2007 (Convertible Subordinated Debentures). Interest was payable semi-annually on June 30 and December 31 of each year. The Convertible Subordinated Debentures were subordinate to all senior indebtedness of the Company and were convertible, at the option of the holder, into shares of the Company s common stock at a conversion price of $31.50 per share.

During fiscal 2001 and 2000, respectively, the Company accepted unsolicited block offers to buy back $4.6 million and $10.4 million, respectively, principal amount of its Convertible Subordinated Debentures.

On May 9, 2002, the Company announced that it would redeem the remaining $58.7 million principal amount of its 6.88% Convertible Subordinated Debentures. The Company set a redemption date of June 12, 2002 for all debentures outstanding. The redemption price was 100.688% of the principal amount plus accrued interest to the redemption date. Holders of the Convertible Subordinated Debentures had the right, as an alternative to redemption, to convert the Convertible Subordinated Debentures into shares of common stock of Quanex Corporation at a conversion price of $31.50 per share of common stock. The right to convert the Convertible Subordinated Debentures expired at the close of business on June 5, 2002. As of June 5, 2002, $57.4 million aggregate principal amount of the Convertible Subordinated Debentures were converted to 1.8 million shares of Company stock and $1.3 million of the Convertible Subordinated Debentures were redeemed on June 12, 2002.

As a result of the redemption of the Convertible Subordinated Debentures, a loss of $930,000 was recognized in fiscal 2002 due to the early extinguishment of debt. This loss resulted from the write-off of the remaining debt issuance costs associated with the subordinated debentures, as well as the .688% premium paid on the $1.3 million of debentures, which were redeemed. In accordance with SFAS No. 145, this loss was classified as ordinary instead of an extraordinary item, net of tax.

Other Debt Instruments

The State of Alabama Industrial Development Bonds were assumed as part of the Nichols Aluminum Alabama acquisition. These bonds matured August 1, 2004.

On June 1, 1999, the Company borrowed $3 million through Scott County, Iowa Variable Rate Demand Industrial Waste Recycling Revenue Bonds Series 1999. The bonds require 15 annual principal payments of $200,000 beginning on July 1, 2000. The variable interest rate is established by the remarketing agent based on the lowest weekly rate of interest that would permit the sale of the bonds at par, on the basis of prevailing financial market conditions. Interest is payable on the first business day of each calendar month. Interest rates on these bonds during fiscal 2004 have ranged from 1.15% to 1.85%. These bonds are secured by a Letter of Credit.

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.

Aggregate maturities of long-term debt at October 31, 2004, are as follows (in thousands):

2005	$	456
2006		509
2007		455
2008		460
2009		474
Thereafter		128,598
Total	$	130,952

11. Pension Plans and Other Postretirement Benefits

The Company has a number of retirement plans covering substantially all employees. The Company provides both defined benefit and defined contribution plans. In general, the plant or location of his/her employment determines an employee s coverage for retirement benefits.

Defined Benefit Plans

The single employer defined benefit pension plans pay benefits to employees at retirement using formulas based upon years of service and either compensation rates near retirement or a flat dollar multiplier, as applicable. The Company s funding policy is generally to make the minimum annual contributions required by applicable regulations. In fiscal 2004, the Company made voluntary contributions in excess of the minimum contribution totaling $4.9 million towards the 2003 plan year. As a result of the voluntary contributions made to the 2003 plan year, there is no

minimum contribution required to be made for the 2004 plan year.

The Company also provides certain healthcare and life insurance benefits for eligible retired employees employed prior to January 1, 1993. Certain employees may become eligible for those benefits if they reach normal retirement age while working for the Company. The Company continues to fund benefit costs on a pay-as-you-go basis. For fiscal year 2004, the Company made benefit payments totaling $0.6 million, compared to $0.4 million and $0.5 million in fiscal 2003 and 2002, respectively.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law on December 8, 2003. This Act introduces a Medicare prescription-drug benefit beginning in 2006 as well as a federal subsidy to sponsors of retiree health care plans that provide a benefit at least actuarially equivalent to the Medicare benefit. Management has concluded that the Company s plans are at least actuarially equivalent to the Medicare benefit and for less than 50% of covered retirees. The Company has included the federal subsidy from the Act for those eligible prospectively as of August 1, 2004. The resulting reduction to the benefit obligation was $0.3 million for the year ended October 31, 2004, and the impact to net periodic pension cost and to benefits paid in future years is not expected to be material.

The Company uses an October 31 measurement date for its defined benefit plans. The following provides a reconciliation of benefit obligations, plan assets and funded status of these plans:

	Pension Benefits		Postretirement Benefits	
		October 31,		
	2004	2003	2004	2003
		(In thousands)		
Change in Benefit Obligation				
Benefit obligation at beginning of year(1)	$ 52,516	$ 43,583	$ 6,893	$ 8,434
Service cost	3,900	2,915	99	100
Interest cost	3,292	2,922	443	417
Amendments	190	487		
Actuarial loss (gain)	5,727	4,112	997	(1,613)
Benefits paid	(1,487)	(1,021)	(590)	(445)
Administrative expenses	(650)	(482)		
Benefit obligation at end of year(1)	$ 63,488	$ 52,516	$ 7,842	$ 6,893
Change in Plan Assets				
Fair value of plan assets at beginning of year	$ 32,871	$ 28,427		
Actual return on plan assets	4,942	4,429		
Employer contributions	7,172	1,518		
Benefits paid	(1,487)	(1,021)		
Administrative expenses	(650)	(482)		
Fair value of plan assets at end of year	$ 42,848	$ 32,871		
Funded Status	$ (20,640)	$ (19,645)	$ (7,842)	$ (6,893)

(1) For the pension benefit plans, the benefit obligation is the projected benefit obligation. For other retiree benefit plans, the benefit obligation is the accumulated postretirement benefit obligation.

	Pension Benefits		Postretirement Benefits	
	October 31,			
	2004	2003	2004	2003
	(In thousands)			
Calculation of Net Amount Recognized				
Funded status at end of year	$ (20,640)	$ (19,645)	$ (7,842)	$ (6,893)
Unrecognized transition asset	(49)	(158)		
Unrecognized prior service cost	1,579	1,599	(479)	(537)
Unrecognized net actuarial loss (gain)	18,536	15,405	611	(385)
Other		5	(35)	(30)
Net amount recognized	$ (574)	$ (2,794)	$ (7,745)	$ (7,845)
Classification of Net Amount Recognized				
Deferred pension credit	$ (9,561)	$ (10,358)	$ (7,745)	$ (7,845)
Intangible asset	1,579	1,599		
Accumulated other comprehensive income	7,408	5,965		
Net amount recognized	$ (574)	$ (2,794)	$ (7,745)	$ (7,845)

Below is data related to pension plans in which the accumulated benefit obligation exceeds plan assets.

	Pension Benefits		Postretirement Benefits	
	October 31,			
	2004	2003	2004	2003
	(In thousands)			
Accumulated benefit obligation	$ 52,397	$ 43,234	$ 7,842	$ 6,893
Fair value of plan assets	42,848	32,871		

Components of the net periodic benefit cost were as follows:

	Pension Benefits			Postretirement Benefits		
	October 31,					
	2004	2003	2002	2004	2003	2002
	(In thousands)					
Service Cost	$ 3,900	$ 2,915	$ 2,170	$ 99	$ 100	$ 102
Interest cost	3,292	2,922	2,617	443	417	560
Expected return on plan assets	(3,133)	(2,444)	(2,044)			
Amortization of unrecognized transition asset	(108)	(111)	(111)	(58)	(155)	(54)
Amortization of unrecognized prior service cost	210	193	163			
Amortization of unrecognized net loss	786	677	263			
Other			(2)			
Net periodic pension cost	$ 4,947	$ 4,152	$ 3,056	$ 484	$ 362	$ 608

42

The Company determines its actuarial assumptions on an annual basis. The assumptions for the pension benefit and postretirement benefits calculations, as well as assumed health care cost trend rates, for the years ended October 31, are as follows:

	Pension Benefits			Postretirement Benefits		
	October 31,					
	2004	2003	2002	2004	2003	2002
Discount rate	5.75%	6.25%	6.75%	5.75%	6.25%	6.75%
Expected return on plan assets	8.50%	8.50%	8.50%			
Rate of compensation increase	4.00%	4.00%	4.00%			
Health care cost trend rate assumed for next year				9.00%	9.00%	6.92%
Ultimate trend rate				4.50%	4.50%	4.75%
Year rate reaches ultimate trend rate				2009	2009	2008

Several factors are considered in developing the estimate for the long-term expected rate of return on plan assets, including historical rates of return on broad equity and bond indices and projected long-term rates of return from pension investment consultants.

Assumed health care cost trend rates could have an effect on the amounts reported for post retirement benefit plans. A one-percentage point change in assumed health care cost trend rates would have the following effects:

	One Percent Increase	One Percent Decrease
	(In thousands)	
Effect on total service and interest cost components	$ 10	$ (9)
Effect on postretirement benefit obligation	195	(176)

The Company s target allocation for the year ending October 31, 2004 and actual asset allocation by asset category as of October 31, 2004 and 2003, are as follows:

	Target Allocation	Actual Allocation at October 31, 2004	2003
Equity securities	70%	70%	72%
Debt securities	30%	30%	28%

The Company s investment objective for defined benefit plan assets is to meet the plans benefit obligations, while minimizing the potential for future required Company plan contributions. The investment strategies focus on asset class diversification, liquidity to meet benefit payments and an appropriate balance of long-term investment return and risk. Target ranges for asset allocations are determined by matching the actuarial projections of the plans future liabilities and benefit payments with expected long-term rates of return on the assets, taking into account investment return volatility and correlations across asset classes. Plan assets are diversified across several investment managers and are generally

invested in liquid funds that are selected to track broad market equity and bond indices. Investment risk is carefully controlled with plan assets rebalanced to target allocations on a periodic basis and continual monitoring of investment managers performance relative to the investment guidelines established with each investment manager.

Management s best estimate of its cash requirements for the pension benefit plans and postretirement benefit plans for the year ending October 31, 2005 is $0.3 million and $0.6 million, respectively. For the pension benefit plans, this is comprised of expected contributions to the plan, whereas for postretirement benefit plans, this is comprised of expected contributions that will be used directly for benefit payments. Expected contributions are dependent on many variables, including the variability of the market value of the assets as compared to the obligation and other market or regulatory conditions. In addition, the Company takes into consideration its business investment opportunities and resulting cash requirements. Accordingly, actual funding may differ greatly from current estimates.

Total benefit payments expected to be paid to participants, which include payments funded from the Company s assets, as discussed above, as well as payments paid from the plans are as follows:

Years Ended October 31,	**Pension Benefits**	**Postretirement Benefits**
	(In thousands)	
Expected Benefit Payments		
2005	$ 1,254	$ 577
2006	1,409	595
2007	1,611	606
2008	1,837	608
2009	2,197	613
2010 - 2014	$ 17,833	$ 3,029

Defined Contribution Plans

The Company also has defined contribution plans to which both employees and the Company make contributions. The Company contributed approximately $6.3 million, $5.5 million and $5.5 million to these plans in fiscal 2004, 2003 and 2002, respectively. At October 31, 2004, assets of the defined contribution plans included shares of the Company s common stock with a market value of approximately $8.2 million, which represented approximately 5.1% of the total fair market value of the assets in the Company s defined contribution plans.

Other

Quanex has a Supplemental Benefit Plan covering certain key officers of the Company. Earned vested benefits under the Supplemental Benefit Plan were approximately $1.2 million, $0.7 million and $2.2 million at October 31, 2004, 2003 and 2002, respectively. These benefits are funded with life insurance policies purchased by the Company.

12. Industry Segment Information

The Company reports segment information in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. SFAS No. 131 requires that the Company disclose certain information about its operating segments where operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments.

Beginning in 2002, Quanex began reporting under two market focused segments, the Vehicular Products segment and the Building Products segment. Corporate and other includes corporate office charges, intersegment eliminations and LIFO inventory adjustments.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies, with the exception of the inventory valuation method. Quanex measures its inventory at the segment level on a FIFO basis, however at the consolidated Quanex level, the majority of the inventory is measured on a LIFO basis. See Note 6 to the financial statements for more information. The Company accounts for intersegment sales and transfers as though the sales or transfers were to third parties, that is, at current market prices.

For the years ended October 31, 2004, 2003 and 2002, no one customer represented 10% or more of the consolidated net sales of the Company. Following is selected segment information.

	For the Years Ended October 31, (In thousands)		
	2004(5)	2003(5)	2002(5)
Net Sales:			
Vehicular Products(1)	$ 817,740	$ 413,293	$ 387,254
Building Products(2) (3)	642,528	484,904	466,176
Consolidated	$ 1,460,268	$ 898,197	$ 853,430
Operating Income (Loss):			
Vehicular Products(1)	$ 74,377	$ 53,302	$ 56,787
Building Products(2) (3)	63,175	32,394	35,954
Corporate & Other	(38,141)	(20,061)	(12,291)
Consolidated	$ 99,411	$ 65,635	$ 80,450
Depreciation and Amortization:			
Vehicular Products(1)	$ 31,589	$ 25,876	$ 24,021
Building Products(2) (3)	18,194	14,732	14,568
Corporate & Other	271	377	525
Consolidated	$ 50,054	$ 40,985	$ 39,114
Capital Expenditures:(4)			
Vehicular Products(1)	$ 8,430	$ 13,729	$ 21,199
Building Products(2) (3)	11,000	11,509	10,061
Corporate & Other	112	133	118
Consolidated	$ 19,542	$ 25,371	$ 31,378
Identifiable Assets:			
Vehicular Products(1)	$ 475,491	$ 315,757	$ 321,132
Building Products(2) (3)	378,688	245,312	253,167
Corporate & Other	39,432	36,467	42,106
Discontinued Operations(5)	35,911	85,578	96,415
Consolidated	$ 929,522	$ 683,114	$ 712,820
Goodwill, Net:			
Vehicular Products(1)	$ 13,496	$ 13,496	$ 13,496
Building Products(2) (3)	121,174	52,940	52,940
Consolidated	$ 134,670	$ 66,436	$ 66,436

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

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

(3) Includes COLONIAL CRAFT operations since the acquisition date of February 12, 2002. See Note 2 to the financial statements.

(4) Includes capitalized interest.

(5) Piper Impact and Nichols Aluminum Golden are included in discontinued operations for all periods.

Net Sales by Product Information

	Years Ended October 31, 2004	2003 (In thousands)	2002
Net Sales			
Engineered Steel Bars	$ 795,370	$ 393,505	$ 365,393
Aluminum Mill Sheet Products	402,345	328,481	315,182
Window and Door Components	240,183	156,423	150,994
Extruded and Fabricated Products	22,370	19,788	21,861
Total	$ 1,460,268	$ 898,197	$ 853,430

Geographic Information

	Years Ended October 31, 2004	2003 (In thousands)	2002
Net Sales			
United States	$ 1,360,467	$ 845,057	$ 806,683
Mexico	43,935	22,036	19,242
Canada	47,254	26,354	23,759
Asian countries	4,485	46	14
European countries	3,554	4,168	3,533
Other foreign countries	573	536	199
Total	$ 1,460,268	$ 898,197	$ 853,430

Net sales by geographic region is attributed to countries based on the location of the customer. Operations of the Company and all identifiable assets are located in the United States.

13. Stockholders Equity

The Company s authorized capital stock consists of 50,000,000 shares of Common Stock, par value $0.50 per share, and 1,000,000 shares of Preferred Stock, no par value. As of October 31, 2004 and 2003, there were no shares of Preferred Stock issued or outstanding.

The Company declared a dividend in 1986 of one Preferred Stock Purchase Right (a Right) on each outstanding share of its common stock. This action was intended to assure that all shareholders would receive fair treatment in the event of a proposed takeover of the Company. On April 26, 1989, the Company amended the Rights to provide for additional protection to shareholders and to provide the Board of Directors of the Company with needed flexibility in responding to abusive takeover tactics. On April 15, 1999, the Second Amended and Restated Rights Agreement went into effect. Each Right, when exercisable, entitles the holder to purchase 1/1,000th of a share of the Company s Series A Junior Participating Preferred Stock at an exercise price of $90. Each 1/1,000th of a share of Series A Junior Participating Preferred Stock will be entitled to a dividend equal to the greater of $.01 or the dividend declared on each share of common stock, and will be entitled to 1/1,000th of a vote, voting together with the shares of common stock. The Rights will be exercisable only if, without the Company s prior consent, a person or group of persons acquires or announces the intention to acquire 20% or more of the Company s common stock. If the Company is acquired

through a merger or other business combination transaction, each Right will entitle the holder to purchase $120 worth of the surviving company s common stock for $90. Additionally, if someone acquires 20% or more of the Company s common stock, each Right not owned by the 20% or greater shareholder would permit the holder to purchase $120 worth of the Company s common stock for $90. The Rights are redeemable, at the option of the Company, at $.02 per Right at any time until ten days after someone acquires 20% or more of the common stock. The Rights expire April 15, 2009.

As a result of the Rights distribution, 150,000 of the 1,000,000 shares of authorized Preferred Stock were reserved for issuance as Series A Junior Participating Preferred Stock.

On December 2, 2004, the Company s Board of Directors authorized a three-for-two stock split in the form of a stock dividend. The stock split is to be distributed on December 31, 2004 to all holders of record on December 17, 2004. All references in the accompanying consolidated financial statements to weighted average numbers of shares outstanding, per share amounts, Stock Repurchase Program and Treasury Stock, and Restricted Stock and Stock Option Plans share data are presented without taking into account the impact of such stock split. See Note 5, Earnings Per Share, for a proforma presentation of the impact of such stock split.

14. Stock Repurchase Program and Treasury Stock

On December 5, 2002, the Board of Directors approved a program to purchase up to a total of 1 million shares of its common stock in the open market or in privately negotiated transactions. During the year ended October 31, 2003, the Company repurchased 438,600 shares at a cost of approximately $13.5 million. These shares were placed in treasury. During the year ended October 31, 2003, 161,677 of these shares were used for the exercise of options and other compensation plans, leaving 294,803 shares in treasury stock with a remaining carrying value of approximately $9.2 million.

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. During the year ended October 31, 2004, all of the shares in treasury stock at the beginning of the year were used through stock option exercises and other compensation plans. There were no repurchases during fiscal 2004 and at October 31, 2004, there were no shares in treasury stock.

15. Restricted Stock and Stock Option Plans

Key Employee and Non-Employee Director Plans

The Company has restricted stock and stock option plans which provide for the granting of common shares or stock options to key employees and non-employee directors.

Restricted Stock Plans

Under the Company s restricted stock plans, common stock may be awarded to key employees, officers and non-employee directors. The recipient is entitled to all of the rights of a shareholder, except that during the forfeiture period the shares are nontransferable. The awards vest over a specified time period. Upon issuance of stock under the plan, unearned compensation equal to the market value at the date of grant is charged to stockholders equity and subsequently amortized to expense over the restricted period. There were 33,300, 3,000 and 0 restricted shares granted in 2004, 2003 and 2002, respectively. The amount charged to compensation expense in 2004, 2003 and 2002 was $0.3 million, $0.3 million and $0.5 million, respectively, relating to amortization of restricted stock granted in 2004 and prior years. In December 2004, subsequent to the fiscal year ended October 31, 2004, the Company granted 27,400 restricted shares to certain officers and directors.

Stock Option Plans

Under the Company s option plans, options are granted at prices determined by the Board of Directors which may not be less than the fair market value of the shares at the time the options are granted. Unless otherwise provided by the Board of Directors at the time of grant, options become exercisable in one-third increments maturing cumulatively on each of the first through third anniversaries of the date of grant and must be exercised no later than ten years from the date of grant. Effective December 5, 2002, the 1996 Employee Plan (the 1996 Plan) was amended to add non-employee Directors as eligible participants. This amendment also increased the number of shares available for options and restricted stock awards under the 1996 Plan by 1,200,000 shares. There were 1,114,254, 1,348,633 and 391,597 shares available for granting of options at October 31, 2004, 2003, and 2002, respectively. The exercise price for the outstanding options as of October 31, 2004 ranged from $18.19 to $50.70 per share.

Stock option transactions for the three years ended October 31, 2004, were as follows:

	Shares Exercisable	Shares Under Option		Average Price Per Share
Balance at October 31, 2001	1,291,129	1,910,304	$	23
Granted		15,000		36
Exercised		(1,085,250)		23
Cancelled/Lapsed		(18,452)		22
Balance at October 31, 2002	489,366	821,602	$	23
Granted		285,500		32
Exercised		(180,936)		22
Cancelled/Lapsed		(45,536)		27
Balance at October 31, 2003	504,535	880,630	$	25
Granted		219,600	$	41
Exercised		(354,845)		23
Cancelled/Lapsed		(13,471)		35
Balance at October 31, 2004	371,262	731,914	$	31

The weighted average contractual life of the 731,914 shares under option was 7.8 years at October 31, 2004. In December 2004, subsequent to the fiscal year ended October 31, 2004, the Company granted 208,550 options to certain officers and employees at an average exercise price of $59.20 per share.

Non-Employee Director Plans

The Company has various non-employee Director Plans, which are described below:

1989 Non-Employee Directors Plan

The Company s 1989 Non-Employee Directors Stock Option Plan provides for the granting of stock options to non-employee Directors to purchase up to an aggregate of 210,000 shares of common stock. Each non-employee Director as of December 6, 1989 was granted an option to purchase 3,000 shares of common stock at a price per share of common stock equal to the fair market value of the common stock as of the date of grant. Also, each non-employee Director who was a director of the Company on any subsequent October 31, while the plan was in effect and shares were available for the granting of options, was granted an option to purchase 3,000 shares of common stock at a price equal to the fair market value of the common stock at the time of the grant. During 1998, the Board of Directors passed a resolution, which decreased the number of options to be granted annually as prescribed above from 3,000 to 2,000. Options become exercisable at any time commencing six months after the grant and must be exercised no later than 10 years from the date of grant. No option may be granted under the plan after December 5, 1999. There were no shares available for granting of options at October 31, 2004, 2003 or 2002. The exercise price of the options outstanding as of October 31, 2004 ranged from $16.88 to $28.50.

Stock option transactions for the three years ended October 31, 2004, were as follows:

	Shares Exercisable	Shares Under Option	Average Price Per Share
Balance at October 31, 2001	115,000	115,000	$ 24
Granted			
Exercised		(51,000)	23
Cancelled		(3,000)	19
Balance at October 31, 2002	61,000		