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

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended January 31, 2007**

**OR**

o **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 ☑ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☑ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o 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 February 23, 2007** |
|---|---|
| Common Stock, par value $0.50 per share | 37,047,561 |

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## PART I. FINANCIAL INFORMATION

*Item 1. Financial Statements*

**QUANEX CORPORATION**
**CONSOLIDATED BALANCE SHEETS**
**(Unaudited)**

| | January 31, 2007 | October 31, 2006 |
|---|---|---|
| | (In thousands except share data) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and equivalents | $ 117,505 | $ 105,708 |
| Short-term investments | 40,000 | — |
| Accounts and notes receivable, net of allowance of $4,687 and $4,180 | 160,086 | 184,311 |
| Inventories | 139,436 | 142,788 |
| Deferred income taxes | 12,373 | 12,218 |
| Other current assets | 6,184 | 5,584 |
| Total current assets | 475,584 | 450,609 |
| Property, plant and equipment, net | 424,443 | 432,058 |
| Goodwill | 196,342 | 196,350 |
| Cash surrender value insurance policies | 29,252 | 29,108 |
| Intangible assets, net | 73,516 | 75,285 |
| Other assets | 17,678 | 18,742 |
| Total assets | $ 1,216,815 | $ 1,202,152 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 135,507 | $ 137,564 |
| Accrued liabilities | 45,047 | 54,943 |
| Income taxes payable | 20,948 | 13,185 |
| Current maturities of long-term debt | 2,700 | 2,721 |
| Total current liabilities | 204,202 | 208,413 |
| Long-term debt | 130,680 | 130,680 |
| Deferred pension credits | 1,568 | 1,115 |
| Deferred postretirement welfare benefits | 7,337 | 7,300 |
| Deferred income taxes | 65,148 | 66,189 |
| Non-current environmental reserves | 13,965 | 14,186 |
| Other liabilities | 17,602 | 15,754 |
| Total liabilities | 440,502 | 443,637 |
| 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 38,301,333 and 38,319,960 | 19,151 | 19,160 |
| Additional paid-in-capital | 209,842 | 208,714 |
| Retained earnings | 593,781 | 579,753 |
| Accumulated other comprehensive income (loss) | (1,796) | (1,736) |
| | 820,978 | 805,891 |
| Less treasury stock, at cost, 1,129,293 and 1,200,617 shares | (42,917) | (45,628) |
| Less common stock held by Rabbi Trust, 130,329 shares | (1,748) | (1,748) |
| Total stockholders' equity | 776,313 | 758,515 |
| Total liabilities and stockholders' equity | $ 1,216,815 | $ 1,202,152 |

The accompanying notes are an integral part of the financial statements.

**QUANEX CORPORATION**
**CONSOLIDATED STATEMENTS OF INCOME**
**(Unaudited)**

| | Three Months Ended January 31, | |
|---|---|---|
| | **2007** | **2006** |
| | **(In thousands, except per share amounts)** | |
| **Net sales** | $ 417,641 | $ 444,569 |
| Cost and expenses: | | |
| Cost of sales (exclusive of items shown separately below) | 342,565 | 352,084 |
| Selling, general and administrative expense | 25,699 | 20,873 |
| Depreciation and amortization | 18,996 | 17,388 |
| **Operating income** | 30,381 | 54,224 |
| Interest expense | (1,035) | (1,240) |
| Other, net | 1,974 | 111 |
| Income from continuing operations before income taxes | 31,320 | 53,095 |
| Income tax expense | (11,275) | (19,645) |
| **Income from continuing operations** | 20,045 | 33,450 |
| Income (loss) from discontinued operations, net of taxes | — | (425) |
| **Net income** | $ 20,045 | $ 33,025 |
| **Basic earnings per common share:** | | |
| Earnings from continuing operations | $ 0.54 | $ 0.88 |
| Income (loss) from discontinued operations | — | (0.01) |
| Basic earnings per share | $ 0.54 | $ 0.87 |
| **Diluted earnings per common share:** | | |
| Earnings from continuing operations | $ 0.53 | $ 0.85 |
| Income (loss) from discontinued operations | — | (0.01) |
| Diluted earnings per share | $ 0.53 | $ 0.84 |
| **Weighted-average common shares outstanding:** | | |
| Basic | 36,897 | 37,866 |
| Diluted | 38,809 | 40,065 |

The accompanying notes are an integral part of the financial statements.

**QUANEX CORPORATION**
**CONSOLIDATED STATEMENTS OF CASH FLOW**
**(Unaudited)**

| | Three Months Ended January 31, | |
|---|---|---|
| | 2007 | 2006 |
| | (In thousands) | |
| **Operating activities:** | | |
| Net income | $ 20,045 | $ 33,025 |
| Loss (income) from discontinued operations | — | 425 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 19,063 | 17,554 |
| Deferred income taxes | (1,186) | 1,950 |
| Stock-based compensation | 2,643 | 886 |
| Changes in assets and liabilities, net of effects from acquisitions and dispositions: | | |
| (Increase) decrease in accounts and notes receivable | 24,216 | (1,385) |
| (Increase) decrease in inventory | 3,328 | (16,279) |
| Increase (decrease) in accounts payable | (2,055) | 12,471 |
| Increase (decrease) in accrued liabilities | (10,232) | (17,181) |
| Increase (decrease) in income taxes payable | 7,849 | 10,362 |
| Increase (decrease) in deferred pension and postretirement benefits | 1,630 | 1,492 |
| Other, net | 553 | (3,772) |
| Cash provided by (used for) operating activities from continuing operations | 65,854 | 39,548 |
| Cash provided by (used for) operating activities from discontinued operations | — | (761) |
| Cash provided by (used for) operating activities | 65,854 | 38,787 |
| **Investing activities:** | | |
| Purchases of short-term investments | (40,000) | — |
| Capital expenditures, net of retirements | (9,613) | (21,405) |
| Proceeds from sale of discontinued operations | — | 5,432 |
| Other, net | (173) | — |
| Cash provided by (used for) investing activities from continuing operations | (49,786) | (15,973) |
| Cash provided by (used for) investing activities from discontinued operations | — | (14) |
| Cash provided by (used for) investing activities | (49,786) | (15,987) |
| **Financing activities:** | | |
| Repayments of long-term debt | (21) | (30) |
| Common stock dividends paid | (5,210) | (3,964) |
| Issuance of common stock from option exercises, including related tax benefits | 997 | 4,217 |
| Purchases of treasury stock | — | (17,906) |
| Other, net | (11) | — |
| Cash provided by (used for) financing activities from continuing operations | (4,245) | (17,683) |
| Cash provided by (used for) financing activities from discontinued operations | — | (56) |
| Cash provided by (used for) financing activities | (4,245) | (17,739) |
| Effect of exchange rate changes on cash equivalents | (26) | 20 |
| Increase (decrease) in cash and equivalents | 11,797 | 5,081 |
| Cash and equivalents at beginning of period | 105,708 | 49,681 |
| Cash and equivalents at end of period | $ 117,505 | $ 54,762 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid during the period for interest | $ 1,707 | $ 1,852 |
| Cash paid during the period for income taxes | $ 4,264 | $ 5,921 |

The accompanying notes are an integral part of the financial statements.

**QUANEX CORPORATION**
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**
**(Unaudited)**

| Three months ended January 31, 2007 | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock & Other | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| | | | (In thousands, except per share amounts) | | | |
| Balance at October 31, 2006 | $ 19,160 | $ 208,714 | $ 579,753 | $ (1,736) | $ (47,376) | $ 758,515 |
| Net income | | | 20,045 | | | 20,045 |
| Common dividends ($0.14 per share) | | | (5,210) | | | (5,210) |
| Stock-based compensation activity: | | | | | | |
| Stock-based compensation earned | | 2,620 | | | | 2,620 |
| Stock options exercised | | | (529) | | 1,177 | 648 |
| Restricted stock awards | | (1,512) | (22) | | 1,534 | — |
| Stock-based compensation tax benefit | | 430 | | | | 430 |
| Other | (9) | (410) | (256) | (60) | | (735) |
| Balance at January 31, 2007 | $ 19,151 | $ 209,842 | $ 593,781 | $ (1,796) | $ (44,665) | $ 776,313 |

The accompanying notes are an integral part of the financial statements.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation**

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

In January 2006, the Company sold Temroc Metals, Inc. (Temroc). Accordingly, its operating results are reported as discontinued operations in the Consolidated Statements of Income and Consolidated Statements of Cash Flow (see Note 15).

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and notes thereto included in the Quanex Corporation Form 10-K filed with the U.S. Securities and Exchange Commission for the year ended October 31, 2006.

**2. New Accounting Pronouncements**

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115"* (SFAS 159). This standard provides companies with an option to measure, at specified election dates, many financial instruments and certain other items at fair value that are not currently measured at fair value. A company will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007 (as of November 1, 2008 for the Company). The Company is currently assessing the impact of applying SFAS 159's elective fair value option on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*" (SFAS 158), which requires recognition of the funded status of a benefit plan in the balance sheet. SFAS 158 also requires recognition, in other comprehensive income, of certain gains and losses that arise during the period but which are deferred under pension accounting rules. SFAS 158 also requires defined benefit plan assets and obligations to be measured as of the date of the employer's fiscal year-end. SFAS 158 provides recognition and disclosure elements that will be effective for fiscal years ending after December 15, 2006 (as of October 31, 2007 for the Company) and measurement date elements that will be effective for fiscal years ending after December 15, 2008 (as of October 31, 2009 for the Company). The Company is currently evaluating the recognition element of adopting SFAS 158; such adoption will be impacted by plan returns during fiscal 2007. The measurement date element will not have an impact on the Company as the Company already measures the plan assets and obligations as of the end of its fiscal year.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*" (SFAS 157), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007 (as of November 1, 2008 for the Company). The Company is currently evaluating the impact of adopting SFAS 157 on its consolidated financial statements.

In September 2006, the FASB ratified the Emerging Issues Task Force (EITF) Issue No. 06-5, "*Accounting for Purchases of Life Insurance — Determining the Amount that Could be Realized in Accordance with FASB Technical Bulletin 85-4"* (EITF 06-5). The EITF concluded that a policyholder should consider any additional amounts included in the contractual terms of the life insurance policy in determining the "amount that could be realized under the insurance contract". For group policies with multiple certificates or multiple policies with a group rider, the EITF also tentatively concluded that the amount that could be realized should be determined at the individual policy or certificate level, (i.e., amounts that would be realized only upon surrendering all of the policies or certificates would not be included when measuring the assets). The provisions of EITF 06-5 are effective for fiscal years beginning after December 15, 2006 (as of November 1, 2007 for the Company). The Company is currently evaluating the impact of adopting EITF 06-5 on its consolidated financial statements.

In September 2006, the FASB issued FASB Staff Position (FSP) No. AUG AIR-1, "*Accounting for Planned Major Maintenance Activities*" (FSP AUG AIR-1) which is effective for fiscal years beginning after December 15, 2006 (as of November 1, 2007 for the Company). FSP AUG AIR-1 prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods. The Company is currently assessing the impact that the adoption of FSP AUG AIR-1 will have on the Company's financial statements.

In September 2006, the SEC released SAB No. 108, "*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements"* (SAB 108), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The Company must apply the guidance of SAB 108 in connection with the preparation of its annual financial statements for the year ending October 31, 2007. The Company does not expect any impact to its consolidated financial statements upon adoption of SAB 108.

In July 2006, the FASB issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*" (FIN 48) which is effective for fiscal years beginning after December 15, 2006 (as of November 1, 2007 for the Company) and is an interpretation of FASB Statement No. 109, "*Accounting for Income Taxes*". FIN 48 prescribes a recognition threshold and measurement attribute for recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition and expanded disclosure requirements. The Company is currently assessing the impact, if any, that the adoption of FIN 48 will have on the Company's financial statements.

In May 2005, the FASB issued SFAS No. 154, "*Accounting Changes and Error Corrections*" (SFAS 154), which replaces Accounting Principles Board Opinion No. 20, "*Accounting Changes*" and FASB Statement No. 3, "*Reporting Accounting Changes in Interim Financial Statements*". SFAS 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005 (as of November 1, 2006 for the Company) and requires retrospective application to prior period financial statements of voluntary changes in accounting principles, unless it is impractical to determine either the period-specific effects or the cumulative effect of the change. The impact of SFAS 154 will depend on the nature and extent of voluntary accounting changes or error corrections, if any, after the effective date. The adoption of SFAS 154 did not have a material impact on the Company's consolidated financial statements.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

### 3. Short-term Investments

In the first quarter of fiscal 2007, the Company began investing in auction rate securities, which are highly liquid, variable-rate debt securities. While the underlying security has a long-term maturity, the interest rate is reset through an auction process, typically held every 7, 28 or 35 days, creating short-term liquidity. The securities trade at par, and interest is paid at the end of each auction period. The Company limits its investments in auction rate securities to securities that carry a AAA (or equivalent) rating from a recognized rating agency and limits the amount of credit exposure to any one issuer. The investments are classified as available-for-sale and are reported as current assets. The Company expects its short-term investments to be sold within one year, regardless of legal maturity date. The auction rate securities are recorded at cost, which approximate fair value due to their variable interest rates that are reset within a period of less than 35 days. Quanex's investment in auction rate securities was $40 million as of January 31, 2007.

### 4. Acquired Intangible Assets

Intangible assets consist of the following (in thousands):

| | As of January 31, 2007 | | As of October 31, 2006 | |
|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets: | | | | |
| Non-compete agreements | $ 250 | $ 250 | $ 250 | $ 237 |
| Patents | 25,877 | 8,486 | 25,877 | 7,618 |
| Trademarks and trade names | 37,930 | 4,128 | 37,930 | 3,705 |
| Customer relationships | 23,691 | 3,843 | 23,691 | 3,453 |
| Other intangibles | 1,201 | 926 | 1,201 | 851 |
| Total | $ 88,949 | $ 17,633 | $ 88,949 | $ 15,864 |
| Unamortized intangible assets: | | | | |
| Trade name | $ 2,200 | | $ 2,200 | |

The aggregate amortization expense for the three month period ended January 31, 2007 was $1.8 million. The aggregate amortization expense for the three month period ended January 31, 2006 was $1.8 million.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

Estimated amortization expense for the next five years, based upon the amortization of pre-existing intangibles follows (in thousands):

| Fiscal Years Ending October 31, | Estimated Amortization[1] |
|---|---|
| 2007 (remaining nine months) | $ 5,266 |
| 2008 | 5,757 |
| 2009 | 3,873 |
| 2010 | 3,792 |
| 2011 | $ 3,792 |

**5. Inventories**

Inventories consist of the following:

| | January 31, 2007 | October 31, 2006 |
|---|---|---|
| | (In thousands) | |
| Raw materials | $ 31,546 | $ 32,050 |
| Finished goods and work in process | 88,157 | 93,258 |
| | 119,703 | 125,308 |
| Supplies and other | 19,733 | 17,480 |
| Total | $ 139,436 | $ 142,788 |

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

| | January 31, 2007 | October 31, 2006 |
|---|---|---|
| | (In thousands) | |
| LIFO | $ 56,959 | $ 59,510 |
| FIFO | 82,477 | 83,278 |
| Total | $ 139,436 | $ 142,788 |

An actual valuation of inventory under the last in, first out (LIFO) method can be made only at the end of each year based on the inventory costs and levels at that time. Accordingly, interim LIFO calculations must be based on management's estimates of expected year-end inventory costs and levels. Because these are subject to many factors beyond management's control, interim results are subject to the final year-end LIFO inventory valuation which could significantly differ from interim estimates. To estimate the effect of LIFO on interim periods, the Company performs a projection of the year-end LIFO reserve and considers expected year-end inventory pricing and expected inventory levels. Depending on this projection, the Company may record an interim allocation of the projected year-end LIFO calculation. With respect to inventories valued using the LIFO method, replacement cost exceeded the LIFO value by approximately $47.4 million as of January 31, 2007 and October 31, 2006.

1 Preexisting intangibles only, which would exclude the acquisition of Atmosphere Annealing, Inc. (AAI) on February 1, 2007. See Note 16 for additional discussion of AAI.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**6. Earnings Per Share**

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

| | For the Three Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | January 31, 2007 | | | January 31, 2006 | | |
| | Income (Numerator) | Shares (Denominator) | Per-Share Amount | Income (Numerator) | Shares (Denominator) | Per-Share Amount |
| Basic earnings per share | $ 20,045 | 36,897 | $ 0.54 | $ 33,450 | 37,866 | $ 0.88 |
| Effect of dilutive securities | | | | | | |
| Common stock equivalents arising from settlement of contingent convertible debentures | 500 | 1,418 | | 492 | 1,544 | |
| Common stock equivalents arising from stock options | — | 325 | | — | 474 | |
| Restricted stock | — | 39 | | — | 51 | |
| Common stock held by rabbi trust | — | 130 | | — | 130 | |
| Diluted earnings per share | $ 20,545 | 38,809 | $ 0.53 | $ 33,942 | 40,065 | $ 0.85 |

The computation of diluted earnings per share excludes outstanding options in periods where inclusion of such options would be anti-dilutive in the periods presented. For the three months ended January 31, 2007 and 2006, 0.5 million and 0.3 million stock options, respectively, were excluded from the computation of diluted earnings per share as the options' exercise price was greater than the average market price of the common stock during the period.

On January 26, 2005, the Company announced that it had irrevocably elected to settle the principal amount of its 2.50% Convertible Senior Debentures due 2034 (the Debentures) in cash when they become convertible and are surrendered by the holders thereof. The Company retains its option to satisfy any excess conversion obligation (stock price in excess of conversion price) with either shares, cash or a combination of shares and cash. As a result of the Company's election, diluted earnings per share include only the amount of shares it would take to satisfy the excess conversion obligation, assuming that all of the Debentures were surrendered. For calculation purposes, the average closing price of the Company's common stock for each of the periods presented is used as the basis for determining dilution.

**7. Comprehensive Income**

Comprehensive income comprises net income and all other non-owner changes in equity, including realized and unrealized gains and losses on derivatives, minimum pension liability adjustments and foreign currency translation adjustments. Comprehensive income for the three months ended January 31, 2007 and 2006 was as follows:

| | Three Months Ended January 31, | |
|---|---|---|
| | 2007 | 2006 |
| | (In thousands) | |
| Comprehensive income: | | |
| Net income | $ 20,045 | $ 33,025 |
| Foreign currency translation adjustment | (60) | 41 |
| Total comprehensive income, net of taxes | $ 19,985 | $ 33,066 |

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**8. Long-term Debt**

Long-term debt consists of the following:

| | January 31, 2007 | October 31, 2006 |
|---|---|---|
| | (In thousands) | |
| Credit Facility Revolver | $ — | $ — |
| 2.50% Convertible Senior Debentures due 2034 | 125,000 | 125,000 |
| 6.50% City of Richmond, Kentucky Industrial Building Revenue Bonds | 5,000 | 5,000 |
| City of Huntington, Indiana Economic Development Revenue Bonds principle due 2010 | 1,665 | 1,665 |
| Scott County, Iowa Industrial Waste Recycling Revenue Bonds | 1,600 | 1,600 |
| Capital lease obligations and other | 115 | 136 |
| Total debt | $ 133,380 | $ 133,401 |
| Less maturities due within one year included in current liabilities | 2,700 | 2,721 |
| Long-term debt | $ 130,680 | $ 130,680 |

Approximately 95% of the total debt had a fixed interest rate at January 31, 2007 and October 31, 2006. See Interest Rate Risk section in Item 3, “Quantitative and Qualitative Disclosures about Market Risk” of this Form 10-Q for additional discussion.

*Credit Facility*

The Company’s $350.0 million Senior Unsecured Revolving Credit Facility (the Credit Facility) was executed on September 29, 2006 and replaced the Company’s $310.0 million Revolving Credit Agreement. The Credit Facility has a five-year term and is unsecured.

The Credit Facility expires September 29, 2011 and provides for up to $50.0 million for standby letters of credit, limited to the undrawn amount available under the Credit Facility. Borrowings under the Credit Facility bear interest at LIBOR based on a combined leverage and ratings grid. The Credit Facility may be increased by an additional $100.0 million in the aggregate prior to maturity, subject to the receipt of additional commitments and the absence of any continuing defaults. Proceeds from the Credit Facility may be used to provide availability for working capital, capital expenditures, permitted acquisitions and general corporate purposes.

The Credit Facility includes two primary financial covenants including a maximum leverage test and minimum interest coverage test. Additionally, there are certain limitations on additional indebtedness, asset or equity sales, and acquisitions. Distributions are permitted so long as after giving effect to such dividend or stock repurchase, there is no event of default. As of January 31, 2007, the Company was in compliance with all current Credit Facility covenants. The Company had no borrowings under the Credit Facility as of January 31, 2007. The aggregate availability under the Credit Facility was $332.6 million at January 31, 2007, which is net of $17.4 million of outstanding letters of credit.

*Convertible Senior Debentures*

On May 5, 2004, the Company issued $125.0 million of the Convertible Senior Debentures (the Debentures) in a private placement offering. The Debentures were subsequently registered in October 2004 pursuant to the registration rights agreement entered into in connection with the offering. In November 2006, the Company filed a post-effective amendment to deregister all unsold securities under

the registration statement as the Company's obligation to maintain the effectiveness of such registration statement has expired; the SEC declared this post-effective amendment effective on November 22, 2006. The Debentures are general unsecured senior obligations, ranking equally in right of payment with all existing and future unsecured senior indebtedness, and senior in right of payment to any existing and future subordinated indebtedness. The Debentures are effectively subordinated to all senior secured indebtedness and all indebtedness and liabilities of subsidiaries, including trade creditors.

The Debentures are convertible into shares of Quanex common stock, upon the occurrence of certain events, at an adjusted conversion rate of 39.2978 shares of common stock per $1,000 principal amount of notes. This conversion rate is equivalent to an adjusted conversion price of $25.45 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. In January 2005, the Company announced that it had irrevocably elected to settle the principal amount of the Debentures in cash when they become convertible and are surrendered by the holders thereof. The Company retains its option to satisfy any excess conversion obligation (stock price in excess of conversion price) with either shares, cash or a combination of shares and cash. Based on the provisions of EITF Issue No. 01-6 "*The Meaning of Indexed to a Company's Own Stock*" and EITF Issue No. 00-19, "*Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock"*, the conversion feature of the Debenture is not subject to the provisions of SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" (SFAS 133) and accordingly has not been bifurcated and accounted for separately as a derivative under SFAS 133.

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. Although the Debentures were not convertible during the first quarter of fiscal 2007, the Debentures are convertible as of February 1, 2007 as the closing price of the Company's common stock exceeded the contingent conversion price as described in (i) above.

**9. Pension Plans and Other Postretirement Benefits**

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

| | Three Months Ended January 31, | |
|---|---|---|
| | 2007 | 2006 |
| | (In thousands) | |
| **Pension Benefits:** | | |
| Service cost | $ 1,537 | $ 1,170 |
| Interest cost | 1,070 | 960 |
| Expected return on plan assets | (1,166) | (967) |
| Amortization of unrecognized transition asset | — | (13) |
| Amortization of unrecognized prior service cost | 53 | 53 |
| Amortization of unrecognized net loss | 252 | 249 |
| Net periodic pension cost | $ 1,746 | $ 1,452 |

| | Three Months Ended January 31, | |
|---|---|---|
| | 2007 | 2006 |
| | (In thousands) | |
| **Postretirement Benefits:** | | |
| Service cost | $ 20 | $ 26 |
| Interest cost | 105 | 135 |
| Net amortization and deferral | (15) | (18) |
| Net periodic postretirement benefit cost | $ 110 | $ 143 |

During the three months ended January 31, 2007, the Company contributed $154 thousand to its defined benefit plans. No additional contributions are required for the remainder of the fiscal year.

The Company froze participation in its traditional defined benefit pension plans to new participants for salaried and non-union hourly employees effective December 31, 2006. In addition, effective January 1, 2007, the Company converted all non-union employees that received an additional benefit above the base matching contribution within a defined contribution plan to a defined benefit cash balance plan named the Quanex Advantage Plan. Employees covered by the Quanex Advantage Plan are entitled to receive a credit against their annual eligible wages. All new employees and many of the employees converted from other plans are eligible to receive credits equivalent to 4% of their annual eligible wages, while some of the employees involved in the conversion were “grandfathered” and are eligible to receive credits ranging up to 6.5% based upon the amount they received prior to the conversion. Additionally, every year the participants will receive an interest related credit on their respective balance equivalent to the prevailing 30-year Treasury rate.

**10. Industry Segment Information**

Quanex has three reportable segments covering two customer-focused markets; the vehicular products and building products markets. The Company’s reportable segments are Vehicular Products, Engineered Building Products, and Aluminum Sheet Building Products. The Vehicular Products segment produces engineered steel bars for the light vehicle, heavy duty truck, agricultural, defense, capital goods, recreational and energy markets. The Vehicular Products segment’s primary market drivers are North American light

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

vehicle builds and, to a lesser extent, heavy duty truck builds. The Engineered Building Products segment produces engineered products and components serving the window and door industry, while the Aluminum Sheet Building Products segment produces mill finished and coated aluminum sheet serving the broader building products markets. The main market drivers of the building products focused segments are residential housing starts and residential remodeling expenditures.

LIFO inventory adjustments along with corporate office charges and intersegment eliminations are reported as Corporate, Intersegment Eliminations and Other. The Company accounts for intersegment sales and transfers as though the sales or transfers were to third parties, that is, at current market prices. Corporate assets primarily include cash and equivalents and cash surrender value of life insurance policies partially offset by the Company's consolidated LIFO inventory reserve.

| | Three Months Ended January 31,[1] | |
|---|---|---|
| | 2007 | 2006 |
| | (In thousands) | |
| **Net Sales:** | | |
| Vehicular Products | $ 217,250 | $ 218,773 |
| Engineered Building Products | 98,870 | 126,286 |
| Aluminum Sheet Building Products | 105,236 | 103,980 |
| Intersegment Eliminations & Other | (3,715) | (4,470) |
| Consolidated | $ 417,641 | $ 444,569 |
| **Operating Income (Loss):** | | |
| Vehicular Products | $ 24,872 | $ 33,249 |
| Engineered Building Products | 3,850 | 10,618 |
| Aluminum Sheet Building Products | 10,587 | 16,089 |
| Corporate, Intersegment Eliminations & Other | (8,928) | (5,732) |
| Consolidated | $ 30,381 | $ 54,224 |

| | January 31, 2007 | October 31, 2006 |
|---|---|---|
| | (In thousands) | |
| **Identifiable Assets:** | | |
| Vehicular Products | $ 449,058 | $ 473,133 |
| Engineered Building Products | 452,496 | 464,605 |
| Aluminum Sheet Building Products | 166,132 | 169,253 |
| Corporate, Intersegment Eliminations & Other | 149,129 | 95,161 |
| Consolidated | $ 1,216,815 | $ 1,202,152 |
| **Goodwill:** | | |
| Vehicular Products | $ — | $ — |
| Engineered Building Products | 175,953 | 175,961 |
| Aluminum Sheet Building Products | 20,389 | 20,389 |
| Consolidated | $ 196,342 | $ 196,350 |

1 All periods exclude Temroc, which is reported in discontinued operations.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**11. Stock Repurchase Program and Treasury Stock**

On August 26, 2004, the Company's Board of Directors approved an increase in the number of authorized shares in the Company's existing stock buyback program, up to 2.25 million shares; and on August 24, 2006 the Board of Directors approved an additional increase of 2.0 million shares to the existing program. The Company records treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. The Company uses a moving average method on the subsequent reissuance of shares, and any resulting proceeds in excess of cost are credited to additional paid in capital while any deficiency is charged to retained earnings. As of October 31, 2006, the number of shares in treasury was 1,200,617. The number of shares in treasury was reduced to 1,129,293 by January 31, 2007 due to stock option exercises and restricted stock issuances. As of January 31, 2007 and October 31, 2006, the remaining shares authorized for repurchase in the program was 2,676,050.

**12. Stock-Based Compensation**

In the first quarter of fiscal 2006, the Company adopted SFAS No. 123 (revised 2004), *"Share-Based Payment"* (SFAS 123R) which required the Company to measure all employee stock-based compensation awards using a fair value method and record such expense in the consolidated financial statements beginning as of November 1, 2005. The Company has stock option, restricted stock, and restricted stock unit (RSU) plans which provide for the granting of stock options, common shares or RSUs to key employees and non-employee directors. The Company's practice is to grant options and restricted stock or RSUs to directors on October 31st of each year, with an additional grant of options to each director on the date of his or her first anniversary of service. Additionally, the Company's practice is to grant options and restricted stock to employees at the Company's December board meeting and occasionally to key employees on their respective dates of hire. The exercise price of the option awards is equal to the closing market price on these pre-determined dates. The Company generally issues shares from treasury, if available, to satisfy stock option exercises. If there are no shares in treasury, the Company issues additional shares of common stock. Stock-based compensation for the three months ended January 31, 2007 was $2.6 million.

As described in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2006, the Company uses the Black-Scholes-Merton option-pricing model to estimate the fair value of its stock options. Stock-based compensation related to stock options for the three months ended January 31, 2007 was $2.1 million. The following is a summary of valuation assumptions for grants during the following periods:

| | Three Months Ended January 31, | |
|---|---|---|
| | **2007** | **2006** |
| Weighted-average expected volatility | 36.5% | 35.0% |
| Expected term (in years) | 4.9-5.1 | 4.8-5.2 |
| Risk-free interest rate | 4.39% | 4.40% |
| Expected dividend yield over expected term | 1.75% | 2.00% |
| Weighted-average grant-date fair value per share | $ 12.44 | $ 12.86 |
| Weighted-average annual forfeiture rate | 4.98% | 6.44% |

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

The Company has various stock option plans for key employees and directors as described in its Annual Report on Form 10-K for the fiscal year ended October 31, 2006. Below is a table summarizing the stock option activity in all plans since October 31, 2006:

| | Shares | Weighted-Average Exercise Price Per Share | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (000's) |
|---|---|---|---|---|
| Outstanding at October 31, 2006 | 1,325,961 | $ 24.48 | | |
| Granted | 265,750 | 37.47 | | |
| Exercised | (30,974) | 20.91 | | |
| Forfeited | (263) | 26.31 | | |
| Expired | — | — | | |
| Outstanding at January 31, 2007 | 1,560,474 | $ 26.76 | 7.2 | $ 19,797 |
| Exercisable at January 31, 2007 | 966,813 | $ 21.37 | 6.3 | $ 17,363 |

The total intrinsic value of options (the amount by which the market price of the stock on the date of exercise exceeded the exercise price of the option) exercised during the three months ended January 31, 2007 and 2006 was $0.5 million and $3.9 million, respectively.

A summary of the nonvested stock option shares under all plans during the three months ended January 31, 2007 is presented below:

| | Shares | Weighted-Average Grant-Date Fair Value Per Share |
|---|---|---|
| Nonvested at October 31, 2006 | 663,799 | $ 9.67 |
| Granted | 265,750 | 12.44 |
| Vested | (335,625) | 8.64 |
| Forfeited | (263) | 8.33 |
| Nonvested at January 31, 2007 | 593,661 | $ 11.49 |

**13. Income Taxes**

The provision for income taxes is determined by applying an estimated annual effective income tax rate to income before income taxes. The rate is based on the most recent annualized forecast of pretax income, permanent book versus tax differences, and tax credits. It also includes the effect of any valuation allowance expected to be necessary during the year. The Company's estimated annual effective tax rate is 36.0% for the first quarter of fiscal 2007. Although the first quarter 2007 rate is less than the 37% reported for first quarter 2006, the 2007 estimated rate is consistent with the full fiscal year 2006 effective rate of 36.1%.

In November 2006, the Internal Revenue Service completed an audit of the tax year ending 2004; no material adjustments were proposed. The Company has a case in Tax Court regarding the disallowance of a capital loss realized in 1997 and 1998. During fiscal 2004, the Company made a tax payment of $10.0 million related to the case to stop the running of the interest outstanding. Adequate provision has been made for this contingency and the Company believes the outcome of the case will not have a material adverse impact on its financial position or results of operations. See Note 14 for further explanation.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**14. Contingencies**

*Environmental*

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

Total environmental reserves and corresponding recoveries for Quanex's current plants, former operating locations, and disposal facilities were as follows:

| | January 31, 2007 | October 31, 2006 |
|---|---|---|
| | (in thousands) | |
| Current[1] | $ 2,353 | $ 2,591 |
| Non-current | 13,965 | 14,186 |
| Total environmental reserves | 16,318 | 16,777 |
| Receivable for recovery of remediation costs[2] | $ 7,200 | $ 7,192 |

Approximately $3.5 million of the January 31, 2007 reserve represents administrative costs; the balance represents estimated costs for investigation, studies, cleanup, and treatment. As discussed below, the reserve includes net present values for certain fixed and reliably determinable components of the Company's remediation liabilities. Without such discounting, the Company's estimate of its environmental liabilities as of January 31, 2007 and of October 31, 2006 would be $18.1 million and $18.6 million, respectively. An associated $7.2 million undiscounted recovery from indemnitors of remediation costs at one plant site is recorded as of January 31, 2007. The change in the environmental reserve during the first quarter of fiscal 2007 primarily consisted of cash payments for existing environmental matters.

1 Reported in Accrued liabilities on the Consolidated Balance Sheets

2 Reported in Other current assets and Other assets on the Consolidated Balance Sheets

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

The Company's Nichols Aluminum-Alabama, Inc. (NAA) subsidiary operates a plant in Decatur, Alabama that is subject to an Alabama Hazardous Wastes Management and Minimization Act Post-Closure Permit. Among other things, the permit requires NAA to remediate, as directed by the state, historical environmental releases of wastes and waste constituents. Consistent with the permit, NAA has undertaken various studies of site conditions and, during the first quarter 2006, started a phased program to treat in place free product petroleum that had been released to soil and groundwater. Based on its studies to date, which remain ongoing, NAA currently expects remediation costs at the Decatur plant to be $6.5 million or approximately 40% of the Company's total environmental reserve. NAA was acquired through a stock purchase in which the sellers agreed to indemnify Quanex and NAA for environmental matters related to the business and based on conditions initially created or events initially occurring prior to the acquisition. Environmental conditions are presumed to relate to the period prior to the acquisition unless proved to relate to releases occurring entirely after closing. The limit on indemnification is $21.5 million excluding legal fees. In accordance with the indemnification, the indemnitors paid the first $1.5 million of response costs and have been paying 90% of ongoing costs. Based on its experience to date, its estimated cleanup costs going forward, and costs incurred to date as of January 31, 2007, the Company expects to recover from the shareholders $7.2 million. Of that, $5.8 million is recorded in Other assets, and the balance is reflected in Other current assets.

The Company's reserve for its MACSTEEL plant in Jackson, Michigan is $5.7 million or 35% of the Company's total environmental reserve. During fiscal 2006, the Company completed studies supporting selection of an interim remedy to address the impact of a historical plant landfill and slag cooling and sorting operation on groundwater. Based on those studies, the Company is proceeding with preparation of design plans for submittal to the Michigan Department of Environmental Quality of a hydraulic barrier (sheet pile) and groundwater extraction and treatment system to prevent impacted groundwater migration. The primary component of the reserve is for the estimated cost of operating the groundwater extraction and treatment system for the interim remedy over the next 10 years. The Company has estimated the annual cost of operating the system to be approximately $0.5 million. These operating costs and certain other components of the Jackson reserve have been discounted utilizing a discount rate of 4.6% and an estimated inflation rate of 2.0%. Without discounting, the Company's estimate of its Jackson remediation liability as of January 31, 2007 would be $6.4 million. In addition to the $5.7 million reserve, the Company anticipates incurring a capital cost of $4.4 million to construct the sheet pile wall and install the groundwater extraction and treatment system. Depending on the effectiveness of the interim remedy, the results of future operations, and regulatory concurrences, the Company may incur additional costs to implement a final site remedy and may pay costs beyond the ten-year time period currently projected for operation of the interim remedy.

Approximately 17% or $2.8 million of the Company's total environmental reserve is currently allocated to cleanup work related to Piper Impact. During the first quarter of 2005, the Company sold the operating assets of the Piper Impact business, including its only active plant on Barkley Drive in New Albany, Mississippi. In the fourth fiscal quarter of 2005, the Company sold the location on Highway 15 in New Albany where Piper Impact previously had operated a plant (the Highway 15 location), but as part of the sale retained environmental liability for pre-closing contamination there. The Company voluntarily implemented a state-approved remedial action plan at the Highway 15 location that includes natural attenuation together with a groundwater collection and treatment system. The Company has estimated the annual cost of operating the existing system to be approximately $0.1 million and has assumed that the existing system will continue to be effective. The primary component of the reserve is the estimated operational cost over the next 28 years, which was discounted to a net present value using a discount rate of 4.7% and an estimated inflation rate of 2.0%. The aggregate undiscounted amount of the Piper Impact remediation costs as of January 31, 2007 is $3.9 million. The Company continues to monitor conditions at the Highway 15 location and to evaluate performance of the remedy.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

The final remediation costs and the timing of the expenditures at the NAA plant, Jackson plant, Highway 15 location and other sites for which the Company has remediation obligations will depend upon such factors as the nature and extent of contamination, the cleanup technologies employed, the effectiveness of the cleanup measures that are employed, and regulatory concurrences. While actual remediation costs therefore may be more or less than amounts accrued, the Company believes it has established adequate reserves for all probable and reasonably estimable remediation liabilities. It is not possible at this point to reasonably estimate the amount of any obligation for remediation in excess of current accruals because of uncertainties as to the extent of environmental impact, cleanup technologies, and concurrence of governmental authorities. The Company currently expects to pay the accrued remediation reserve through at least fiscal 2034, although some of the same factors discussed earlier could accelerate or extend the timing.

*Tax Liability*

As reported in its Annual Report on Form 10-K for the year ended October 31, 2006, the Company is currently involved in a case in Tax Court regarding the disallowance of a capital loss realized in 1997 and 1998. During 2004, the Company made a tax payment of $10.0 million related to the case. The payment was made to stop the running of interest outstanding. The Company has reserves for income tax contingencies primarily associated with this case as of January 31, 2007 and October 31, 2006 of $13.5 million. Adequate provision has been made for this contingency and the Company believes the outcome of the case will not have a material impact on its financial position or results of operations.

*Other*

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

**15. Discontinued Operations**

In accordance with SFAS No. 144, "*Accounting for the Impairment of Disposal of Long-Lived Assets*," the results of operations, financial position and cash flows of Temroc have been reflected in the consolidated financial statements and notes as discontinued operations for all periods presented. Temroc was sold on January 27, 2006.

There were no assets or liabilities of discontinued operations as of January 31, 2007 or October 31, 2006.

**QUANEX CORPORATION**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS** (continued)

Operating results of the discontinued operations were as follows:

| | Three Months Ended January 31, | |
|---|---|---|
| | **2007** | **2006** |
| Net sales | $ — | $ 5,230 |
| Income (loss) from discontinued operations | — | (184) |
| Gain (loss) on sale of discontinued operations | — | (311) |
| Income tax benefit (expense) | — | 70 |
| Income (loss) from discontinued operations, net of taxes | $ — | $ (425) |

First quarter 2006 net sales and loss from discontinued operations relate to Temroc. First quarter 2007 has no comparable activity as Temroc was sold and related purchase price adjustments were settled in fiscal 2006.

**16. Subsequent Events**

On February 1, 2007, Quanex purchased the assets of Atmosphere Annealing, Inc. (AAI), a wholly owned subsidiary of Maxco, Inc. for approximately $57.5 million, excluding transactions costs and a final working capital-based purchase price adjustment. The acquisition was funded by cash on hand. AAI is a metal heat treating business with four plants in the Midwest and fiscal 2006 sales of approximately $46 million.

At the Company's annual meeting on February 27, 2007, the Company's stockholders approved an increase of the Company's authorized common stock from 50,000,000 shares to 100,000,000 shares. The Company has no current plans, proposals or understandings that would require the use of these additional shares; rather, the increase provides the Company with additional flexibility in issuing stock dividends and in effecting acquisitions and financings to enable the Company to raise capital and accomplish other corporate objectives in response to market conditions or growth opportunities as and when they become available.

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

**General**

The discussion and analysis of Quanex Corporation and its subsidiaries' financial condition and results of operations should be read in conjunction with the January 31, 2007 and October 31, 2006 Consolidated Financial Statements of the Company and the accompanying notes. References made to the "Company" or "Quanex" include Quanex Corporation and its subsidiaries unless the context indicates otherwise.

**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 Financial Condition and Results of Operations" are "forward-looking" statements as defined under the Private Securities Litigation Reform Act of 1995. Generally, the words "expect," "believe," "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 projections or expectations. As and when made, management believes that these forward-looking statements are reasonable. However, caution should be taken not to place undue reliance on any such forward-looking statements since such statements speak only as of the date when made and there can be no assurance that such forward-looking statements will occur. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Factors exist that could cause the Company's actual results to differ materially from the expected results described in or underlying the Company's forward-looking statements. Such factors include domestic and international economic activity, prevailing prices of steel and aluminum scrap and other raw material costs, the rate of change in prices for steel and aluminum scrap, energy costs, interest rates, construction delays, market conditions, particularly in the vehicular, home building and remodeling markets, any material changes in purchases by the Company's principal customers, labor supply and relations, environmental regulations, changes in estimates of costs for known environmental remediation projects and situations, world-wide political stability and economic growth, the Company's successful implementation of its internal operating plans, acquisition strategies and integration, 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. For more information, please see Part I, Item 1A, "Risk Factors" in the Quanex Corporation Form 10-K filed with the U.S. Securities and Exchange Commission for the year ended October 31, 2006.

**Consolidated Results of Operations**

*Summary Information*

| | Three Months Ended January 31,[1] | | | |
|---|---|---|---|---|
| | 2007 | 2006 | Change | % |
| | (Dollars in millions) | | | |
| Net sales | $ 417.6 | $ 444.6 | $ (27.0) | (6.1)% |
| Cost of sales[2] | 342.5 | 352.1 | (9.6) | (2.7) |
| Selling, general and administrative | 25.7 | 20.9 | 4.8 | 23.0 |
| Depreciation and amortization | 19.0 | 17.4 | 1.6 | 9.2 |
| Operating income | 30.4 | 54.2 | (23.8) | (43.9) |
| Operating income margin | 7.3% | 12.2% | (4.9)% | |
| Interest expense | (1.0) | (1.2) | 0.2 | (16.7) |
| Other, net | 1.9 | 0.1 | 1.8 | 1800.0 |
| Income tax expense | (11.3) | (19.6) | 8.3 | (42.3) |
| Income from continuing operations | $ 20.0 | $ 33.5 | $ (13.5) | (40.3)% |

*Overview*

The Company's underlying market drivers experienced year over year decreases and were the primary influence in the 6.1% reduction in net sales. While all of the businesses realized net sales decreases in the first fiscal quarter of 2007 compared to the first fiscal quarter of 2006, the decreases were not to the level of our served markets due to continued efforts to introduce new products and to expand the customer base for existing products. In addition, raw material prices were generally flat or up, thereby compressing margins in the three months ended January 31, 2007 when compared to the same period of last year. Selling, general and administrative expenses increased from a combination of mark-to-market expenses tied to the Company's common stock and increased stock option expense. Notwithstanding the foregoing, the Company managed to outperform its primary markets by focusing on the controllable factors.

*Business Segments*

Business segments are reported in accordance with Statement of Financial Accounting Standards (SFAS) No. 131, "*Disclosures about Segments of an Enterprise and Related Information*" (SFAS 131). SFAS 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.

Quanex has three reportable segments covering two customer-focused markets: the vehicular products and building products markets. The Company's reportable segments are Vehicular Products, Engineered Building Products, and Aluminum Sheet Building Products. The Vehicular Products segment produces engineered steel bars for the light vehicle, heavy duty truck, agricultural, defense, capital goods, recreational and energy markets. The Vehicular Products segment's primary market drivers are North American light vehicle builds and, to a much lesser extent, heavy duty truck builds. The Engineered Building Products segment produces engineered products and components serving the window and door industry, while the Aluminum Sheet Building Products segment produces mill finished and coated aluminum sheet serving the broader building products markets and secondary markets such as recreational vehicles and capital equipment. The primary market drivers of the building and construction focused segments are residential housing starts and remodeling expenditures.

1 All periods exclude Temroc, which is reported in discontinued operations.

2 Exclusive of items shown separately below

For financial reporting purposes three of the Company's five operating divisions, Homeshield, Truseal and Mikron, have been aggregated into the Engineered Building Products reportable segment. The remaining two divisions, MACSTEEL and Nichols Aluminum, are reported as separate reportable segments with the Corporate & Other comprised of corporate office expenses and certain inter-division eliminations. The sale of products between segments is recognized at market prices. Operating income is a primary determinant in assessing performance. The segments follow the accounting principles described in the Summary of Significant Accounting Principles. Note that the three reportable segments value inventory on a FIFO basis and the LIFO reserve relating to those operations accounted for under the LIFO method of inventory valuation is computed on a consolidated basis in a single pool and treated as a corporate expense. Prior periods have been adjusted to reflect the current presentation.

**Three Months Ended January 31, 2007 Compared to Three Months Ended January 31, 2006**

*Vehicular Products*

The following table sets forth selected operating data for the Vehicular Products segment:

| | Three Months Ended January 31, (Dollars in millions) | | | |
|---|---|---|---|---|
| | 2007 | 2006 | Change | % |
| Net sales | $ 217.3 | $ 218.8 | $ (1.5) | (0.7)% |
| Cost of sales[1] | 178.5 | 173.2 | 5.3 | 3.1 |
| Selling, general and administrative | 4.7 | 4.1 | 0.6 | 14.6 |
| Depreciation and amortization | 9.2 | 8.2 | 1.0 | 12.2 |
| Operating income | $ 24.9 | $ 33.3 | $ (8.4) | (25.2)% |
| Operating income margin | 11.5% | 15.2% | (3.7)% | |

The Vehicular Products segment's primary market drivers are North American light vehicle production (approximately 65% of sales) and Class 8 heavy duty truck production (approximately 10% of sales). Light vehicle builds decreased 6.7% from the first fiscal quarter of 2006 to the first fiscal quarter of 2007, which was a larger decline than the Company's 0.7% reduction in net sales that serve this market. The segment's addition of new programs and the addition of select short-term secondary business combined to minimize the impact of the market decline. Sales prices negotiated on an annual calendar basis resulted in flat pricing, resulting from a combination of base price and surcharge formula adjustments.

Net sales for the first quarter of 2007 were slightly lower than the first quarter of 2006 as a result of a 0.4% decrease in volume and a 0.3% decrease in average selling prices. Operating income for the first quarter decreased 25.2% versus the same period last year due primarily to changes in product mix that included less value added output and, to a lesser extent, rising steel scrap costs. Depreciation expense increased due to the recently completed capital projects at MACSTEEL Fort Smith and MACSTEEL Monroe. The decrease in operating income margin for the first quarter versus last year was a result of the product mix, higher steel scrap costs and lower operating rates.

1 Exclusive of items shown separately below

*Engineered Building Products & Aluminum Sheet Building Products*

The following table sets forth selected operating data for the two reportable segments within Building Products, Engineered Building Products (Engineered BP) and Aluminum Sheet Building Products (Aluminum Sheet BP):

| | Three Months Ended January 31, (Dollars in millions) | | | |
|---|---|---|---|---|
| | 2007 | 2006 | Change | % |
| Engineered BP net sales | $ 98.8 | $ 126.3 | $ (27.5) | (21.8)% |
| Aluminum Sheet BP net sales | 105.2 | 104.0 | 1.2 | 1.2 |
| Net sales | 204.0 | 230.3 | (26.3) | (11.4) |
| Cost of sales[1] | 167.8 | 183.3 | (15.5) | (8.5) |
| Selling, general and administrative | 12.1 | 11.2 | 0.9 | 8.0 |
| Depreciation and amortization | 9.7 | 9.1 | 0.6 | 6.6 |
| Engineered BP operating income | 3.8 | 10.6 | (6.8) | (64.2) |
| Aluminum Sheet BP operating income | 10.6 | 16.1 | (5.5) | (34.2) |
| Operating income | $ 14.4 | $ 26.7 | $ (12.3) | (46.1)% |
| Engineered BP operating income margin | 3.8% | 8.4% | (4.6)% | |
| Aluminum Sheet BP operating income margin | 10.1% | 15.5% | (5.4)% | |
| Operating income margin | 7.1% | 11.6% | (4.5)% | |

The primary market drivers of both the Engineered Building Products segment and Aluminum Sheet Building Products segment are North American new housing starts and residential remodeling activity. The primary drivers were both down for the first fiscal quarter of 2007 compared to the same period of 2006, with housing starts estimated to be down approximately 28%. Several of the Engineered Building Products segment's customers experienced demand decreases comparable to the decrease in housing starts, thereby impacting the segment's sales. The Aluminum Sheet Building Products segment was impacted by the lower housing starts, but benefited from higher selling prices and increased spreads.

The decrease in net sales at the Engineered Building Products segment for the three months ended January 31, 2007 is comprised of significantly reduced volumes coupled with flat average selling prices of select products and reduced average selling prices of PVC products that dropped as a result of decreases in the resin price index. The Engineered Building Products segment sells products to customers considered to be industry leaders. This coupled with recent product introductions are expected to result in this segment outperforming the underlying market drivers this year. The increase in net sales at Aluminum Sheet Building Products for the first quarter of fiscal 2007 was the result of a 14.0% volume decrease, offset by a 17.6% increase in average selling price.

Operating income and the corresponding margin declined at the Company's Engineered Building Products segment for the three months ended January 31, 2007 as a direct result of the reduced volume and lower average selling prices. Labor costs during the quarter were brought in line as the operations were staffed to more closely match demand.

1 Exclusive of items shown separately below

Several factors influenced the reduced operating income and margin recognized by the Aluminum Sheet Building Products segment versus the first quarter last year. The strong spread partially offset the impact of the low volume and the low absorption caused by reduced operating rates. Exacerbating the comparison versus last year were non-recurring favorable items in the first quarter of 2006, the largest of which was a $2.0 million gain recognized from the sale of Owens Corning receivables claim.

*Corporate and Other*

| | Three Months Ended January 31, (Dollars in millions) | | | |
|---|---|---|---|---|
| | 2007 | 2006 | Change | % |
| Net sales | $ (3.7) | $ (4.5) | $ 0.8 | (17.8)% |
| Cost of sales | (3.8) | (4.4) | 0.6 | (13.6) |
| Selling, general and administrative | 8.9 | 5.6 | 3.3 | 58.9 |
| Depreciation and amortization | 0.1 | 0.1 | — | — |
| Operating income | $ (8.9) | $ (5.8) | $ (3.1) | 53.4% |

Corporate and other operating expenses, not included in the operating segments mentioned above, include the consolidated LIFO inventory adjustments (calculated on a combined pool basis), corporate office expenses and inter-segment eliminations. The $3.3 million increase in selling, general and administrative is primarily related to an increase in stock option expense and the mark-to-market expense of the Company's Deferred Compensation Plan recognized as a result of the increase in the Company's common stock price during the quarter. Stock option expense over the remaining quarters of fiscal 2007 is expected to be comparatively lower due to the fact that the Company recognized the expense associated with those employees eligible to retire at the time of grant immediately in the first quarter of fiscal 2007.

*Other Items*

Interest expense for the three months ended January 31, 2007 decreased $0.2 million from the same period a year ago as a result of the reduced fees associated with the Revolving Credit Agreement the Company entered into during the fourth quarter of fiscal 2006. During the first quarter of fiscal 2007, the Company had no amounts outstanding under the Revolving Credit Agreement.

Other, net for the three months ended January 31, 2007 was income of $1.9 million compared to $0.1 million in the first quarter of 2006. One of the main components of this category is interest income earned on the Company's cash and equivalents and other short-term investments. As a result of an increase in these balances, the amount of interest income also has increased. Other, net also includes changes associated with the cash surrender value of company owned life insurance.

The Company's effective tax rate declined to 36.0% for the three months ended January 31, 2007 compared to 37.0% during the three months ended January 31, 2006. The lower effective rate in the first quarter of 2007 was for the most part attributable to lower effective state rates.

The year-over-year changes in income (loss) from discontinued operations, net of taxes, for the three months ended January 31, 2007, is entirely related to the sale of the Company's Temroc business during the first quarter of fiscal 2006.

*Outlook*

Current demand in the Company's two end markets is weak, but the outlook calls for a sequential improvement in demand throughout the year.

At Vehicular Products, business activity is expected to increase as light vehicle build rates improve. MACSTEEL's bar shipments in fiscal 2007 are expected to match 2006 levels, in part on the strength of new programs with both the Big Three and transplant automotive customers, as well as from ongoing opportunities in secondary markets like energy and service centers. Light vehicle builds in calendar 2007 are expected to be about even with 2006 builds of 15.2 million.

For Building Products, housing starts in calendar 2007 are expected to lag 2006 starts by some 15%. Customer demand at Engineered Products, while seasonally weak at this time, is expected to improve over the course of the year based on a gradual improvement in housing starts. New programs with both existing and new customers will also enhance sales. At Nichols Aluminum, first half fiscal 2007 aluminum sheet shipments are expected to lag first half 2006 shipments, then exceed them in the second half of the fiscal year based on an improving housing market.

For the fiscal second quarter, Quanex expects to report diluted earnings per share from continuing operations within a range of $0.70 to $0.78. Guidance for the year remains unchanged at $3.10 to $3.60 pending greater clarity in both the timing and magnitude of improvements in the Company's primary markets.

**Liquidity and Capital Resources**

*Sources of Funds*

The Company's principal sources of funds are cash on hand, cash flow from operations, and borrowings under its $350.0 million Senior Unsecured Revolving Credit Facility (the Credit Facility). The Credit Facility was executed on September 29, 2006 and has a five-year term. Proceeds from the Credit Facility may be used to provide availability for working capital, capital expenditures, permitted acquisitions and general corporate purposes. The Credit Facility may be increased by an additional $100.0 million in the aggregate prior to maturity, subject to the receipt of additional commitments and the absence of any continuing defaults.

At January 31, 2007 and October 31, 2006, the Company had no borrowings under the Credit Facility and had $125.0 million outstanding 2.50% Senior Convertible Debentures due May 15, 2034 (the Debentures). The aggregate availability under the Credit Facility was $332.6 million at January 31, 2007, which is net of $17.4 million of outstanding letters of credit.

In addition to the $117.5 million of cash and cash equivalents as of January 31, 2007, Quanex was holding $40.0 million in auction rate securities at the end of the quarter. In the first quarter of fiscal 2007, the Company began investing in auction rate securities, which are highly liquid, variable-rate debt securities. While the underlying security has a long-term maturity, the interest rate is reset through an auction process, typically held every 7, 28 or 35 days, creating short-term liquidity.

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

The Company's working capital was $271.4 million on January 31, 2007 compared to $242.2 million on October 31, 2006. The net increase of $29.2 million includes an $11.8 million increase in cash and equivalents and a $40.0 million investment in auction rate securities. Cash and investment balances accumulated during the quarter as the Company focused efforts on reducing the controllable items of working capital in anticipation of the first quarter downturn. Conversion capital (accounts receivable plus inventory less corresponding accounts payable) was reduced by $25.5 million during the quarter ending January 31, 2007.

The following table summarizes the Company's cash flow results for the three months ended January 31, 2007 and 2006:

| | Three months ending January 31, | |
|---|---|---|
| | 2007 | 2006 |
| | (In millions) | |
| Cash flows from operating activities | $ 65.9 | $ 38.8 |
| Cash flows from investing activities | $ (49.8) | $ (16.0) |
| Cash flows from financing activities | $ (4.2) | $ (17.7) |

Highlights from our cash flow results for the three months ended January 31, 2007 and 2006 are as follows:

*Operating Activities*

The increase of $27.1 million in cash provided by operating activities for the first quarter of 2007 compared to the first quarter of 2006 primarily relates to conversion capital (accounts receivable plus inventory less accounts payable). During the first quarter of 2006, conversion capital increased (use of cash) by $5.2 million to match the pickup in demand. In contrast, during the first quarter of 2007, conversion capital decreased (source of cash) by $25.5 million to match the downturn in the Company's end markets.

*Investment Activities*

The Company used $33.8 million more for investment activities during the three months ended January 31, 2007 compared to the same period of fiscal 2006. As mentioned previously, Quanex invested $40.0 million in auction rate securities during 2007. The Company began investing in these securities during 2007 as their yields were more attractive than other investment vehicles traditionally classified as cash equivalents for reporting purposes. Offsetting this quarter over quarter increase in investments was an $11.8 million reduction in capital expenditures. Capital spending in the Vehicular Products segment declined by $6.6 million primarily due to the completion of the MACSTEEL Monroe value-added capacity project at the end of 2006. Additionally, Mikron's capital spending declined by $4.9 million as expenditures for its capacity expansion project were primarily incurred during fiscal 2006. The Company estimates that fiscal 2007 capital expenditures will be approximately $35.0 million. At January 31, 2007, the Company had commitments of approximately $10.3 million for the purchase or construction of capital assets. The Company plans to fund these capital expenditures with cash flow from operations.

On February 1, 2007 (subsequent to the first quarter), Quanex purchased the assets of Atmosphere Annealing, Inc. (AAI), a wholly owned subsidiary of Maxco, Inc. for approximately $57.5 million, excluding transactions costs and a final working capital-based purchase price adjustment. The acquisition was funded by cash on hand. AAI is a metal heat treating business with four plants in the Midwest and fiscal 2006 sales of approximately $46 million.

*Financing Activities*

The Company used $13.5 million less for financing activities during the three months ended January 31, 2007 compared to the same prior year period. The decrease primarily relates to the Company's stock buyback program activity in fiscal 2006. During the three months ended January 31, 2006, the Company purchased 531,750 shares of its common stock for $17.9 million; the Company has not purchased any of its stock in fiscal 2007. Partially offsetting this is a $3.2 million reduction in cash and tax benefits received related to stock option exercises during the first quarter 2007 compared to the first quarter of 2006. Additionally, the $1.2 million increase in dividends paid for the three months of 2007, compared to 2006, is a result of the 35% or $0.037 per share cumulative increase to the Company's dividend rate effective March and September 2006.

**Critical Accounting Estimates**

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, the Company's management must make decisions which impact the reported amounts and the related disclosures. Such decisions include the selection of the appropriate accounting principles to be applied and assumptions on which to base estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to revenue recognition, allowances for doubtful accounts, inventory, long-lived assets, environmental contingencies, insurance, U.S. pension and other post-employment benefits, litigation and contingent liabilities, and income taxes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company's management believes the critical accounting estimates listed and described in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of the Company's 2006 Annual Report on Form 10-K are the most important to the fair presentation of the Company's financial condition and results. These policies require management's significant judgments and estimates in the preparation of the Company's consolidated financial statements. There have been no significant changes to the Company's critical accounting estimates since October 31, 2006.

**New Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*" (SFAS 158), which requires recognition of the funded status of a benefit plan in the balance sheet. SFAS 158 also requires recognition, in other comprehensive income, of certain gains and losses that arise during the period but which are deferred under pension accounting rules. SFAS 158 also requires defined benefit plan assets and obligations to be measured as of the date of the employer's fiscal year-end. SFAS 158 provides recognition and disclosure elements that will be effective for fiscal years ending after December 15, 2006 (as of October 31, 2007 for the Company) and measurement date elements that will be effective for fiscal years ending after December 15, 2008 (as of October 31, 2009 for the Company). The Company is currently evaluating the recognition element of adopting SFAS 158; such adoption will be impacted by plan returns during fiscal 2007. The measurement date element will not have an impact on the Company as the Company already measures the plan assets and obligations as of the end of its fiscal year.

In July 2006, the FASB issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*" (FIN 48) which is effective for fiscal years beginning after December 15, 2006 (as of November 1, 2007 for the Company) and is an interpretation of FASB Statement No. 109, "*Accounting for Income Taxes*". FIN 48 prescribes a recognition threshold and measurement attribute for recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition and expanded disclosure requirements. The Company is currently assessing the impact, if any, that the adoption of FIN 48 will have on the Company's financial statements.

***Item 3. Quantitative and Qualitative Disclosures about Market Risk***

The following discussion of the Company and its subsidiaries' exposure to various market risks contains "forward looking statements" that involve risks and uncertainties. These projected results have been prepared utilizing certain assumptions considered reasonable in light of information currently available to the Company. Nevertheless, because of the inherent unpredictability of interest rates, foreign currency rates and metal commodity prices as well as other factors, actual results could differ materially from those projected in such forward looking information. The Company does not use derivative financial instruments for speculative or trading purposes.

**Interest Rate Risk**

The Company and its subsidiaries have a Credit Facility and other long-term debt which subject the Company to the risk of loss associated with movements in market interest rates.

At January 31, 2007, the Company had fixed-rate debt totaling $126.8 million or 95% of total debt, which does not expose the Company to the risk of earnings loss due to changes in market interest rates. The Company and certain of its subsidiaries' floating-rate obligations totaled $6.6 million, or 5% of total debt, at January 31, 2007. Based on the floating-rate obligations outstanding at January 31, 2007, a one percent increase or decrease in the average interest rate would result in a change to pre-tax interest expense of approximately $66 thousand.

**Commodity Price Risk**

The Vehicular Products segment has a scrap surcharge program in place, which is a practice that is well established within the engineered steel bar industry. The scrap surcharge is based on a three city, one- or three- month trailing average of #1 bundle scrap prices. The Company's long-term exposure to changes in scrap costs is significantly reduced because of the surcharge program. Over time, the Company recovers the majority of its scrap cost increases, though there is a level of exposure to short-term volatility because of this lag. Prior to fiscal 2006, the segment's scrap surcharge was based on a three-month trailing average. However, beginning during the first quarter of 2006, Quanex moved approximately 85% of the accounts, representing about 70% of shipments, to a one-month cycle. Reducing the adjustment period from three months to one month generally reduces the segment's margin volatility.

Within the Aluminum Sheet Building Products segment, the Company uses various grades of aluminum scrap as well as minimal amounts of prime aluminum ingot as raw materials for its manufacturing processes. 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, Nichols Aluminum enters into firm price raw material purchase commitments (which are designated as "normal purchases" under SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*") as well as option contracts on the 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, to the extent not covered by fixed price purchase commitments.

Through the use of firm price raw material purchase commitments and LME contracts, the Company intends to protect cost of sales from the effects of changing prices of aluminum. To the extent that the raw material costs factored into the firm price sales commitments are matched with firm price raw material purchase commitments, changes in aluminum prices should have no effect. During fiscal 2007 and 2006, the Company primarily relied upon firm price raw material purchase commitments to protect cost of sales tied to firm price sales commitments. There were no outstanding LME hedges as of January 31, 2007 and October 31, 2006.

Within the Engineered Building Products segment, polyvinyl resin (PVC) is the significant raw material consumed during the manufacture of vinyl extrusions. The Company has a monthly resin adjustor in place with its customers that is adjusted based upon published industry resin prices. This adjuster effectively shares the base pass-through price changes of PVC with its customers commensurate with the market at large. The Company's long-term exposure to changes in PVC prices is thus significantly reduced due to the contractual component of the resin adjustor program.

***Item 4. Controls and Procedures***

**Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (1934 Act) as of January 31, 2007. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of January 31, 2007, the disclosure controls and procedures are effective.

**Changes in Internal Control over Financial Reporting**

During the most recent fiscal quarter, there have been no changes in internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the 1934 Act) that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

***Item 1. Legal Proceedings***

On January 22, 2007, the Michigan Department of Environmental Quality and the Company executed a consent order with respect to alleged past violations of air emission requirements. The agreed upon civil penalty of $139,000 was paid in January 2007.

***Item 1A. Risk Factors***

There have been no material changes in the Company's Risk Factors as set forth in Item 1A of the Company's Form 10-K for the fiscal year ended October 31, 2006.

***Item 6. Exhibits***

| Exhibit Number | Description of Exhibits |
|---|---|
| 3.1 | Restated Certificate of Incorporation of the Registrant dated as of November 10, 1995, filed as Exhibit 3.1 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1995 and incorporated herein by reference. |
| 3.2 | Certificate of Amendment to Restated Certificate of Incorporation of the Registrant dated as of February 27, 1997, filed as Exhibit 3.2 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1999 and incorporated herein by reference. |
| 3.3 | Amendment to Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Registrant dated as of April 15, 1999, filed as Exhibit 3.3 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1999 and incorporated herein by reference. |
| 3.4 | Certificate of Correction of Amendment to Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock dated as of April 16, 1999, filed as Exhibit 3.4 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1999 and incorporated herein by reference. |
| 3.5 | Amended and Restated Bylaws of the Registrant, as amended June 1, 2005, filed as Exhibit 3.5 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended April 30, 2005 and incorporated herein by reference. |
| *3.6 | Certificate of Amendment to Restated Certificate of Incorporation, dated as of February 27, 2007. |
| 4.1 | Form of Registrant's Common Stock certificate, filed as Exhibit 4.1 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended April 30, 1987, and incorporated herein by reference. |
| 4.2 | Indenture dated as of May 5, 2004 between Quanex Corporation and Union Bank of California, N.A. as trustee relating to the Company's 2.50% Convertible Senior Debentures due May 15, 2034, filed as Exhibit 4.9 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended April 30, 2004, and incorporated herein by reference. |

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| 4.3 | Registration Rights Agreement dated as of May 5, 2004 among Quanex Corporation, Credit Suisse First Boston LLC, Bear, Stearns & Co. Inc., Robert W. Baird & Co. Incorporated, and KeyBanc Capital Markets relating to the Company's 2.50% Convertible Senior Debentures due May 15, 2034, filed as Exhibit 4.10 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended April 30, 2004, and incorporated herein by reference. |
| 4.4 | Third Amended and Restated Rights Agreement dated as of September 15, 2004, between the Registrant and Wells Fargo Bank, N.A. as Rights Agent, filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K (Reg. No. 001-05725) dated September 17, 2004, and incorporated herein by reference. |
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| 4.6 | Credit Agreement dated as of September 29, 2006, among the Company, certain of its subsidiaries as guarantors, Wells Fargo Bank, National Association, in its capacity as administrative agent, and certain lender parties, filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K (Reg. No. 001-05725) dated September 29, 2006 and incorporated herein by reference. |
| † * 10.1 | Quanex Corporation Employees' 401(k) Savings Plan (Amended and Restated Effective January 1, 2007), dated October 2, 2006. |
| † * 10.2 | First Amendment to Quanex Corporation Employees' 401(k) Savings Plan, dated October 26, 2006. |
| † * 10.3 | Fifth Amendment to Quanex Corporation 401(k) Savings Plan for Hourly Employees, dated October 26, 2006. |
| † * 10.4 | Sixth Amendment to Quanex Corporation Hourly Bargaining Unit Employee Savings Plan, dated October 26, 2006. |
| * 31.2 | Certification by chief financial officer pursuant to Rule 13a-14(a)/15d-14(a). |
| * 32.1 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

† Management Compensation or Incentive Plan

* Filed herewith

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

**SIGNATURES**

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

**QUANEX CORPORATION**

/s/ Thomas M. Walker
Thomas M. Walker
Senior Vice President — Finance and Chief Financial Officer
(Principal Financial Officer)

Date: February 28, 2007

## EXHIBIT INDEX

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† Management Compensation or Incentive Plan

* Filed herewith

**EXHIBIT 3.6**

**QUANEX CORPORATION**

**CERTIFICATE OF AMENDMENT**
**TO**
**RESTATED CERTIFICATE OF INCORPORATION**

Quanex Corporation, a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the "Company"), does hereby certify:

**FIRST**: That the Board of Directors of the Company, at a meeting duly called and held on December 5, 2006, adopted resolutions proposing and declaring advisable the following amendment to the Restated Certificate of Incorporation of the Company, and directed that such amendment be considered at the next annual meeting of stockholders of the Company:

To amend the first paragraph of Article Fourth of the Restated Certificate of Incorporation in its entirety to read as follows:

> "FOURTH: The total number of shares of all classes of stock which the Corporation shall have authority to issue is One Hundred and One Million (101,000,000)**,** of which One Hundred Million (100,000,000) shall be shares of Common Stock, par value Fifty Cents ($.50) per share, and of which One Million (1,000,000) shares shall be Preferred Stock, no par value."

**SECOND**: That at the annual meeting of stockholders of the Company duly called and held on February 27, 2007, in accordance with Section 222 of the General Corporation Law of the State of Delaware, the holders of a majority of the shares of Common Stock of the Company entitled to vote on such amendment voted in favor of such amendment.

**THIRD**: That the aforesaid amendment was duly adopted in accordance with the applicable provisions of Section 242 of the General Corporation Law of the State of Delaware;

**IN WITNESS WHEREOF**, the Company has caused this Certificate of Amendment to be signed by Thomas M. Walker, its Senior Vice President – Finance and Chief Financial Officer, this 27th day of February, 2007.

**QUANEX CORPORATION**

By: /s/ THOMAS M. WALKER
Thomas M. Walker
Senior Vice President – Finance
and Chief Financial Officer

**Exhibit 10.1**

**QUANEX CORPORATION**
**EMPLOYEE'S 401(k) SAVINGS PLAN**

***Amended and Restated***
***Effective January 1, 2007***

**Exhibit 10.1**

**QUANEX CORPORATION EMPLOYEES' 401(k) SAVINGS PLAN**

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

**W I T N E S S E T H:**

**WHEREAS**, effective April 1, 1986, the Sponsor established the Quanex Corporation Employee Savings Plan;

**WHEREAS,** the Quanex Corporation Employee Savings Plan is intended to be a profit sharing plan;

**WHEREAS**, effective January 1, 2007, the Sponsor desires to merge the Quanex Corporation 401(k) Savings Plan, the Mikron Industries, Inc. Salary Deferral Plan and the TruSeal Technologies, Inc. 401(k) Profit Sharing Plan into the Quanex Corporation Employee Savings Plan;

**WHEREAS**, the Sponsor desires to amend and restate the Quanex Corporation Employee Savings Plan and rename the plan the Quanex Corporation Employees' 401(k) Savings Plan;

**NOW, THEREFORE,** the plan is hereby amended and restated in its entirety as set forth below.

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## Article I

## DEFINITIONS

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

1.01 ***"Account"*** means all ledger accounts pertaining to a Participant or former Participant which are maintained by the Committee to reflect the Participant's or former Participant's interest in the Trust. The Committee shall establish the following Accounts and any additional Accounts that the Committee considers necessary to reflect the entire interest of the Participant or former Participant in the Trust. Each of the Accounts listed below and any additional Accounts established by the Committee shall reflect the Contributions or amounts transferred to the Trust, if any, and the appreciation or depreciation of the assets in the Trust and the income earned or loss incurred on the assets in the Trust attributable to the Contributions and/or other amounts transferred to the Account.

(a) *Salary Deferral Contribution Account* — the Participant's or former Participant's before-tax contributions, if any, made pursuant to Section 3.01.

(b) *Catch-up Salary Deferral Account* — the Participant's or former Participant's before-tax contributions, if any, made pursuant to Section 3.02.

(c) *After-Tax Contribution Account* — the Participant's or former Participant's after-tax contributions, if any, made pursuant to Section 3.03.

(d) *Matching Contribution Account* — the Employer's matching contributions, if any, made pursuant to Section 3.04.

(e) *Supplemental Contribution Account* — the Employer's contributions, if any, made pursuant to Section 3.05.

(f) *QNEC Account* — the Employer's contributions, known as "qualified nonelective employer contributions", made as a means of passing the actual deferral percentage test set forth in section 401(k) of the Code or the actual contribution percentage test set forth in section 401(m) of the Code.

(g) *Rollover Account* — funds transferred from another qualified plan or individual retirement account for the benefit of a Participant or former Participant.

1.02 ***"Active Service"*** means the Periods of Service which are counted for eligibility and vesting purposes as calculated under Article X.

1.03 ***"Affiliated Employer"*** means the Employer and any employer which is a member of the same controlled group of corporations within the meaning of section 414(b) of the Code or which is a trade or business (whether or not incorporated) which is under common control (within the meaning of section 414(c) of the Code), which is a member of an affiliated service group (within the meaning of section 414(m) of the Code) with the Employer, or which is required to be aggregated with the Employer under section 414(o) of the Code. For purposes of the limitation on allocations contained in Appendix A, the definition of Affiliated Employer is modified by substituting the phrase "more than 50 percent" in place of the phrase "at least 80 percent" each place the latter phrase appears in section 1563(a)(1) of the Code.

1.04 ***"Annual Compensation"*** means the Employee's wages from the Affiliated Employers as defined in section 3401(a) of the Code for purposes of federal income tax withholding at the source (but determined without regard to any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed) modified by including elective contributions under a cafeteria plan maintained by an Affiliated Employer that are excludable from the Employee's gross income pursuant to section 125 of the Code, elective contributions under a qualified transportation fringe benefit plan maintained by an Affiliated Employer that are excludable from the Employee's gross income pursuant to section 132(f)(4) of the Code and elective contributions made on behalf of the Employee to any plan maintained by an Affiliated Employer that is qualified under or governed by section 401(k), 408(k), or 403(b) of the Code. Except for purposes of Section A.4.1 of Appendix A of the Plan, Annual Compensation in excess of $200,000.00 (as adjusted by the Secretary of Treasury for increases in the cost of living) will be disregarded. If the Plan Year is ever less than twelve months, the $200,000.00 limitation (as adjusted by the Secretary of Treasury for increases in the cost of living) will be prorated by multiplying the limitation by a fraction, the numerator of which is the number of months in the Plan Year, and the denominator of which is twelve (12).

1.05 ***"Applicable Distribution Period"*** means:

(a) *Distributions During the Participant's or former Participant's Life*. For Distribution Calendar Years commencing on or after January 1, 2003, up to and including the Distribution Calendar Year that includes the Participant's or former Participant's death, the "*Applicable Distribution Period*" is the Participant's or former Participant's life expectancy determined using the Uniform Lifetime Table in Regulation section 1.401(a)(9)-9 for his age as of his birthday in the relevant Distribution Calendar Year. However, if the Participant's or former Participant's sole Section 401(a)(9) Beneficiary for the entire Distribution Calendar Year is his Spouse, for distributions during his lifetime, his *"Applicable Distribution Period"* shall not be less than the joint life expectancy of him and his Spouse using his and his Spouse's attained ages as of his and his Spouse's birthdays in the Distribution Calendar Year.

(b) *Distributions after the Participant's or former Participant's Death*. Effective for Distribution Calendar *Years* commencing on or after January, 1, 2003, if a Participant or former Participant dies on or after his Required Beginning Date, the *"Applicable Distribution Period"* for Distribution Calendar Years after the Distribution Calendar Year containing the Participant's or former Participant's date of death is the longer of the remaining life expectancy of his Section 401(a)(9) Beneficiary (if any) determined in accordance with the Final Section 401(a)(9) Regulations (calculated by using the age of the Section 401(a)(9) Beneficiary in the year following the year of the former Participant's death, reduced by one for each subsequent year) or the remaining life expectancy of the former Participant determined in accordance with the Final Section 401(a)(9) Regulations (calculated by using the age of the former Participant in the year of death, reduced by one or each subsequent year). However, if the former Participant's surviving Spouse is the former Participant's sole Section 401(a)(9) Beneficiary, the remaining life expectancy of the surviving Spouse is calculated for each Distribution Calendar Year after the year of the former Participant's death using the surviving Spouse's age as the surviving Spouse's birthday in that year; and for distribution calendar years after the year of the surviving Spouse's death, the remaining life expectancy of the surviving Spouse is calculated using the age of the surviving Spouse as of the surviving Spouse's birthday in the calendar year of the surviving Spouse's death, reduced by one for each subsequent calendar year.

(c) *Distribution Calendar Years Commencing Before January 1, 2003*. For Distribution Calendar Years commencing before January 1, 2003, *"Applicable Distribution Period"* means the period of time computed in accordance with the applicable rules specified in Section 5.06(f).

1.06 ***"Beneficiary" or "Beneficiaries"*** means the person or persons, or the trust or trusts created for the benefit of a natural person or persons or the Participant's or former Participant's estate, designated by the Participant or former Participant to receive the benefits payable under the Plan upon his death.

1.07 ***"Benefit Commencement Date"*** means the date on which the Trustee disburses the lump sum or rollover distribution.

1.08 ***"Board"*** or ***"Board of Directors"*** means the board of directors of the Sponsor.

1.09 ***"Catch-up Eligible Participant"*** means a Participant who is age 50 or who is projected to attain the age of 50 by December 31 of the applicable Plan Year.

1.10 ***"Claimant"*** means a Participant, former Participant or Beneficiary, as applicable.

1.11 ***"Code"*** means the Internal Revenue Code of 1986, as amended from time to time.

1.12 ***"Committee"*** means the committee appointed by the Sponsor to administer the Plan.

1.13 ***"Considered Compensation"*** means Annual Compensation paid to a Participant by an Affiliated Employer for a Plan Year, *reduced* by all of the following items (even if includable in gross income): all reimbursements or other expense allowances (such as the payment of moving expenses or automobile mileage reimbursements), cash and noncash fringe benefits (such as the use of an automobile owned by the Employer, club memberships, tax gross-ups, attendance and safety awards, fitness reimbursements, housing allowances, financial planning benefits and Beneflex opt-out dollars), deferred compensation (such as amounts realized upon the exercise of a nonqualified stock option or upon the premature disposition of an incentive stock option, pay for accrued vacation upon Separation From Service, amounts realized when restricted property or other property held by a Participant either becomes freely transferable or no longer subject to a substantial risk of forfeiture under section 83 of the Code), and welfare benefits (such as severance pay). An Employee's Considered Compensation paid to him during any period in which he is not eligible to participate in the Plan under Article II shall be disregarded. Considered Compensation in excess of $200,000.00 (as adjusted by the Secretary of Treasury for increases in the cost of living) will be disregarded. If the Plan Year is ever less than twelve months, the $200,000.00 limitation (as adjusted by the Secretary of Treasury for increases in the cost of living) will be prorated by multiplying the limitation by a fraction, the numerator of which is the number of months in the Plan Year, and the denominator of which is twelve (12).

1.14 ***"Contribution"*** means the total amount of contributions made under the terms of the Plan. Each specific type of Contribution shall be designated by the type of contribution made as follows:

(a) *Salary Deferral Contribution* — a before-tax contribution made by the Employer pursuant to Section 3.01 and the Employee's salary deferral agreement.

(b) *Catch-up Salary Deferral Contribution* — a contribution made by the Employer pursuant to Section 3.02 and the Participant's salary deferral agreement.

(c) *After-Tax Contribution* — an after-tax contribution made by the Employee.

(d) *Matching Contribution* — a contribution made by the Employer pursuant to Section 3.04.

(e) *Supplemental Contribution* — a contribution made by the Employer pursuant to Section 3.05.

(f) *QNEC* — an extraordinary contribution, known as a "qualified nonelective employer contribution", that is an employer contribution other than a Matching Contribution, Supplemental Contribution or an elective contribution that the Employee may not elect to have paid to him in cash instead of being contributed to the Plan, and that meets the nonforfeitability and distribution restrictions that apply to elective contributions under plans governed by section 401(k) of the Code.

(g) *Rollover Contribution* — a contribution made by a Participant which consists of any part of an eligible rollover distribution (as defined in section 402 of the Code) from a qualified employee trust described in section 401(a) of the Code.

1.15 ***"Decatur Plan"*** means the Decatur Aluminum Corporation Salaried Employees' 401(k) Retirement Plan and Trust.

1.16 ***"Direct Rollover"*** means a payment by the Plan to the Eligible Retirement Plan specified by the Distributee.

1.17 ***"Disability"*** means a mental or physical disability which, in the opinion of a physician selected by the Committee, shall prevent the Participant or former Participant from earning a reasonable livelihood with any Affiliated Employer and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months and which: (a) was not contracted, suffered or incurred while the Participant or former Participant was engaged in, or did not result from having engaged in, a felonious criminal enterprise; (b) did not result from alcoholism or addiction to narcotics; and (c) did not result from an injury incurred while a member of the Armed Forces of the United States for which the Participant or former Participant receives a military pension.

1.18 ***"Distributee"*** means an Employee or former Employee. In addition, the Employee's or former Employee's surviving Spouse and the Employee's or former Employee's Spouse or former Spouse who is the alternate payee under a Qualified Domestic Relations Order, are Distributees with regard to the interest of the Spouse or former Spouse.

1.19 ***"Distribution Calendar Year"*** A calendar year for which a minimum distribution is required to be made to a Participant or former Participant under section 401(a)(9) of the Code and Department of Treasury Regulations thereunder. If a Participant's or former Participant's Required Beginning Date is April 1 of the calendar year following the calendar year in which he attains age 70½, his first Distribution Calendar Year is the calendar year in which he attains age 70½. If a Participant's or former Participant's Required Beginning Date is April 1 of the calendar year following the calendar year in which he incurs a Separation From Service, his first Distribution Calendar Year is the calendar year in which he incurs a Separation From Service.

1.20 ***"Eligible Employee"*** means an Employee who is employed by an Employer and that is not included in a unit of Employees covered by a collective bargaining agreement between the Employees' representative and the Employer, unless the collective bargaining agreement requires that such Employee be an Eligible Employee under the Plan.

1.21 ***"Eligible Retirement Plan"*** means (a) an individual retirement account described in section 408(a) of the Code, (b) an individual retirement annuity described in section 408(b) of the Code (other than an endowment contract), (c) an annuity plan described in section 403(a) of the Code, (d) a qualified plan described in section 401(a) of the Code that is a defined contribution plan that accepts the Distributee's Eligible Rollover Distribution, (e) an eligible deferred compensation plan described in section 457(b) of the Code that is maintained by an eligible employer described in section 457(e)(1)(A) of the Code but only if the plan agrees to separately account for amounts rolled into such plan, or (f) an annuity contract described in section 403(b) of the Code.

1.22 ***"Eligible Rollover Distribution"*** means any distribution of all or any portion of the balance to the credit of the Distributee, except that an Eligible Rollover Distribution does *not* include: (a) any distribution that is one of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the Distributee or the joint lives (or joint life expectancies) of the Distributee and the Distributee's Beneficiary, or for a specified period of ten years or more; (b) any distribution to the extent the distribution is required under section 401(a)(9) of the Code; (c) the portion of any distribution that is not includable in gross income (determined without regard to the exclusion for net unrealized appreciation with respect to employer securities) unless the Eligible Retirement Plan to which the distribution is transferred (1) agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is not includable in gross income or (2) is an individual retirement account described in section 408(a) of the Code or an individual retirement annuity described in section 408(b) of the Code (other than an endowment contract); and, (d) a distribution from any of the Participant's Accounts due to a financial hardship of the Participant.

1.23 ***"Employee"*** means, except as otherwise specified in this Section, all common law employees of an Affiliated Employer and all Leased Employees.

1.24 "***Employee Savings Plan***" means this Plan prior to its amendment and restatement as the Quanex Corporation Employee 401(k) Savings Plan, and prior to the mergers of the 401(k) Savings Plan, the Mikron Plan and the TruSeal Plan into the Plan.

1.25 ***"Employer" or "Employers"*** means the Sponsor and any other business organization that adopts the Plan. As of January 1, 2007, the term "Employer" includes: Quanex Corporation, MACSTEEL Monroe, Inc., Nichols Aluminum-Alabama, Inc., Colonial Craft, Inc., Imperial Products, Inc., Mikron Industries, Inc., Mikron Washington LLC , Besten Equipment, Inc. and TruSeal Technologies, Inc.

1.26 ***"ERISA"*** means the Employee Retirement Income Security Act of 1974, as amended from time to time.

1.27 ***"Final Section 401(a)(9) Regulations"*** means the final Department of Treasury Regulations issued under section 401(a)(9) of the Code which were published in the Federal Register on April 17, 2002.

1.28 ***"Five Percent Owner"*** means an Employee who is a five percent owner as defined in section 416(i) of the Code.

1.29 ***"Forfeitable Interest"*** means a Participant's or former Participant's forfeitable interest in amounts credited to his Account determined in accordance with Article VIII.

1.30 ***"401(k) Savings Plan"*** means the Quanex Corporation 401(k) Savings Plan.

1.31 ***"Highly Compensated Employee"*** means an Employee or an Affiliated Employer who, during the Plan Year or the preceding Plan Year, (a) was at any time a Five Percent Owner at any time during the Plan Year or the preceding Plan Year or (b) had Annual Compensation from the Affiliated Employers in excess of $80,000.00 (as adjusted from time to time by the Secretary of the Treasury) for the preceding Plan Year.

1.32 ***"Hour of Service"*** means each hour that an Employee is paid or entitled to payment by an Affiliated Employer for the performance of duties.

1.33 ***"Leased Employee"*** means any person who (a) is not a common law employee of an Affiliated Employer, (b) pursuant to an agreement between an Affiliated Employer and any other person, has performed services for an Affiliated Employer (or for an Affiliated Employer and related persons determined in accordance with section 414(n)(6) of the Code) on a substantially full-time basis for a period of at least one year and (c) performs the services under primary direction and control of the recipient.

1.34 **"*Maternity or Paternity Absence*"** means a period in which an Employee is absent from work (a) by reason of the pregnancy of the Employee, (b) by reason of the birth of a child of the Employee, (c) by reason of the placement of a child with the Employee in connection with the adoption of the child by the Employee, or (d) for purposes of caring for such child for a period immediately following such birth or placement for adoption.

1.35 ***"Mikron Plan"*** means the Mikron Industries, Inc. Salary Deferral Plan.

1.36 ***"Nonforfeitable Interest"*** means a Participant's or former Participant's nonforfeitable interest in amounts credited to his Account determined in accordance with Article VIII.

1.37 ***"Non-Highly Compensated Employee"*** means an Employee who is not a Highly Compensated Employee.

1.38 ***"Participant"*** means an Employee who is eligible to participate in the Plan under the provisions of Article II.

1.39 ***"Period of Service"*** means a period of employment with an Affiliated Employer which commences on the later of (1) April 1, 1986 or (2) the day on which an Employee performs his initial Hour of Service or performs his initial Hour of Service after he Separates From Service, whichever is applicable, and ends on the date the Employee subsequently Separates From Service.

1.40 ***"Period of Severance"*** means the period of time commencing on the Employee's Separation From Service Date and ending on the date the Employee subsequently performs an Hour of Service.

1.41 ***"Plan"*** means the Quanex Corporation Employees' 401(k) Savings Plan, as amended from time to time.

1.42 ***"Plan Year"*** means the calendar year.

1.43 ***"Qualified Domestic Relations Order"*** means a domestic relations order which the Committee has determined constitutes a qualified domestic relations order within the meaning of section 414(p) of the Code.

1.44 ***"Regulation"*** means the Department of Treasury regulation specified, as it may be changed from time to time.

1.45 ***"Required Beginning Date"*** means:

(a) in the case of an individual who is not a Five Percent Owner in the Plan Year that ends in the calendar year in which he attains age 70½, the Required Beginning Date is April 1 of the calendar year following the later of (1) the calendar year in which the individual attains age 70½, or (2) the calendar year in which the individual incurs a Separation From Service;

(b) in the case of an individual who is a Five Percent Owner in the Plan Year that ends in the calendar year in which he attains age 70½, the Required Beginning Date is April 1 of the calendar year following the calendar year in which he attains age 70½; and

(c) notwithstanding subsection (a), in the case of an individual who attained age 70½ prior to January 1, 2001, the Required Beginning Date is April 1 of the calendar year following the calendar year in which the individual attained age 70½.

1.46 ***"Retirement Age"*** means age 65. With respect to amounts contributed to the Plan on or before December 31, 2006, "Retirement Age" also means (1) for a Participant who was a participant in the Mikron Plan, age 55 and the completion of seven (7) years of service and (2) for a Participant who was a participant in the TruSeal Plan, the fifth anniversary of the Participant's participation in the TruSeal Plan or the Plan.

1.47 ***"Rollover Contribution"*** means the amount contributed by a Participant of the Plan which consists of any part of an Eligible Rollover Distribution from a qualified employee trust described in section 401(a) of the Code other than an amount that is not includable in the Participant's gross income.

1.48 ***"Section 401(a)(9) Beneficiary"*** means an individual who is a Participant's or former Participant's Beneficiary on the date of the Participant's or former Participant's death and (unless the Beneficiary dies after the date of the Participant's or former Participant's death and before September 30 of the following calendar year without disclaiming benefits under the Plan) who remains a Beneficiary as of September 30 of the calendar year following the calendar year of the Participant's or former Participant's death. If the Participant's or former Participant's Beneficiary is a trust, an individual beneficiary of the trust may be a Section 401(a)(9) Beneficiary of the Participant or former Participant if the requirements of Regulation Section 1.401(a)(9)-4 are satisfied

1.49 ***"Separates From Service"*** means the occurrence of a Participant's or former Participant's Separation From Service Date.

1.50 ***"Separation From Service"*** means an individual's termination of employment with an Affiliated Employer *without* commencing or continuing employment with any other Affiliated Employer.

1.51 **"*Separation From Service Date"*** means the earlier of the date of the Employee's Separation From Service, or the first anniversary of the date on which the Employee is absent from service (with or without pay) for any reason other than his Separation From Service or a Maternity or Paternity Absence, such as vacation, holiday, sickness, or leave of absence. The Separation From Service Date of an Employee who is absent beyond the first anniversary of his first day of absence by reason of a Maternity or Paternity Absence is the second anniversary of the first day of the absence.

1.52 ***"Sponsor"*** means Quanex Corporation, a Delaware corporation.

1.53 ***"Sponsor Stock"*** means the common stock of the Sponsor or such other publicly-traded stock of an Affiliated Employer as meets the requirements of section 407(d)(5) of ERISA with respect to the Plan.

1.54 ***"Spouse"*** means the person to whom the Participant or former Participant is married under applicable local law. In addition, to the extent provided in a Qualified Domestic Relations Order, a surviving former spouse of a Participant or former Participant will be treated as the Spouse of the Participant or former Participant, and to the same extent any current spouse of the Participant or former Participant will not be treated as a Spouse of the Participant or former Participant. For purposes of Section 5.06, a former Spouse to whom all or a portion of a Participant's or former Participant's Plan benefit is payable under a Qualified Domestic Order shall, to that extent, be treated as a Spouse or surviving Spouse regardless of whether the Qualified Domestic Relations Order specifically provides that the former Spouse is to be treated as the Spouse for purposes of Sections 401(a)(11) and 417 of the Code.

1.55 ***"TruSeal Plan"*** means the TruSeal Technologies, Inc. 401(k) Profit Sharing Plan.

1.56 ***"Trust"*** means the trust estate created to fund the Plan.

1.57 ***"Trustee"*** means collectively one or more persons or corporations with trust powers which have been appointed by the initial Sponsor and have accepted the duties of Trustee and any successor appointed by the Sponsor.

1.58 ***"Valuation Date"*** means each business day of the Plan Year.

## Article II

## ELIGIBILITY

2.01 **Eligibility Requirements**. Each Eligible Employee shall be eligible to participate in the Plan beginning on the first day he performs one Hour of Service. However, an Employee who is included in a unit of Employees covered by a collective bargaining agreement between the Employees' representative and the Employer shall be excluded, even if he has met the requirements for eligibility, if there has been good faith bargaining between the Employer and the Employees' representative pertaining to retirement benefits and the agreement does not require the Employer to include such Employees in the Plan. In addition, a Leased Employee shall not be eligible to participate in the Plan unless the Plan's qualified status is dependent upon coverage of the Leased Employee. An Employee who is a nonresident alien (within the meaning of section 7701(b) of the Code) and receives no earned income (within the meaning of section 911(d)(2) of the Code) from any Affiliated Employer that constitutes income from sources within the United States (within the meaning of section 861(a)(3) of the Code) is not eligible to participate in the Plan. An Employee who is a nonresident alien (within the meaning of section 7701(b) of the Code) and who does receive earned income (within the meaning of section 911(d)(2) of the Code) from any Affiliated Employer that constitutes income from sources within the United States (within the meaning of section 861(a)(3) of the Code) all of which is exempt from United States income tax under an applicable tax convention is not eligible to participate in the Plan. During any period in which an individual is classified by an Employer as an independent contractor with respect to such Employer, the individual is not eligible to participate in the Plan (even if he is subsequently reclassified by the Internal Revenue Service as a common law employee of the Employer and the Employer acquiesces to the reclassification). During any period in which an individual is classified by an Employer as an intern or student with respect to such Employer, the individual is not eligible to participate in the Plan. Finally, an Employee who is employed outside the United States is not eligible to participate in the Plan unless the Committee elects to permit him to participate in the Plan.

2.02 **Eligibility Upon Reemployment.** If an Employee incurs a Separation From Service, he shall be eligible to recommence participation in the Plan beginning on the first day he performs one Hour of Service following his Separation From Service. Subject to Section 2.03, once an Employee becomes a Participant, his eligibility to participate in the Plan shall continue until he Separates From Service.

2.03 **Cessation of Participation**. An individual who has become a Participant will cease to be a Participant on the earliest of the date on which he (a) Separates From Service, (b) is transferred from the employ of an Employer to the employ of an Affiliated Employer that has not adopted the Plan, (c) becomes included in a unit of employees covered by a collective bargaining agreement that does not require coverage of those employees under the Plan, (d) becomes a Leased Employee, or (e) becomes included in another classification of Employees who, under the terms of the Plan, are not eligible to participate. Under these circumstances, the Participant's Account becomes frozen; he cannot contribute to the Plan or share in the allocation of any Contributions for the frozen period. However, his Accounts shall continue to share in any Plan income allocable to his Accounts during the frozen period of time.

2.04 **Recommencement of Participation**. A former Participant will again become a Participant on the day on which he again becomes included in a classification of Employees that, under the terms of the Plan, is eligible to participate.

## Article III

## CONTRIBUTIONS

3.01 **Salary Deferral Contributions**. Each Employer shall make a Salary Deferral Contribution in an amount equal to the amount by which the Considered Compensation of its Employees who are Participants was reduced on a pre-tax basis pursuant to salary deferral agreements (excluding amounts of Considered Compensation deferred pursuant to Section 3.02 that are properly characterized as Catch-up Salary Deferral Contributions). Any such salary deferral agreement shall be an agreement in a form satisfactory to the Committee to prospectively receive Considered Compensation from the Employer in a reduced amount and to have the Employer contribute an amount equal to the amount of the reduction to the Trust on account of the Participant. Any such salary deferral agreement shall be revocable in accordance with its terms, provided that no revocation shall be retroactive or permit payment to the Participant of the amount required to be contributed to the Trust. A Participant's or former Participant's right to benefits attributable to Salary Deferral Contributions made to the Plan on his behalf shall be nonforfeitable.

This paragraph shall be effective January 1, 2007. Except as provided below, each Employee who first becomes employed by the Employer on or after January 1, 2007 and who satisfies the requirements of Section 3.1 shall have three percent (3%) of his Considered Compensation automatically deducted from his pay as a Salary Deferral Contribution to this Plan (the "Automatic Deduction"). No Automatic Deduction shall be made with respect to an Employee if (a) the Employee affirmatively elects a different level of Salary Deferral Contributions in accordance with the provisions of this Plan or (b) the Employee affirmatively elects not to make Salary Deferral Contributions in accordance with the provisions of this Plan.

The maximum amount a Participant may elect to reduce his Considered Compensation under his salary deferral agreement and have contributed to the Plan on a pre-tax basis shall be determined by the Committee, in its sole discretion from time to time. The election to have Salary Deferral Contributions made, the ability to change the rate of Salary Deferral Contributions, the right to suspend Salary Deferral Contributions, and the manner of commencing new Salary Deferral Contributions shall be permitted under any uniform method determined by the Committee from time to time.

3.02 **Catch-up Salary Deferral Contributions.** The Employer shall make a Catch-up Salary Deferral Contribution in an amount equal to the amounts by which its Catch-up Eligible Participants' Considered Compensation was reduced as a result of salary deferral agreements authorizing Catch-up Salary Deferral Contributions (to the extent that their deferrals are properly characterized as Catch-up Salary Deferral Contributions). Any such salary deferral agreement shall be an agreement in a form satisfactory to the Committee to prospectively receive Considered Compensation from the Employer in a reduced amount and to have the Employer contribute an amount equal to the amount of the reduction to the Trust on behalf of the Catch-up Eligible Participant. Further, any such salary deferral agreement shall be revocable in accordance with its terms, provided that no revocation shall be retroactive or permit payment to the Participant of the amount required to be contributed to the Trust. A Participant's or former Participant's right to benefits derived from Catch-up Salary Deferral Contributions made to the Plan on his behalf shall be nonforfeitable.

Catch-up Salary Deferral Contributions on behalf of a Catch-up Eligible Participant shall be permitted to the extent that the Catch-up Salary Deferral Contributions do not exceed the lesser of (a) the "applicable dollar amount" under section 414(v) of the Code for the Plan Year (as adjusted from time to time by the Secretary of Treasury), or (b) an amount equal to the Participant's Annual Compensation for the Plan Year minus the Catch-up Eligible Participant's Salary Deferral Contributions for the Plan Year.

A final determination as to whether amounts deferred under the Plan by a Catch-up Eligible Participant are properly characterized as Salary Deferral Contributions or Catch-up Salary Deferral Contributions for a Plan Year shall be made as of the end of the Plan Year. To the extent that amounts deferred under the Plan on a pre-tax basis at the election of a Catch-up Eligible Participant exceed the least of (a) the lowest statutory limit on Salary Deferral Contributions (including limits imposed under sections 401(a)(30) and 415 of the Code), (b) the maximum limitation on Salary Deferral Contributions, if any, imposed by the Committee pursuant to Section 3.01, or (c) the highest amount of Salary Deferral Contributions on behalf of the Catch-up Eligible Participant that may be retained in the Plan under the rules of section 401(k)(8)(C) of the Code, the amounts deferred shall be characterized as Catch-up Salary Deferral Contributions. Any amounts deferred under the Plan on a pre-tax basis at the election of a Catch-up Eligible Participant that are not properly characterized as Catch-up Salary Deferral Contributions pursuant to the rules of the preceding sentence shall be characterized as Salary Deferral Contributions for all purposes under the Plan.

3.03 **After-Tax Contributions.** To the extent permitted by the Committee, each Participant may make voluntary after-tax contributions to the Plan through payroll deductions. A Participant's or former Participant's right to benefits attributable to After-Tax Contributions made to the Plan on his behalf shall be nonforfeitable.

The maximum amount a Participant may elect to contribute to the Plan on an after-tax basis shall be determined by the Committee from time to time. The election to have After-Tax Contributions made, the ability to change the rate of After-Tax Contributions, the right to suspend After-Tax Contributions, and the manner of commencing new After-Tax Contributions shall be permitted under any uniform method determined by the Committee from time to time.

3.04 **Matching Contributions.** Each Employer will make a Matching Contribution on behalf of each of its Employees who is a Participant in an amount equal to 50 percent of the first five percent of such Participant's Considered Compensation contributed to the Plan pursuant to such Participant's Salary Deferral Contributions. A Participant shall not be entitled to a Matching Contribution on any After-Tax Contributions contributed for periods beginning after December 31, 2006.

3.05 **Supplemental Contributions.** Each Employer may contribute for a Plan Year a Supplemental Contribution to be allocated among Participants in such amount, if any, as shall be determined by the Employer. The rate of the Supplemental Contribution need not be uniform among all divisions of the Employer.

3.06 **Rollover Contributions and Plan-to-Plan Transfers**. The Committee may permit Rollover Contributions by Participants and/or direct transfers to or from another qualified plan on behalf of Participants from time to time. If Rollover Contributions and/or direct transfers to or from another qualified plan are permitted, the opportunity to make those contributions and/or direct transfers must be made available to Participants on a nondiscriminatory basis. For this purpose only, all Employees who are included in a classification of Employees who are eligible to participate in the Plan shall be considered to be Participants of the Plan even though they may not have met the Active Service requirements for eligibility. However, they shall not be entitled to elect to have Salary Deferral Contributions made or to share in Employer Contributions or forfeitures unless and until they have met the requirements for eligibility, contributions and allocations. A Rollover Contribution shall not be accepted unless it is directly rolled over to the Plan in a rollover described in section 401(a)(31) of the Code. A Participant shall not be permitted to make a Rollover Contribution if the property he intends to contribute is for any reason unacceptable to the Trustee. A Participant's or former Participant's right to benefits attributable to his Rollover Contributions made to the Plan shall be nonforfeitable.

3.07 **QNECS — Extraordinary Employer Contributions.** Any Employer may make a QNEC in such amount, if any, as shall be determined by it. A Participant's or former Participant's right to benefits attributable to QNECs made to the Plan on his behalf shall be nonforfeitable. In no event will QNECs be distributed before Salary Deferral Contributions may be distributed from the Plan.

3.08 **Restoration Contributions.** The Employer shall, for each Plan Year, make a restoration contribution in an amount equal to the sum of (a) such amount, if any, as shall be necessary to fully restore all Matching Contribution Accounts and Supplemental Contribution Accounts required to be restored pursuant to the provisions of Section 9.02 after the application of all forfeitures available for such restoration; plus (b) an amount equal in value to the value of forfeited benefits required to be restored under Section 9.03, after the application of all forfeitures available for such restoration.

3.09 **Restorative Payments.** If due to an oversight or inadvertent error an Employer fails to make a Contribution to the Plan on behalf of a Participant or former Participant, as soon as administratively practicable following the Employer's discovery of the error, the Employer shall make a restorative payment to the Plan on behalf of the Participant or former Participant in an amount equal to the amount of required Contributions the Employer should have made to the Plan on behalf of the Participant or former Participant plus interest thereon (both determined in a manner that is consistent with then current guidance from the Department of Treasury concerning such restorative payments) after the application of forfeitures available for such restoration.

3.10 **Nondeductible Contributions Not Required**. Notwithstanding any other provision of the Plan, no Employer shall be required to make any contribution that would be a "nondeductible contribution" within the meaning of section 4972 of the Code.

3.11 **Form of Payment of Contributions.** Contributions may be paid to the Trustee either in cash or in qualifying employer securities (as such term is defined in section 407(d) of ERISA) or any combination thereof, provided that payment may not be made in any form constituting a prohibited transaction under section 4975 of the Code or section 406 of ERISA.

3.12 **Deadline for Payment of Contributions**. Salary Deferral Contributions, Catch-up Salary Deferral Contributions, and After-Tax Contributions shall be paid to the Trustee in installments. The installment for each payroll period shall be paid as soon as administratively feasible. The Matching Contributions, Supplemental Contributions and QNECs for a Plan Year shall be paid to the Trustee in one or more installments, as the Employer may from time to time determine; provided, however, that such contributions may not be paid later than the time prescribed by law (including extensions thereof) for filing the Employer's income tax return for its taxable year ending with or within such Plan Year.

3.13 **Return of Contributions for Mistake, Disqualification or Disallowance of Deduction.** Subject to the limitations of section 415 of the Code, the assets of the Trust shall not revert to any Employer or be used for any purpose other than the exclusive benefit of Participants, former Participants and their Beneficiaries and the reasonable expenses of administering the Plan except:

(a) any Employer Contribution made because of a mistake of fact may be repaid to the Employer within one year after the payment of the Contribution; and

(b) all Employer Contributions are conditioned upon their deductibility under section 404 of the Code; therefore, to the extent the deduction is disallowed, the Contributions may be repaid to the Employer within one year after the disallowance.

The Employer has the exclusive right to determine if a Contribution or any part of it is to be repaid or is to remain as a part of the Trust except that the amount to be repaid is limited, if the Contribution is made by mistake of fact or if the deduction for the Contribution is disallowed, to the excess of the amount contributed over the amount that would have been contributed had there been no mistake or over the amount disallowed. Earnings which are attributable to any excess contribution cannot be repaid. Losses attributable to an excess contribution must reduce the amount that may be repaid. All repayments of Contributions made due to a mistake of fact or with respect to which a deduction is disallowed are limited so that the balance in a Participant's or former Participant's Account cannot be reduced to less than the balance that would have been in the Participant's or former Participant's Account had the mistaken amount or the amount disallowed never been contributed.

## Article IV

## ALLOCATION AND VALUATION OF ACCOUNTS

4.01 **Information Statements from Employer.** Upon request by the Committee, the Employer shall provide the Committee with a schedule setting forth the amount of its Salary Deferral Contribution, Supplemental Contribution, QNEC, and restoration contribution; the names of its Participants, the number of years of Active Service of each of its Participants and former Participants, the amount of Considered Compensation and Annual Compensation paid to each Participant and former Participant, and the amount of Considered Compensation and Annual Compensation paid to all its Participants and former Participants. Such schedules shall be conclusive evidence of such facts.

4.02 **Allocation of Salary Deferral Contributions**. The Committee or its designee shall allocate the Salary Deferral Contribution among the Participants by allocating to each Participant the amount by which his Considered Compensation was reduced pursuant to a salary deferral agreement (as described in Section 3.01) and shall credit each such Participant's share to his Salary Deferral Contribution Account.

4.03 **Allocation of Catch-up Salary Deferral Contribution**. The Committee shall allocate the Catch-up Salary Deferral Contribution among the Participants by allocating to each Participant the amount by which his Considered Compensation was reduced pursuant to a salary deferral agreement under Section 3.02 and shall credit each such Participant's share to his Catch-up Salary Deferral Contribution Account.

4.04 **Allocation of After-Tax Contributions**. The Committee or its designee shall allocate After-Tax Contributions made by a Participant in the amount of such After-Tax Contributions and shall credit such After-Tax Contributions to the Participant's After-Tax Contribution Account.

4.05 **Allocation of Matching Contributions.** The Committee or its designee shall separately allocate the Matching Contribution made by an Employer among the Employer's Participants in the proportion which the matched Salary Deferral Contributions, matched Catch-up Salary Deferral Contributions, and, for periods beginning before January 1, 2007, matched After-Tax Contributions of each such Participant bear to the total matched Salary Deferral Contributions, matched Catch-up Salary Deferral Contributions, and, for periods beginning before January 1, 2007, matched After-Tax Contributions of all such Participants. Each Participant's proportionate share shall be credited to his Matching Contribution Account.

4.06 **Allocation of Supplemental Contributions.** For each Plan Year, the Committee or its designee shall allocate the Supplemental Contribution made by an Employer among the Participants who are employed by the Employer during the Plan Year, based upon each such Participant's Considered Compensation paid by the Employer as compared to the Considered Compensation for all such Participants employed by the Employer and eligible for the allocation.

4.07 **Allocation of QNECs.** The Committee or its designee shall separately allocate the QNEC among the Non-Highly Compensated Employees who are Participants based upon each such Participant's Considered Compensation as compared to the Considered Compensation of all such Participants.

4.08 **Allocation of Forfeitures**. At the time a forfeiture occurs pursuant to Article IX, Section A.3.3 of Appendix A, the amount forfeited will first be used to reinstate any Account required to be reinstated under Article IX, and any remaining amount will be applied to reduce the Employer's obligation to make future Matching Contributions or Supplemental Contributions. However, in no event will amounts forfeited pursuant to Section A.3.3 of Appendix A be allocated to the Accounts of Participants whose Matching Contributions are forfeited pursuant to Section A.3.3 of Appendix A.

4.09 **Valuation of Accounts**. A Participant's or former Participant's Accounts shall be valued by the Trustee at fair market value on each Valuation Date. The earnings and losses attributable to any asset in the Trust will be allocated solely to the Account of the Participant or former Participant on whose behalf the investment in the asset was made. In determining the fair market value of the Participant's or former Participant's Accounts, the Trustee shall utilize such sources of information as it may deem reliable including, but not limited to, stock market quotations, statistical evaluation services, newspapers of general circulation, financial publications, advice from investment counselors or brokerage firms, or any combination of sources which in the opinion of the Trustee will provide the price such assets were last traded at on a registered stock exchange; provided, however, that with respect to regulated investment company shares, the Trustee shall rely exclusively on information provided to it by the investment adviser to such funds.

4.10 **No Rights Unless Otherwise Prescribed**. No allocations, adjustments, credits, or transfers shall ever vest in any Participant or former Participant any right, title, or interest in the Trust except at the times and upon the terms and conditions set forth in the Plan.

## Article V

## BENEFITS

5.01 **Benefit Upon a Separation From Service or Retirement**. Upon his Separation From Service, a Participant or former Participant is entitled to receive his Nonforfeitable Interest in his Account balances.

5.02 **Death Benefit.** If a Participant or former Participant dies, the death benefit payable to his Beneficiary shall be the Participant's Nonforfeitable Interest in 100 percent of the remaining amount of his Account balances.

5.03 **Distribution Method.** Any distribution under the Plan shall be made in the form of a single sum in cash.

5.04 **Payment Upon or Following Separation From Service.**

(a) *Immediate Payment of Small Amount Upon Separation From Service*. Each Participant or former Participant whose Nonforfeitable Interest in his Account balance at the time of a distribution to him on account of his Separation From Service is, in the aggregate, less than or equal to $1,000.00, shall be paid in the form of an immediate single sum cash payment and/or as a Direct Rollover, as elected by him under Section 5.05. However, if a Distributee who is subject to this Section does not furnish instructions in accordance with Plan procedures to directly roll over his Plan benefit within 45 days after he has been given direct rollover procedures or forms, he will be deemed to have elected to receive an immediate lump sum cash distribution of his entire Plan benefit. If a Participant's or former Participant's Nonforfeitable Interest in his Account balance payable upon his Separation From Service is zero (because he has no Nonforfeitable Interest in his Account balance), he will be deemed to receive an immediate distribution of his entire Nonforfeitable Interest in his Account balance.

(b) *Age 65*. Each Participant or former Participant who has Separated From Service and who has not elected to receive a distribution of his entire Nonforfeitable Interest in his Account Balance, shall, upon the attainment of age 65, be paid in the form of an immediate single sum cash payment and/or as a Direct Rollover, as elected by him under Section 5.05. If a Distributee who is subject to this Section does not furnish instructions in accordance with Plan procedures to directly roll over his Plan benefit within 45 days after he has been given direct rollover procedures or forms, he will be deemed to have elected to receive an immediate lump sum cash distribution of his entire Nonforfeitable Interest in his Account Balance.

5.05 **Direct Rollover Option**. To the extent required under Regulations, a Distributee has the right to direct that any portion of his Eligible Rollover Distribution will be directly paid to an Eligible Retirement Plan specified by him that will accept the Eligible Rollover Distribution.

5.06 **Required Distributions**. Notwithstanding any other provision of the Plan, any benefit payable under the Plan shall be distributed, or commence to be distributed, in compliance with the following provisions:

(a) ***Required Distributions for Certain Persons Who are 70½ or Older***. Unless a Participant's or former Participant's entire Nonforfeitable Interest in his Plan benefit is distributed to him in a single sum no later than his Required Beginning Date, the Participant's or former Participant's Nonforfeitable Interest in his Plan benefit must begin to be distributed, not later than his Required Beginning Date, over the life of the Participant or former Participant, or the joint lives of the Participant or former Participant and his Section 401(a)(9) Beneficiary, or over a period not extending beyond the life expectancy of the Participant or former Participant or the joint and last survivor expectancy of the Participant or former Participant and his Section 401(a)(9) Beneficiary. The distribution required to be made on or before the Participant's or former Participant's Required Beginning Date shall be the distribution required for his first Distribution Calendar Year. The minimum required distribution for other Distribution Calendar Years, including the required minimum distribution for the Distribution Calendar Year in which the Participant's or former Participant's Required Beginning Date occurs must be made on or before December 31 of that Distribution Calendar Year. In the case of a benefit payable in a form other than a single sum, the amount that must be distributed for a Distribution Calendar Year is an amount equal to the amount specified in Paragraph (b) of this Section.

(b) ***Required Minimum Distributions***. If a Participant's or former Participant's Required Beginning Date is before the date on which he incurs a Separation From Service, the Participant or former Participant (if he is then alive) must be paid either the entire amount credited to his Account or annual distributions from the Plan in the amounts required under section 401(a)(9) of the Code and Regulations thereunder commencing no later than his Required Beginning Date until his entire interest under the Plan has been distributed under this Article XI. The distribution required to be made on or before the Participant's or former Participant's Required Beginning Date shall be the distribution required for his first Distribution Calendar Year. The minimum required distribution for other Distribution Calendar Years, including the required minimum distribution for the Distribution Calendar Year in which the Participant's or former Participant's Required Beginning Date occurs must be made on or before December 31 of that Distribution Calendar Year. The amount that must be distributed for a Distribution Calendar Year is an amount equal to (1) the Participant's or former Participant's Account balance as of the last Valuation Date in the calendar year immediately preceding the Distribution Calendar Year, increased by any contributions or forfeitures allocated and made to the Account during such immediately preceding calendar year after the Valuation Date, and decreased by distributions made during such immediately preceding calendar year after the Valuation Date, divided by (2) the Participant's or former Participant's Applicable Distribution Period.

(c) ***Distribution Deadline for Death Benefit When Participant or Former Participant Dies Before His Distributions Begin***. If a Participant or former Participant dies before the date distribution of his Nonforfeitable Interest in his Plan benefit begins, his entire Nonforfeitable Interest in his Plan benefit will be distributed, or begin to be distributed, to his Section 401(a)(9) Beneficiary no later than as follows:

(1) If the Participant's or former Participant's surviving Spouse is the Participant's or former Participant's sole Section 401(a)(9) Beneficiary, then distributions to the surviving Spouse will begin by December 31 of the calendar year immediately following the calendar year in which the Participant or former Participant died, or by December 31 of the calendar year in which the Participant or former Participant would have attained age 70 1/2, if later.

(2) If the Participant's or former Participant's surviving Spouse is not the Participant's or former Participant's sole Section 401(a)(9) Beneficiary and the payment of Plan death benefits to the Section 401(a)(9) Beneficiary will not be in the form of a single sum, then distributions to the Section 401(a)(9) Beneficiary will begin by December 31 of the calendar year immediately following the calendar year in which the Participant or former Participant died.

(3) If the Participant's or former Participant's surviving Spouse is the Participant's or former Participant's sole Section 401(a)(9) Beneficiary, and the payment of a Plan death benefit to the Section 401(a)(9) Beneficiary will be in the form of a single sum, then the Participant's or former Participant's entire Nonforfeitable Interest in his Plan benefit will be distributed by December 31 of the calendar year containing the fifth anniversary of the Participant's or former Participant's death.

(4) If there is no Section 401(a)(9) Beneficiary as of September 30 of the calendar year following the calendar year of the Participant's or former Participant's death, then the Participant's or former Participant's entire Nonforfeitable Interest in his Plan benefit will be distributed by December 31 of the calendar year containing the fifth anniversary of the Participant's or former Participant's death.

(5) If the Participant's or former Participant's surviving Spouse is the Participant's or former Participant's sole Section 401(a)(9) Beneficiary and the surviving Spouse dies after the Participant or former Participant but before distributions to the surviving Spouse begin, this Section 5.06(c), other than Section 5.06(c)(1), will apply as if the surviving Spouse were the Participant.

Unless the Participant's or former Participant's interest is distributed in a single sum on or before the Required Beginning Date, as of the first Distribution Calendar Year distributions will be made in accordance with Paragraph (b) of this Section.

(d) ***Distribution of Death Benefit When Participant or Former Participant Dies On or After His Required Beginning Date***. If a Participant or former Participant dies on or after his Required Beginning Date, his Plan benefit must be distributed to his Section 401(a)(9) Beneficiary at least as rapidly as the method of payment of minimum required distributions being used as of the date of his death.

(e) ***Limitations on Death Benefits***. Benefits payable under the Plan shall not be provided in any form that would cause a Participant's or former Participant's death benefit to be more than incidental. Any distribution required to satisfy the incidental benefit requirement shall be considered a required distribution for purposes of section 401(a)(9) of the Code.

(f) ***Compliance with Section 401(a)(9)***. All distributions under the Plan will be made in accordance with the requirements of section 401(a)(9) of the Code and all Regulations promulgated thereunder, including, effective January 1, 2001, until January 1, 2003, Regulations that were proposed in January of 2001 but not including Regulations that were proposed prior to January of 2001; and including, effective January 1, 2003, the Final Section 401(a)(9) Regulations, including sections 1.401(a)(9)-1 through 1.401(a)(9)-9 of the Final Section 401(a)(9) Regulations. The provisions of the Plan reflecting section 401(a)(9) of the Code override any distribution options in the Plan inconsistent with section 401(a)(9) of the Code.

(g) ***Compliance with Section 401(a)(14)***. Unless the Participant or former Participant otherwise elects, the payment of benefits under the Plan to the Participant or former Participant will begin not later than the 60th day after the close of the Plan Year in which occurs the latest of (a) the date on which the Participant or former Participant attains the later of age 62 or Retirement Age, (b) the tenth anniversary of the year in which the Participant or former Participant commenced participation in the Plan, or (c) the Participant' or former Participant's Separation From Service.

5.07 **Consent to Distribution.** Notwithstanding any other provision of the Plan, no benefit shall be distributed or commence to be distributed to a Participant or former Participant prior to his attainment of age 65 without his consent, unless the benefit is payable immediately under Section 5.04. Any such consent shall be valid only if given not more than 90 days prior to the Participant's or former Participant's Benefit Commencement Date and after his receipt of the notice regarding benefits described in Section 5.08(a).

5.08 **Information Provided to Participants.** Information regarding the form of benefits available under the Plan shall be provided to Participants or former Participants in accordance with the following provisions:

(a) *General Information*. The Sponsor shall provide each Participant or former Participant with a written general explanation of the Participant's or former Participant's right, if any, to defer receipt of the distribution.

(b) *Time for Giving Notice*. The written general explanation or description regarding any optional forms of benefit available under the Plan shall be provided to a Participant or former Participant no less than 30 days and no more than 90 days before his Benefit Commencement Date unless he legally waives this requirement.

(c) *Exception for Participants with Small Benefit Amounts.* Notwithstanding the preceding provisions of the Section, no information regarding any optional forms of benefit otherwise available under the Plan shall be provided to the Participant or former Participant if his benefit is payable in a single sum under Section 5.04.

5.09 **Designation of Beneficiary**. Each Participant and former Participant has the right to designate and to revoke the designation of his Beneficiary or Beneficiaries. Each designation or revocation must be evidenced in the form required by the Committee, signed by the Participant or former Participant and filed with the Committee or its designee. If no designation is on file at the time of a Participant's or former Participant's death or if the Committee determines that the designation is ineffective, the designated Beneficiary shall be the Participant's or former Participant's Spouse, if living, or if not, the executor, administrator or other personal representative of the Participant's or former Participant's estate. If a Participant or former Participant is considered to be married under local law, his designation of any Beneficiary, other than his Spouse, shall not be valid unless the Spouse acknowledges in writing or such form as required by the Committee that the Spouse understands the effect of the Participant's or former Participant's beneficiary designation and consents to it. The consent must be to a specific Beneficiary. The acknowledgement and consent must be filed with the Committee or its designee, signed by the Spouse and at least two witnesses, one of whom must be a member of the Committee or a notary public. However, if the Spouse cannot be located or there exist other circumstances as described in sections 401(a)(11) and 417(a)(2) of the Code, the requirement of the Participant's or former Participant's Spouse's acknowledgement and consent may be waived. If a Beneficiary other than the Participant's or former Participant's Spouse is named, the designation shall become invalid if the Participant or former Participant is later determined to be married under local law, the Participant's or former Participant's missing Spouse is located or the circumstances which resulted in the waiver of the requirement of obtaining the consent of his Spouse no longer exist.

5.10 **Distributions to Minors and Incapacitated Persons**. If the Committee determines that any person to whom a payment is due is a minor or is unable to care for his affairs because of physical or mental disability, it shall have the authority to cause the payments to be made to the Spouse, brother, sister or other person the Committee determines to have incurred, or to be expected to incur, expenses for that person unless a prior claim is made by a qualified guardian or other legal representative. The Committee and the Trustee shall not be responsible to oversee the application of those payments. Payments made pursuant to this power shall be a complete discharge of all liability under the Plan and the Trust and the obligations of the Employer, the Trustee, the Trust and the Committee.

5.11 **Distributions Pursuant to Qualified Domestic Relations Orders.** The Committee will instruct the Trustee to pay benefits in accordance with the terms of any order that has been determined, in accordance with Plan procedures, to be a Qualified Domestic Relations Order. A Qualified Domestic Relations Order may require the payment of an immediate cash lump sum to an alternate payee even if the Participant or former Participant is not then entitled to receive an immediate payment of Plan benefits.

5.12 **Claims Review Procedures; Claims Appeal Procedures.**

(a) *Claims Review Procedures.* When a benefit is due, the Claimant should submit a claim in accordance with procedures prescribed by the Committee. Under normal circumstances, the Committee or its designee will make a final decision as to a claim within 90 days after receipt of the claim. If the Claimant is notified in writing during the initial 90-day period, the period may be extended up to 180 days after the initial receipt of the claim. The written notice must indicate the circumstances necessitating the extension and the anticipated date for the final decision. If a claim is denied during the claims period, the Claimant must be notified in writing, and the written notice must set forth in a manner calculated to be understood by the Claimant:

(i) the specific reason or reasons for denial;

(ii) specific reference to the Plan provisions on which the denial is based;

(iii) a description of any additional material or information necessary for the Claimant to perfect the claim and an explanation of why such material or information is necessary; and

(iv) an explanation of the Plan claims review procedures and time limits, including a statement of the Claimant's right to bring a civil action under section 502(a) of ERISA.

If a decision is not given to the Claimant within the claims review period, the claim is treated as if it were denied on the last day of the claims review period.

(b) *Claims Appeals Procedures.* If a Claimant's claim made pursuant to Section 5.12(a) is denied and he wants a review, he must apply to the Committee or its designee in writing. That application can include any arguments, written comments, documents, records, and other information relating to the claim for benefits. In addition, the Claimant is entitled to receive on request and free of charge reasonable access to and copies of all information relevant to the claim. For this purpose, "relevant" means information that was relied on in making the benefit determination or that was submitted, considered or generated in the course of making the determination, without regard to whether it was relied on, and information that demonstrates compliance with the Plan's administrative procedures and safeguards for assuring and verifying that Plan provisions are applied consistently in making benefit determinations. The review must take into account all comments, documents, records, and other information submitted by the Claimant relating to the claim, without regard to whether the information was submitted or considered in the initial benefit determination. The Claimant may either represent himself or appoint a representative, either of whom has the right to inspect all documents pertaining to the claim and its denial. The Committee or its designee can schedule any meeting with the Claimant or his representative that it finds necessary or appropriate to complete its review.

(c) This Section does not apply in connection with determinations as to whether a Participant or former Participant has incurred a Disability. Rather, such determinations shall be subject to the procedures specified in Section 5.13.

5.13 **Disability Benefit Claims Procedure.**

(a) **Disability Benefit Initial Determination Procedure**. In the case of a claim for Disability benefits, the Claimant should submit a claim to the office designated by the Committee to receive claims. Under normal circumstances, the Claimant shall be notified of any Disability claims denial (wholly or partially) within 45 days after receipt of the claim.

The initial 45-day Disability claims determination period may be extended by a period not to exceed an additional 30 days, if it is determined that such extension is necessary due to matters beyond the control of the Committee or its designee. If the initial Disability claims determination period is extended, the Claimant shall, prior to the expiration of the initial 45 day Disability claims determination period, be notified in writing of the extension and of the circumstances requiring the extension of the Disability claims determination period.

If, prior to the end of the first 30-day extension, it is determined that, due to matters beyond the control of the Plan, a decision cannot be rendered within the extension period, the Disability claims determination period may be extended for an additional 30 days, provided that, prior to the expiration of the first 30-day extension period, the Claimant is notified in writing of the circumstances requiring the extension and the date on which the Plan expects to render a decision. In the case of any notice extending the Disability claims determination period, the notice must be in writing and shall specifically explain the standards on which the entitlement to a benefit is based; the unresolved issues that prevent a determination on a claim; additional information that is needed to resolve those issues; and, if additional information is required from the Claimant, a statement as to the amount of time the Claimant has to supply that information.

*Calculation of Time Periods*. The period of time within which a Disability benefit determination is required to be made shall begin on that date the claim is filed in accordance with this Section, without regard to whether all the information necessary to make the Disability benefits determination accompanies the filing. In the event the Disability claims determination period is extended due to the Claimant's failure to submit information necessary to such determination, the Disability claims determination period shall be tolled from the date on which the notification of the extension is sent to the Claimant until the date on which the Claimant responds to the request for additional information. The Claimant shall be afforded at least 45 days from receipt of the notice of extension to provide the specified information. If the Claimant fails to supply the specified information within the 45-day period, the claim determination process shall continue and the specified information shall be deemed not to exist.

(b) **Disability Claims Appeal Procedure**. If a Claimant's claim for a Disability benefit is denied (in whole or in part), he is entitled to a full and fair review of that denial. A full and fair review of a Disability benefit claim denial shall provide the Claimant with 180 days from the receipt of any adverse claim determination to appeal the denial. If the Claimant does not file an appeal within 180 days of the adverse claim determination, such denial becomes final.

Under the full and fair review, the Claimant shall be afforded an opportunity to submit written comments, documents, records, and other information relating to the claim for benefits to the reviewing fiduciary. The Claimant shall be entitled to receive upon request and free of charge reasonable access to and copies of all information relevant to the claim. For purposes of a Disability benefit claim denial, the term "relevant" shall mean information that was relied on in making the benefit determination or that was submitted, considered or generated in the course of making the determination, without regard to whether it was relied on, and information that demonstrates compliance with the Plan's administrative procedures and safeguards for assuring and verifying that Plan provisions are applied consistently in making benefit determinations. For this purpose, the term "relevant" shall also include a statement of policy or guidance with respect to the Plan concerning the Disability benefit for the diagnoses of the Claimant, without regard to whether such advice or statement was relied upon in making the claims determination. The review of a benefit claim denial shall not afford any deference to the initial adverse claim determination.

The review of the Disability claims denial shall be conducted by the appropriate named fiduciary who is *neither* the named fiduciary who made the initial adverse claim determination *nor* subordinate to such individual.

In reviewing a denial of a claim for a Disability benefit, in which the denial was based in whole or in part on medical judgement, the appropriate named fiduciary shall consult with a health care professional who has appropriate training and experience in the field of medicine involved in the medical judgement. The health care professional consulted upon review of an adverse benefit claim denial shall be *neither* the health care professional that was consulted in connection with the adverse benefit determination that is the subject of the appeal *nor* a subordinate of any such individual. The reviewing fiduciary shall provide the identification of the medical or vocational experts whose advice was obtained on behalf of the Plan in connection with Claimant's Disability benefit claim denial, without regard as to whether the advice was relied upon in making the benefit determination.

The appropriate reviewing fiduciary must take into account all comments, documents, records, and other information submitted by the Claimant relating to the claim, without regard as to whether the information was submitted or considered in the initial benefit determination. The Claimant may either represent himself or appoint a representative, either of whom has the right to inspect all documents pertaining to the claim and its denial. The reviewing fiduciary can schedule any meeting with the Claimant or his representative that it finds necessary or appropriate to complete its review.

If a timely request is made, the reviewing fiduciary shall notify the Claimant of the determination upon appeal within 45 days after receipt of the request for review (without regard to whether all the information necessary to make the benefit determination accompanies the filing). The reviewing fiduciary retains the authority to unilaterally extend the initial 45-day review period by a period not to exceed an additional 45 days, if the fiduciary determines that special circumstances exist requiring additional time for reviewing the claim. If the initial review period is extended by the unilateral action of the appropriate reviewing fiduciary, the fiduciary shall, prior to the expiration of the initial 45 day review period, notify the Claimant in writing of the extension. The written notice of extension shall identify the special circumstances necessitating the extension and provide the anticipated date by which the Plan expects to render the determination on review.

*Calculation of Time Periods Upon Appeal*. The period of time within which a determination on a Disability claims appeal is required to be made shall begin on that date the appeal is filed in accordance with this Section, without regard to whether all the information necessary to make the Disability benefits determination accompanies the filing. In the event the Disability claims review period is extended due to the Claimant's failure to submit information necessary to such determination, the Disability claims review period shall be tolled from the date on which the notification of the extension is sent to the Claimant until the date on which the Claimant responds to the request for additional information. The Claimant shall be afforded at least 45 days from receipt of the notice of extension to provide the requested information. If the Claimant fails to supply the requested information within the 45-day period, the claims review process shall continue and the specified information shall be deemed not to exist.

The reviewing fiduciary shall provide the Claimant with a written notice of the Plan's benefit determination upon review. The notice shall set forth the specific reasons for its action, the Plan provisions on which its decision is based, and a statement that the Claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the Claimant's claim for benefits, and a statement of the Claimant's right to bring an action under section 502(a) of ERISA. The notice shall also include the following statement,

> "*You and the Plan may have other voluntary alternative dispute resolution options, such as mediation. One way to find out what may be available is to contact your local U.S. Department of Labor Office and your State insurance regulatory agency.*"

If a decision is not given to the Claimant within the review period, the claim is treated as if it were denied on the last day of the review period.

The request for review must be filed within 90 days after the denial. If it is not, the denial becomes final. If a timely request is made, the reviewing fiduciary must make its decision, under normal circumstances, within 60 days of the receipt of the request for review. However, if the reviewing fiduciary notifies the Claimant prior to the expiration of the initial review period, it may extend the period of review up to 120 days following the initial receipt of the request for a review. The written notice must indicate the circumstances necessitating the extension and the anticipated date for the final decision. All decisions of the reviewing fiduciary must be in writing and must include the specific reasons for its action, the Plan provisions on which its decision is based, and a statement that the Claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the Claimant's claim for benefits, and a statement of the Claimant's right to bring an action under section 502(a) of ERISA. If a decision is not given to the Claimant within the review period, the claim is treated as if it were denied on the last day of the review period.

## Article VI

## LOANS

Except as specified below, the Committee may direct the Trustees to make loans to Participants (and Beneficiaries who are "parties in interest" within the meaning of ERISA) who have Nonforfeitable Interests in their Account balances. The Committee will be responsible for administering the Plan loan program. All loans will comply with the following requirements:

(a) All loans will be made solely from the Participant's or Beneficiary's Account.

(b) Loans will be available on a nondiscriminatory basis to all Beneficiaries who are "parties in interest" within the meaning of ERISA, and to all Participants.

(c) Loans will not be made for less than $1,000.00. A Participant may not have more than one loan (either a general purpose loan or residential loan) outstanding at any given time.

(d) The maximum amount of a loan may not exceed the lesser of (A) $50,000.00 reduced by the person's highest outstanding loan balance from the Plan during the preceding one-year period, or (B) one-half of the person's Nonforfeitable Interest in his Account balance under the Plan determined as of the date on which the loan is approved by the Committee.

(e) Any loan from the Plan will be evidenced in such form (signed by the person applying for the loan in accordance with procedures established by the Committee), having such maturity, bearing such rate of interest, and containing such other terms as the Committee will require by uniform and nondiscriminatory rules consistent with this Article and proper lending practices.

(f) All loans will bear a reasonable rate of interest which will be established by the Committee. In determining the proper rate of interest to be charged, at the time any loan is made or renewed, the Committee will contact at least two of the largest banks in the geographic location in which the Participant or Beneficiary resides to determine what interest rate the banks would charge for a similar loan taking into account the collateral offered.

(g) Each loan will be fully secured by a pledge of the borrowing person's Nonforfeitable Interest in his Account balance. No more than 50 percent of the person's Nonforfeitable Interest in his Account balance (determined immediately after the origination of the loan) will be considered as security for any loan.

(h) The term of the loan will not be less than 18 months. Generally, the term of the loan will not be more than five years. The Committee may agree to a longer term (but not more than seven years) only if such term is otherwise reasonable and the proceeds of the loan are to be used to acquire a dwelling which will be used within a reasonable time (determined at the time the loan is made) as the principal residence of the borrowing person.

(i) The terms of each Plan loan agreement will require substantially level amortization of the loan (with payments not less frequently than quarterly) over the term of the loan. However, the level amortization requirement will not apply for a period, not longer than one year (or such longer period as may apply under the Uniformed Services Employment and Reemployment Rights Act of 1994) that an eligible borrower is on a bona fide leave of absence, either without pay from the District or at a rate of pay (after income and employment tax withholding) that is less than the amount of the installment payments required under the terms of the loan. However, the loan (including interest that accrues during the leave of absence) must be repaid by the five-year loan maturity deadline specified in paragraph (h) above (unless the loan was a home loan described in paragraph (h) above), and the amount of the installments due after the leave ends (or, if earlier, after the first anniversary of the leave or such longer period as may apply under the Uniformed Services Employment and Reemployment Rights Act of 1994) must not be less than the amount required under the terms of the original loan.

(j) Except with respect to a former Employee as provided in subsection (l) herein, a Participant's loan agreement will require that loan repayments be made through payroll deductions.

(k) If a person fails to make a required payment within 30 days of the due date set forth in the loan agreement, the loan will be in default.

(l) If a Participant or former Participant has an outstanding loan from the Plan at the time of his Separation From Service, the Participant or former Participant will have the right to elect to continue to repay the loan in accordance with its terms; provided that if such an election is made such election shall be irrevocable and the Participant shall not be eligible to receive a distribution from the Plan until he has fully repaid the loan. A former Participant with an outstanding loan balance may continue to repay the loan in accordance with procedures as determined by the Committee. If the Participant or former Participant does not elect to continue to repay the loan in accordance with its terms, the outstanding loan principal balance and any accrued but unpaid interest will become immediately due in full. The Participant or former Participant will have the right to immediately pay the Trustee that amount. If the Participant or former Participant fails to repay the loan, the Trustee will foreclose on the loan and the Participant will be deemed to have received a Plan distribution of the amount foreclosed upon. The Trustee will not foreclose upon a Participant's or former Participant's Salary Deferral Contribution Account or Catch-up Salary Deferral Contributions Account until the Participant's Separation From Service.

(m) If a Beneficiary defaults on his loan, the Trustee will foreclose on the loan and the Beneficiary will be deemed to have received a Plan distribution of the amount foreclosed upon.

(n) No amount that is pledged as collateral for a Plan loan to a Participant will be available for withdrawal before he has fully repaid his loan.

(o) All interest payments made pursuant to the terms of the loan agreement will be credited to the borrowing person's Account and will not be considered as general earnings of the Trust Fund to be allocated to other Participants.

Notwithstanding the foregoing, if (a) a Participant was a participant in the Cargill Partnership Plan on December 31, 2003, and had a loan outstanding under the Cargill Partnership Plan on December 31, 2003, and (b) the loan note and all other rights with respect to such loan held by or for the Cargill Partnership Plan are rolled over to the Plan, then such loan shall be continued under the Plan, and shall be administered under the terms and provisions applicable to the loan under the loan agreement and the Cargill Partnership Plan documents applicable to such loan in effect as of December 31, 2003.

Notwithstanding clause (c) above, a Participant who was a participant in the TruSeal Plan on December 31, 2006, and who had two loans outstanding under the TruSeal Plan on such date, shall be permitted to maintain the two loans under this Plan under the terms and provisions applicable to the loan under the loan agreement and the TruSeal Plan documents applicable to such loan in effect as of December 31, 2006; *provided*, *however*, that such a Participant shall not be permitted to apply for a new loan under the Plan until the Participant has fully repaid both of the loans.

## Article VII

## IN-SERVICE DISTRIBUTIONS

7.01 **In-Service Financial Hardship Distributions.**

(a) *General*. Prior to his Separation From Service, a Participant is entitled to receive a distribution from his Salary Deferral Contribution Account (except for income that was not credited to his Salary Deferral Account as of December 31, 1988), his Catch-up Salary Deferral Contribution Account (except for income credited to his Catch-up Salary Deferral Contribution Account), his Rollover Account, his After-Tax Contribution Account, his Nonforfeitable Interest in his Matching Contribution Account and his Nonforfeitable Interest in his Supplemental Contribution Account in the event of an immediate and heavy financial need incurred by the Participant and the Committee's determination that the withdrawal is necessary to alleviate that hardship.

(b) *Permitted Reasons For Financial Hardship Distributions*. A distribution shall be made on account of financial hardship only if the distribution is for:

(i) expenses for (or necessary to obtain) medical care that would be deductible under section 213(d) of the Code (determined without regard to whether the expenses exceed 7.5% of adjusted gross income)

(ii) costs directly related to the purchase of a principal residence for the Participant (excluding mortgage payments),

(iii) payment of tuition, related educational fees, and room and board expenses, for up to the next 12 months of post-secondary education for the Participant, his Spouse, children or dependents (as defined in section 152 of the Code, without regard to section 152(b)(1), (b)(2) and (d)(1)(B) of the Code);

(iv) payments necessary to prevent the eviction of the Participant from his principal residence or foreclosure on the mortgage on that residence,

(v) payments for burial or funeral expenses for the Participant's deceased parent, Spouse, children or dependents (as defined in section 152 of the Code, without regard to section 152(d)(1)(B) of the Code);

(vi) expenses for the repair of damage to the Participant's principal residence that would qualify for the casualty deduction under section 165 of the Code (determined without regard to whether the loss exceeds 10% of adjusted gross income).; or

(vii) any other event added to this list by the Commissioner of Internal Revenue.

(c) *Amount*. A distribution to satisfy an immediate and heavy financial need shall not be made in excess of the amount of the immediate and heavy financial need of the Participant and the Participant must have obtained all distributions, other than hardship distributions, and all nontaxable (at the time of the loan) loans currently available under all plans maintained by the Employer. The amount of a Participant's immediate and heavy financial need includes any amounts necessary to pay any federal, state or local income taxes or penalties reasonably anticipated to result from the financial hardship distribution.

(d) *Suspension of Participation in Certain Benefit Programs*. The Participant's hardship distribution shall terminate his right to have the Employer make any Salary Deferral Contributions on his behalf until the next time Salary Deferral Contributions are permitted after (1) the lapse of 12 months following the hardship distribution, and (2) his timely filing of a written request to resume his Salary Deferral Contributions. In addition, for 12 months after he receives a hardship distribution from the Plan, the Participant is prohibited from making elective contributions and employee contributions to or under all other qualified and nonqualified plans of deferred compensation maintained by the Employer, including stock option plans, stock purchase plans and Code section 401(k) cash or deferred arrangements that are part of cafeteria plans described in section 125 of the Code. However, the Participant is not prohibited from making contributions to a health or welfare benefit plan, including one that is part of a cafeteria plan within the meaning of section 125 of the Code.

(e) *Order of Distributions*. Financial hardship distributions will be made in the following order: First withdrawals will be made from the Participant's After-Tax Contribution Account, then from his Rollover Contribution Account, then from his Matching Contribution Account, then from his Supplemental Contribution Account, then from his Salary Deferral Contribution Account, and finally, from his Catch-up Salary Deferral Contribution Account. A Participant shall not be entitled to receive a financial hardship distribution of any amount credited to his QNEC Account.

7.02 **In-Service Distribution of After-Tax Contributions and Matching Contributions.**

(a) After-Tax Contributions. Each Participant shall be entitled to withdraw a portion or all of his After-Tax Contribution Account.

(b) Certain Matching Contributions. A Participant shall be entitled to withdraw a portion or all of his Nonforfeitable Interest in his Matching Contribution Account if the Participant has been a Participant in the Plan for five or more years or the amounts withdrawn from the Matching Contribution Account have been credited to his Account for a minimum of two years.

(c) Amount and Number of In-Service Distributions. The minimum amount of the distribution permitted under this Section 7.02 shall be the lesser of $1,000.00 or the total amount which could otherwise be distributed under this Section 7.02. Also, a Participant may not make another distribution request under this Section 7.02 for a period of 12 months after receiving a distribution pursuant to this Section 7.02.

7.03 **In-Service Distributions for Participants Who Have Attained Age 59½.** Prior to his Separation From Service, a Participant who is at least age 59½ is entitled to withdraw all or any portion of any vested amounts credited to his Accounts, including, but not limited to, his Salary Deferral Contribution Account, his Catch-up Salary Deferral Contribution Account, the Nonforfeitable Interest in his Matching Contribution Account and the Nonforfeitable Interest in his Supplement Contribution Account (excluding, however, any amounts in his QNEC Account).

7.04 **Method of Payment.** Any distribution made pursuant to this Article VI will be paid in the form of a single sum in cash.

## Article VIII

## VESTING

A Participant or former Participant has a fully Nonforfeitable Interest in his entire Account balance when he (a) incurs a Disability on or prior to the date of his Separation From Service, (b) attains his Retirement Age on or prior to the date of his Separation From Service, or (c) incurs a Separation From Service due to death. A Participant or former Participant shall at all times have a fully Nonforfeitable Interest in amounts credited to his Salary Deferral Contribution Account, his Catch-up Salary Deferral Contribution Account, his QNEC Account, his Rollover Account and his After-Tax Contribution Account. A Participant or former Participant shall have a Nonforfeitable Interest in the following percentage of amounts credited to his Matching Contribution Account and his Supplemental Contribution Account:

| Years of Active Service Completed by the Participant or Former Participant | Vested Percentage |
|---|---|
| Less than one | 0 |
| One but less than two | 20 |
| Two but less than three | 40 |
| Three but less than four | 60 |
| Four but less than five | 80 |
| Five or more | 100 |

Subject to the possible application of Section B.2.3 of Appendix B or Section 13.05, except as specified above, a Participant or former Participant has no Forfeitable Interest in his Account balance and shall not be entitled to any benefits under the Plan upon or following his Separation From Service.

*Special Rule for Participants who were Participants in the TruSeal Plan*. With respect to amounts credited to his Matching Contribution Account under the TruSeal Plan on or before December 31, 2006, a Participant or former Participant who was a participant in the TruSeal Plan shall have a Nonforfeitable Interest in 100% of such amounts upon completing three (3) years of vesting service.

## Article IX

## FORFEITURES AND RESTORATIONS

9.01 **Forfeiture on Termination of Participation.**

(a) If as a result of his Separation From Service a Participant or former Participant receives (or is deemed to receive under Section 5.04), a distribution of his entire Nonforfeitable Interest in his Account balance not later than the end of the second Plan Year following the Plan Year in which his Separation From Service occurs, the remaining Forfeitable Interest in his Account balance will be immediately forfeited upon the distribution.

(b) If a Participant or former Participant neither receives nor is deemed to receive a distribution as a result of his Separation From Service, his Forfeitable Interest in his Account balance will be permanently forfeited (with no right of reinstatement under Section 9.02) on the *later* of the date of his Separation From Service or the date on which he has incurred a Period of Severance of five consecutive years.

9.02 **Restoration of Forfeited Amounts**. If a Participant or former Participant who forfeited any portion of his Account balance pursuant to the provisions of Section 9.01 subsequently performs an Hour of Service, then the following provisions shall apply:

(a) *Repayment Requirement.* The Participant's Account balance (unadjusted for gains or losses subsequent to the forfeiture) shall be restored if he repays to the Trustee the full amount of any distribution with respect to which the forfeiture arose prior to the *earlier* of (1) the date on which he incurs a Period of Severance of five years commencing after his distribution, or (2) the fifth anniversary of the first date on which the Participant subsequently performs his first Hour of Service after his Separation From Service. A Participant who is deemed to have received a distribution under Section 5.04 (because he had no Nonforfeitable Interest in his Account balance) will be deemed to have repaid his Account balance upon his reemployment if he is reemployed before the earlier of the dates specified in clauses (1) and (2) in the preceding sentence.

(b) *Amount Restored.* The amount to be restored under the preceding provisions of this Section 9.02 shall be the dollar value of the Account balance, both the amount distributed and the amount forfeited. The Participant's Account balance shall be restored as soon as administratively practicable after the later of the date the Participant first performs an Hour of Service after his Separation From Service or the date on which any required repayment is completed.

(c) *No Other Basis for Restoration.* Except as otherwise provided above, a Participant's Account balance shall not be restored after it has been forfeited pursuant to Section 9.01.

9.03 **Forfeitures by Lost Participants or Beneficiaries.** If a person who is entitled to a distribution cannot be located during a reasonable search after the Committee has initially attempted making payment, his Account balance shall be forfeited. However, if at any time prior to the termination of the Plan and the complete distribution of the Trust assets, the missing former Participant or Beneficiary files a claim with the Committee for the forfeited Account balance, that Account balance shall be reinstated (without adjustment for trust income or losses during the period of forfeiture) effective as of the date of the receipt of the claim.

## Article X

## ACTIVE SERVICE

10.01 **General.** For purposes of determining an Employee's eligibility to participate in the Plan and his Nonforfeitable Interest in his Account balance, the Employee shall receive credit for Active Service commencing on the later of (1) April 1, 1986 or (2) the date he first performs an Hour of Service and ending on his Separation From Service Date. If an Employee Separates From Service, he shall recommence earning Active Service when he again performs an Hour of Service. If an Employee performs an Hour of Service within twelve months after his Separation From Service Date, the intervening Period of Severance shall be counted as Active Service. When determining an Employee's Active Service, all Periods of Service, whether or not completed consecutively, shall be aggregated on a per-day basis. In aggregating Active Service, thirty days shall be counted as one month and 365 days shall be counted as one year of Active Service. Except to the extent expressly provided otherwise in the Plan, an Employee shall be granted credit for all Periods of Service with Affiliated Employers (including Periods of Service performed while the Employee is not eligible to participate in the Plan because he does not satisfy the requirements of Section 2.01).

10.02 **Disregard of Certain Service.** If an Employee incurs a Separation From Service at a time when he does not have a Nonforfeitable Interest in a portion of his Matching Contribution Account balance or his Supplemental Contribution Account balance and his Period of Severance continues for a continuous period of five years or more, the Period of Service completed by the Employee before the Period of Severance shall not be taken into account as Active Service, if his Period of Severance equals or exceeds his Period of Service, whether or not consecutive, completed before the Period of Severance.

10.03 **Certain Brief Absences Counted as Active Service.** If an Employee performs an Hour of Service within 365 days after he Separates From Service, the intervening Period of Severance shall be counted as a Period of Service.

10.04 **Service Credit Required by Law.** An Employee will be granted credit for Active Service for time he is not actively performing services for an Affiliated Employer to the extent required under federal law. An Employee will be granted credit for Active Service for services performed for a predecessor employer to the extent required by section 414(a) of the Code and Regulations issued thereunder.

10.05 **Special Maternity or Paternity Absence Rules.** Except as specified below, the period of time between (a) the first anniversary of the first day of a Maternity or Paternity Absence of an Employee and (b) the second anniversary of the first day of the absence shall not be counted as a Period of Severance or as Active Service. However, if the Employee returns to active employment with an Affiliated Employer prior to the expiration of twelve months following the earlier of (1) the date of his Separation From Service or (2) the second anniversary of the first day of his Maternity or Paternity Absence, he shall be granted Active Service for the entire period of his Maternity or Paternity Absence.

10.06 **Employment Records Conclusive.** The employment records of the Employer shall be conclusive for all determinations of Active Service.

10.07 **Credit for Service With North Star Steel Company**. For purposes of determining an Employee's Active Service for eligibility to participate and vesting, his service with North Star Steel Company, a Minnesota corporation, and any predecessor will be counted as Active Service under the Plan.

10.08 **Credit for Service With Other Employers.** For purposes of determining an Employee's Active Service for eligibility to participate and vesting, his service with Alumi-Brite Corporation, an Illinois corporation, Fruehauf Trailer Corporation, a Delaware corporation, Decatur Aluminum Holdings Corp., a Delaware corporation, (and wholly-owned subsidiaries of Decatur Aluminum Holdings Corp.), Alcoa, Inc., a Pennsylvania corporation, Golden Aluminum Company, while owned by ACX Technologies, Inc. or Crown, Cork & Seal Company, Inc., and Temroc Metals, Inc., prior to its sale by the Sponsor, will be counted as Active Service under the Plan.

10.09 **Special Transitional Rules.** Any Employee of the Sponsor who was an Employee prior to January 20, 1995 and was a participant in the 401(k) Savings Plan, prior to its merger into the Plan, shall have his Active Service for all purposes calculated under the provisions of the Plan in effect before January 20, 1995, if that method of calculating his Active Service is more beneficial for him than the method otherwise set out in this Article X. In addition, any Employee of Nichols Aluminum-Alabama who was a participant in the Decatur Plan shall have his Active Service for all purposes calculated under the provisions of the Decatur Plan in effect before July 1, 1999, if that method of calculating his Active Service is more beneficial for him than the method otherwise set out in this Article X.

## Article XI

## INVESTMENT ELECTIONS

11.01 **Investment Funds Established**. It is contemplated that the assets of the Plan shall be invested in such categories of assets as may be determined from time to time by the Committee and announced and made available on an equal basis to all Participants and former Participants. In accordance with procedures established by the Committee, each Participant and former Participant may designate the percentage of his Account to be invested in each investment fund available under the Plan. Up to one hundred percent of the Trust assets may be invested in Sponsor Stock.

11.02 **Election Procedures Established**. The Committee shall, from time to time, establish rules to be applied in a nondiscriminatory manner as to all matters relating to the administration of the investment of funds including, but not limited to, the following:

(a) the percentage of a Participant's or former Participant's Account as it exists, from time to time, that may be transferred from one fund to another and the limitations based on amounts, percentages, time, or frequency, if any, on such transfers;

(b) the percentage of a Participant's future contributions, when allocated to his Account, that may be invested in any one or more funds and the limitations based upon amounts, percentages, time, or frequency, if any, on such investments in various funds;

(c) the procedures for making investment elections and changing existing investment elections;

(d) the period of notice required for making investment elections and changing existing investment elections;

(e) the handling of income and change of value in funds when funds are in the process of being transferred between investment funds and to investment funds; and

(f) all other matters necessary to permit the orderly operation of investment funds within the Plan.

When the Committee changes any previous applicable rule, it shall state the effective time of the change and the procedures for complying with any such change. Any change shall remain effective until such date as stated in the change, or if none is stated, then until revoked or changed in a like manner.

## Article XII

## ADOPTION OF PLAN BY OTHER EMPLOYERS

12.01 **Adoption Procedure.** Any business organization may, with the approval of the Board, adopt the Plan by:

(a) a certified resolution or consent of the board of directors of the adopting Employer or an executed adoption instrument (approved by the board of directors of the adopting Employer) agreeing to be bound as an Employer by all the terms, conditions and limitations of the Plan except those, if any, specifically described in the adoption instrument; and

(b) providing all information required by the Committee and the Trustee.

12.02 **No Joint Venture Implied**. The document which evidences the adoption of the Plan by an Employer shall become a part of the Plan. However, neither the adoption of the Plan and the Trust by an Employer nor any act performed by it in relation to the Plan and the Trust shall ever create a joint venture or partnership relation between it and any other Employer.

12.03 **All Trust Assets Available to Pay All Benefits**. The Accounts of Participants employed by the Employers that adopt the Plan shall be commingled for investment purposes. All assets in the Trust shall be available to pay benefits to all Participants employed by any Employer.

12.04 **Qualification a Condition Precedent to Adoption and Continued Participation**. The adoption of the Plan and the Trust by a business organization is contingent upon and subject to the express condition precedent that the initial adoption meets all statutory and regulatory requirements for qualification of the Plan and the exemption of the Trust that are applicable to it and that the Plan and Trust continue in operation to maintain their qualified and exempt status. In the event the adoption fails to initially qualify, the adoption shall fail retroactively for failure to meet the condition precedent and the portion of the Trust assets applicable to the adoption shall be immediately returned to the adopting business organization and the adoption shall be void ab initio. In the event the adoption as to a given business organization later becomes disqualified and loses its exemption for any reason, the adoption shall fail retroactively for failure to meet the condition precedent and the portion of the Trust assets allocable to the adoption by that business organization shall be immediately spun off, retroactively as of the last date for which the Plan qualified, to a separate trust for its sole benefit and an identical but separate Plan shall be created, retroactively effective as of the last date the Plan as adopted by that business organization qualified, for the benefit of the Participants covered by that adoption.

## Article XIII

## AMENDMENT AND TERMINATION

13.01 **Right to Amend and Limitations Thereon.** The Sponsor has the sole right to amend the Plan. An amendment may be made by a certified resolution or consent of the Board, or by an instrument in writing executed by the appropriate officer of the Sponsor. The amendment must describe the nature of the amendment and its effective date. No amendment shall:

(a) vest in an Employer any interest in the Trust;

(b) cause or permit the Trust assets to be diverted to any purpose other than the exclusive benefit of the present, former or future Participants and their Beneficiaries except under the circumstances described in Section 3.13;

(c) decrease the Account of any Participant or former Participant, or eliminate an optional form of payment in violation of section 411(d)(6) of the Code; or

(d) change the vesting schedule to one which would result in a Participant's or former Participant's Nonforfeitable Interest in his Account balance (determined as of the later of the date of the adoption of the amendment or of the effective date of the amendment) of any Participant or former Participant being less than his Nonforfeitable Interest computed under the Plan without regard to the amendment. If the Plan's vesting schedule is amended or if the Plan is deemed amended by an automatic change to or from a top-heavy vesting schedule, each Participant or former Participant who has at least three years of Active Service as of the date of the amendment or change shall have his nonforfeitable percentage computed under the Plan without regard to the amendment or the change if that results in a higher Nonforfeitable Interest in his Account balance.

Each Employer shall be deemed to have adopted any amendment made by the Sponsor unless the Employer notifies the Committee of its rejection in writing within 30 days after it receives a copy of the amendment. A rejection shall constitute a withdrawal from the Plan by that Employer unless the Sponsor acquiesces in the rejection.

13.02 **Mandatory Amendments**. The Contributions of each Employer to the Plan are intended to be:

(a) deductible under the applicable provisions of the Code;

(b) except as otherwise prescribed by applicable law, exempt from the Federal Social Security Act;

(c) except as otherwise prescribed by applicable law, exempt from with- holding under the Code; and

(d) excludable from any Employee's regular rate of pay, as that term is defined under the Fair Labor Standards Act of 1938, as amended.

The Sponsor shall make any amendment necessary to carry out this intention, and it may be made retroactively.

13.03 **Withdrawal of Employer.** An Employer may withdraw from the Plan and the Trust if the Sponsor does not acquiesce in its rejection of an amendment or by giving written notice of its intent to withdraw to the Committee. The Committee shall then determine the portion of the Trust assets that is attributable to the Participants employed by the withdrawing Employer and shall notify the Trustee to segregate and transfer those assets to the successor trustee when it receives a designation of the successor from the withdrawing Employer.

A withdrawal shall not terminate the Plan and the Trust with respect to the withdrawing Employer, if the Employer either appoints a successor trustee and reaffirms the Plan and the Trust as its new and separate plan and trust intended to qualify under section 401(a) of the Code, or establishes another plan and trust intended to qualify under section 401(a) of the Code.

The determination of the Committee, in its sole discretion, of the portion of the Trust assets that is attributable to the Participants employed by the withdrawing Employer shall be final and binding upon all parties; and, the Trustee's transfer of those assets to the designated successor Trustee shall relieve the Trustee of any further obligation, liability or duty to the withdrawing Employer, the Participants employed by that Employer and their Beneficiaries, and the successor trustee.

13.04 **Termination of Plan**. The Sponsor may terminate the Plan and the Trust with respect to all Employers by executing and delivering to the Committee and the Trustee, a notice of termination, specifying the date of termination.

13.05 **Partial or Complete Termination or Complete Discontinuance of Contributions**. Without regard to any other provision of the Plan, if there is a partial or total termination of the Plan (within the meaning of section 411 of the Code) or there is a complete discontinuance of the Employer's Contributions (within the meaning of section 411 of the Code), each of the affected Participants shall immediately have a fully Nonforfeitable Interest in his Account as of the end of the last Plan Year for which a substantial Employer Contribution was made and in any amounts later allocated to his Account. If the Employer then resumes making substantial Contributions at any time, the appropriate vesting schedule shall again apply to all amounts allocated to each affected Participant's Account beginning with the Plan Year for which they were resumed.

## Article XIV

## MISCELLANEOUS

14.01 **Plan Not an Employment Contract**. The maintenance of the Plan and the Trust is not a contract between any Employer and its Employees which gives any Employee the right to be retained in its employment. Likewise, it is not intended to interfere with the rights of any Employer to discharge any Employee at any time or to interfere with the Employee's right to terminate his employment at any time.

14.02 **Benefits Provided Solely From Trust**. All benefits payable under the Plan shall be paid or provided for solely from the Trust. No Employer assumes any liability or responsibility to pay any benefit provided by the Plan.

14.03 **Assignments Prohibited**. No principal or income payable or to become payable from the Trust Fund shall be subject to anticipation or assignment by a Participant, former Participant or Beneficiary to attachment by, interference with, or control of any creditor of a Participant, former Participant or Beneficiary; or to being taken or reached by any legal or equitable process in satisfaction of any debt or liability of a Participant, former Participant, or Beneficiary prior to its actual receipt by the Participant, former Participant or Beneficiary. Any attempted conveyance, transfer, assignment, mortgage, pledge, or encumbrance of any Trust assets, any part of it, or any interest in it by a Participant, former Participant or Beneficiary prior to distribution shall be void, whether that conveyance, transfer, assignment, mortgage, pledge, or encumbrance is intended to take place or become effective before or after any distribution of Trust assets or the termination of the Trust itself. The Trustee shall never under any circumstances be required to recognize any conveyance, transfer, assignment, mortgage, pledge or encumbrance by a Participant , former Participant, or Beneficiary of the Trust, any part of it, or any interest in it, or to pay any money or thing of value to any creditor or assignee of a Participant, former Participant or Beneficiary for any cause whatsoever. These prohibitions against the alienation of a Participant's Account shall not apply to a Qualified Domestic Relations Order or to a voluntary revocable assignment of benefits not in excess of ten percent of the amount of any payment from the Plan if such assignment complies with Regulations issued under section 401(a)(13) of the Code. Further, effective for judgments, orders and decrees issued, and settlement agreements entered into, on or after August 5, 1997, these prohibitions shall not apply to any offset of a Participant's or former Participant's benefits provided under a Plan against an amount that the Participant or former Participant is ordered or required to pay to the Plan if—(a) the order or requirement to pay arises—(1) under a judgment of conviction for a crime involving the Plan, (2) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with an alleged violation of part 4 of subtitle B of title I of ERISA, or (3) pursuant to a settlement agreement between the Secretary of Labor and the Participant or former Participant in connection with a violation (or alleged violation) of part 4 of subtitle B of ERISA by a fiduciary or any other person, and (b) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the Plan against the Participant's or former Participant's benefits provided under the Plan.

14.04 **Requirements Upon Merger or Consolidation of Plans**. The Plan shall not merge or consolidate with or transfer any assets or liabilities to any other plan unless each Participant and former Participants would receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the Plan had then terminated).

14.05 **Gender of Words Used**. If the context requires it, words of one gender when used in the Plan shall include the other gender, and words used in the singular or plural shall include the other.

14.06 **Severability**. Each provision of this Agreement may be severed. If any provision is determined to be invalid or unenforceable, that determination shall not affect the validity or enforceability of any other provision.

14.07 **Reemployed Veterans**. The requirements of the Uniformed Services Employment and Reemployment Rights Act of 1994 will be complied with in the operation of the Plan in the manner permitted under section 414(u) of the Code.

14.08 **Limitations on Legal Actions**. No person may bring an action pertaining to the Plan or Trust until he has exhausted his administrative claims and appeal remedies identified in Section 5.12 and 5.13. Further, no person may bring an action pertaining to a claim for benefits under the Plan or the Trust following 180 days after the Committee's final denial of his claim for benefits.

14.09 **Governing Law**. The provisions of the Plan shall be construed, administered, and governed under the laws of the United States unless the specific matter in question is governed by state law in which event the laws of the State of Texas shall apply.

14.10 **Special Provisions Applicable to Nichols Aluminum-Golden, Inc. Employees.**

(a) *Cessation of Participation*. Upon the closing of the sale by the Sponsor of the stock of Nichols Aluminum-Golden, Inc., (the "*NAG Sale*"), an individual who is employed by Nichols Aluminum-Golden, Inc. shall cease to be eligible to participate in the Plan.

(b) *Sale is Distribution Event*. An individual who continues to be employed by Nichols Aluminum-Golden, Inc. following the NAG Sale shall be deemed to have incurred a "Separation From Service" for all purposes under the Plan.

(c) *Vesting*. Notwithstanding any other provision of the Plan to the contrary, an individual who continues to be employed by Nichols Aluminum-Golden, Inc. immediately following the NAG Sale shall have a fully Nonforfeitable Interest in his Account balance upon the Sale.

(d) *Loans*. Notwithstanding any other provision of the Plan to the contrary, an individual who on the date of the NAG Sale (i) has an outstanding loan from the Plan and (ii) is deemed to incur a Separation From Service as a result of the Sale, will be allowed to repay to the Trustee the outstanding loan principal balance and any accrued but unpaid interest over the remaining term of the loan in accordance with the amortization schedule provided in his loan agreement as if he had not incurred a Separation From Service. The individual's loan repayments will not be required to be made on a payroll deduction basis; but rather may be made utilizing a loan coupon procedure established by the Committee.

**IN WITNESS WHEREOF**, Quanex Corporation has caused this Agreement to be executed this 2nd day of October, 2006, in multiple counterparts, each of which shall be deemed to be an original, to be effective the 1st day of January, 2007, except for those provisions which have an earlier effective date provided by law, or as otherwise provided under applicable provisions of the Plan.

**QUANEX CORPORATION**

By: /s/ Kevin P. Delaney
Title: Senior Vice President — General Counsel and Secretary

## Appendix A

## LIMITATIONS ON CONTRIBUTIONS AND ALLOCATIONS

### PART A.1 *Definitions*

**Definitions.** As used herein the following words and phrases have the meaning attributed to them below:

A.1.1 ***"Actual Contribution Ratio"*** shall mean the ratio of Section 401(m) Contributions actually paid into the Trust on behalf of an Employee for a Plan Year to the Employee's Annual Compensation for the same Plan Year. For this purpose, Annual Compensation for any portion of the Plan Year in which the Employee was not an eligible Employee (as defined in Section A.2.4) will not be taken into account.

A.1.2 ***"Actual Deferral Percentage"*** means, for a specified group of Employees for a Plan Year, the average of the ratios (calculated separately for each Employee in the group) of the amount of Section 401(k) Contributions actually paid into the Trust on behalf of the Employee for the Plan Year to the Employee's Annual Compensation for the Plan Year.

A.1.3 ***"Actual Deferral Ratio"*** means the ratio of Section 401(k) Contributions actually paid into the Trust on behalf of an Employee for a Plan Year to the Employee's Annual Compensation for the same Plan Year. For this purpose, Annual Compensation for any portion of the Plan Year in which the Employee was not an eligible Employee (as defined in Section A.2.3) will not be taken into account.

A.1.4 ***"Annual Additions"*** means the sum of the following amounts credited on behalf of a Participant for the Limitation Year: (a) Employer contributions excluding Catch-up Salary Deferral Contributions and including Salary Deferral Contributions, (b) Employee after-tax contributions, and (c) forfeitures. For this purpose, Employee contributions are determined without regard to any rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3) and 457(e)(16) of the Code without regard to employee contributions to a simplified employee pension which are excludable from gross income under section 408(k)(6) of the Code). Excess 401(k) Contributions for a Plan Year are treated as Annual Additions for that Plan Year even if they are corrected through distribution. Excess Deferrals that are timely distributed as set forth in Section A.3.1 will not be treated as Annual Additions.

A.1.5 ***"Contribution Percentage"*** shall mean, for a specified group of Employees for a Plan Year, the average of the ratios (calculated separately for each Employee in the group) of the amount of Section 401(m) Contributions actually paid into the Trust on behalf of the Employee for the Plan Year to the Employee's Annual Compensation for the Plan Year.

A.1.6 ***"Excess Aggregate 401(m) Contributions"*** means, with respect to any Plan Year, the excess of (a) the aggregate amount of Section 401(m) Contributions actually paid into the Trust on behalf of Highly Compensated Employees for the Plan Year over (b) the maximum amount of those contributions permitted under the limitations set out in the first sentence of Section A.2.4.

A.1.7 ***"Excess Amount"*** shall mean the excess of the Annual Additions credited to the Participant's Account for the Limitation Year over the Maximum Permissible Amount.

A.1.8 ***"Excess 401(k) Contributions"*** means, with respect to any Plan Year, the excess of (a) the aggregate amount of Section 401(k) Contributions actually paid to the Trustee on behalf of Highly Compensated Employees for the Plan Year over (b) the maximum amount of those contributions permitted under the limitations set out in the first sentence of Section A.2.3.

A.1.9 ***"Limitation Year"*** shall mean the Plan Year. All qualified plans maintained by any Affiliated Employer must use the same Limitation Year. If the Limitation Year is amended to a different 12-consecutive month period, the new Limitation Year must begin on a date within the Limitation Year in which the amendment is made.

A.1.10 ***"Maximum Permissible Amount"*** means the lesser of (1) $40,000.00 as adjusted by the Secretary of Treasury for increases in the cost of living or (2) 100 percent of the Participant's Annual Compensation for the Limitation Year. The Annual Compensation limitation referred to in clauses (2) of the immediately preceding sentences shall not apply to any contribution for medical benefits (within the meaning of section 401(h) or section 419A(f)(2) of the Code) that is otherwise treated as an Annual Addition under section 415(l)(1) or section 419A(d)(2) of the Code. If a short Limitation Year is created because of an amendment changing the Limitation Year to a different 12-consecutive month period, the Maximum Permissible Amount shall not exceed the dollar limitation in effect under section 415(c)(1)(A) of the Code multiplied by a fraction, the numerator of which is the number of months in the short Limitation Year, and the denominator of which is 12.

A.1.11 ***"Section 401(k) Contributions"*** means the sum of Salary Deferral Contributions made on behalf of the Participant during the Plan Year, and QNECs that the Employer elects to have treated as section 401(k) Contributions pursuant to section 401(k)(3)(d)(ii) of the Code.

A.1.12 ***"Section 401(m) Contributions"*** shall mean the sum of Matching Contributions and After-Tax Contributions made on behalf of the Participant during the Plan Year and other amounts that the Employer elects to have treated as Section 401(m) Contributions pursuant to section 401(m)(3)(B) of the Code.

**PART A.2** ***Limitations on Contributions***

A.2.1 **Limitations Based upon Deductibility and the Maximum Allocation Permitted to a Participant's Account**. Notwithstanding any other provision of the Plan, no Employer shall make any contribution that would be a nondeductible contribution within the meaning of section 4972 of the Code or that would cause the limitation on allocations to each Participant's Account under section 415 of the Code and Section A.4.1 to be exceeded.

A.2.2 **Dollar Limitation upon Salary Deferral Contributions**. The maximum Salary Deferral Contribution that a Participant may elect to have made on hib behalf during a calendar year may not, when added to his elective deferrals under other plans or arrangements which are both (1) described in sections 401(k), 403(b), 408(k) and 408(p)(2) of the Code and (2) maintained by the Employer or an Affiliated Employer, exceed the amount of the limitation in effect under section 402(g)(1) of the Code for the Participant's taxable year beginning in such calendar year. For purposes of applying the requirements of Section A.2.3, Excess Deferrals shall not be disregarded merely because they are Excess Deferrals or because they are distributed in accordance with this Section. However, Excess Deferrals made to the Plan on behalf of Non-Highly Compensated Employees are not to be taken into account under Section A.2.3.

A.2.3 **Limitation Based upon Actual Deferral Percentage**. The Actual Deferral Percentage for eligible Highly Compensated Employees for any Plan Year must bear a relationship to the Actual Deferral Percentage for all other eligible Employees for the preceding Plan Year which meets either of the following tests:

(a) the Actual Deferral Percentage of the eligible Highly Compensated Employees is not more than the Actual Deferral Percentage of all other eligible Employees multiplied by 1.25; or

(b) the excess of the Actual Deferral Percentage of the eligible Highly Compensated Employees over that of all other eligible Employees is not more than two percentage points, and the Actual Deferral Percentage of the eligible Highly Compensated Employees is not more than the Actual Deferral Percentage of all other eligible Employees multiplied by two.

For purposes of this test an eligible Employee is an Employee who is directly or indirectly eligible to make Salary Deferral Contributions for all or part of the Plan Year. A person who is suspended from making Salary Deferral Contributions because he has made a withdrawal is an eligible Employee. If no Salary Deferral Contributions are made for an eligible Employee, the Actual Deferral Ratio that shall be included for him in determining the Actual Deferral Percentage is zero. If the Plan and any other plan or plans which include cash or deferred arrangements are considered as one plan for purposes of section 401(a)(4) or 410(b) of the Code, the cash or deferred arrangements included in the Plan and the other plans shall be treated as one plan for purposes of this Section. If any Participant who is a Highly Compensated Employee is a participant in any other cash or deferred arrangements of the Employer, when determining the deferral percentage of such Participant, all such cash or deferred arrangements are treated as one plan for these dates.

Notwithstanding the foregoing, an individual who is not a Highly Compensated Employee and who has not satisfied the minimum age and service requirements of section 410(a)(1)(A) of the Code will not be treated as an eligible Employee for purposes of this Section A.2.3 if the Sponsor elects to apply section 410(b)(4)(3) of the Code in determining whether the Plan meets the requirements of section 401(k)(3) of the Code.

A Salary Deferral Contribution will be taken into account under the Actual Deferral Percentage test of section 401(k) of the Code and this Section for a Plan Year only if it relates to Considered Compensation that either would have been received by the Employee in the Plan Year (but for the deferral election) or is attributable to services performed by the Employee in the Plan Year and would have been received by the Employee within 2½ months after the close of the Plan Year (but for the deferral election). In addition, a Section 401(k) Contribution will be taken into account under the Actual Deferral Percentage test of section 401(k) of the Code and this Section for a Plan Year only if it is allocated to an Employee as of a date within that Plan Year. For this purpose a Section 401(k) Contribution is considered allocated as of a date within a Plan Year if the allocation is not contingent on participation or performance of services after such date and the Section 401(k) Contribution is actually paid to the Trust no later than 12 months after the Plan Year to which the Section 401(k) Contribution relates.

Failure to correct Excess 401(k) Contributions by the close of the Plan Year following the Plan Year for which they were made will cause the Plan's cash or deferred arrangement to be disqualified for the Plan Year for which the Excess 401(k) Contributions were made and for all subsequent years during which they remain in the Trust. Also, the Employer will be liable for a ten percent excise tax on the amount of Excess 401(k) Contributions unless they are corrected within 2½ months after the close of the Plan Year for which they were made.

A.2.4 **Limitation Based upon Contribution Percentage**. The Contribution Percentage for eligible Highly Compensated Employees for any Plan Year must bear a relationship to the Actual Contribution Percentage for all other eligible Employees for the preceding Plan Year which meets either of the following tests:

(a) the Contribution Percentage for all other eligible Employees multiplied by 1.25; or

(b) the lesser of the Contribution Percentage for all other eligible Employees multiplied by two, or the Contribution Percentage for all other eligible Employees plus two percentage points.

For purposes of this test an eligible Employee is an Employee who is directly or indirectly eligible to receive an allocation of Matching Contributions for all or part of the Plan Year. Except as provided below, an Employee who would be eligible to receive an allocation of Matching Contributions but for his election not to participate is an eligible Employee. An Employee who would be eligible to receive an allocation of Matching Contributions but for the limitations on his Annual Additions imposed by section 415 of the Code is an eligible Employee.

Notwithstanding the foregoing, an individual who is not a Highly Compensated Employee and who has not satisfied the minimum age and service requirements of section 410(a)(1)(A) of the Code will not be treated as an eligible Employee for purposes of this Section A.2.4 if the Sponsor elects to apply section 410(b)(4)(B) of the Code in determining whether the Plan meets the requirements of section 401(m)(2) of the Code.

If no Section 401(m) Contributions are made on behalf of an eligible Employee the Actual Contribution Ratio that shall be included for him in determining the Contribution Percentage is zero. If the Plan and any other plan or plans to which Section 401(m) Contributions are made are considered as one plan for purposes of section 401(a)(4) or 410(b) of the Code, the Plan and those plans are to be treated as one. The Actual Contribution Ratio of a Highly Compensated Employee who is eligible to participate in more than one plan of an Affiliated employer to which employee or matching contributions are made is calculated by treating all the plans in which the Employee is eligible to participate as one plan. However, plans that are not permitted to be aggregated under Regulation section 1.410(m)-1(b)(3)(ii) are not aggregated for this purpose.

A Matching Contribution will be taken into account under this Section for a Plan Year only if (1) it is allocated to the Employee's Account as of a date within the Plan Year, (2) it is paid to the Trust no later than the end of the 12-month period beginning after the close of the Plan Year, and (3) it is made on behalf of an Employee on account of his Salary Deferral Contributions for the Plan Year.

At the election of the Employer, a Participant's Salary Deferral Contributions, and QNECs made on behalf of the Participant during the Plan Year shall be treated as Section 401(m) Contributions that are Matching Contributions provided that the conditions set forth in Regulation section 1.401(m)-1(b)(5) are satisfied. Salary Deferral Contributions may not be treated as Matching Contributions for purposes of the contribution percentage test set forth in this Section unless such contributions, including those taken into account for purposes of the test set forth in this Section, satisfy the actual deferral percentage test set forth in Section A.2.3. Moreover, Salary Deferral Contributions and QNECs may not be taken into account for purposes of the test set forth in this Section to the extent that such contributions are taken into account in determining whether any other contributions satisfy the actual deferral percentage test set forth in Section A.2.3. Finally, Salary Deferral Contributions and QNECs may be taken into account for purposes of the test set forth in this Section only if they are allocated to the Employee's Account as of a date within the Plan Year being tested within the meaning of Regulation section 1.401(k)-1(b)(4).

Failure to correct Excess Aggregate 401(m) Contributions by the close of the Plan Year following the Plan Year for which they were made will cause the Plan to fail to be qualified for the Plan Year for which the Excess Aggregate 401(m) Contributions were made and for all subsequent years during which they remain in the Trust. Also, the Employer will be liable for a ten percent excise tax on the amount of Excess Aggregate 401(m) Contributions unless they are corrected within $2^1/_2$ months after the close of the Plan Year for which they were made.

**PART A.3 *Correction Procedures For Erroneous Contributions***

A.3.1 **Excess Deferral Fail Safe Provision**. As soon as practical after the close of each Plan Year, the Committee shall determine if there would be any Excess Deferrals. If there would be an Excess Deferral by a Participant, the Excess Deferral as adjusted by any earnings or losses, will be distributed to the Participant no later than April 15 following the Participant's taxable year in which the Excess Deferral was made. The income allocable to the Excess Deferrals for the taxable year of the Participant shall be determined by multiplying the income for the taxable year of the Participant allocable to Salary Deferral Contributions by a fraction. The numerator of the fraction is the amount of the Excess Deferrals made on behalf of the Participant for the taxable year. The denominator of the fraction is the Participant's total Salary Deferral Account balance as of the beginning of the taxable year plus the Participant's Salary Deferral Contributions for the taxable year.

A.3.2 **Actual Deferral Percentage Fail Safe Provision**. As soon as practicable after the close of each Plan Year, the Committee shall determine whether the Actual Deferral Percentage for the Highly Compensated Employees would exceed the limitation set forth in Section A.2.3. If the limitation would be exceeded for a Plan Year, before the close of the following Plan Year (a) the amount of Excess 401(k) Contributions for that Plan Year (and any income allocable to those contributions as calculated in the specific manner required by Section A.3.5) shall be distributed or (b) the Employer may make a QNEC which it elects to have treated as a Section 401(k) Contribution. However, a QNEC shall not be taken into account for purposes of the test set forth in section 401(k) of the Code and Section A.2.3 for such Plan Year unless it is made and allocated by the close of such Plan Year.

The amount of Excess 401(k) Contributions to be distributed shall be determined in the following manner:

First, the Plan will determine how much the Actual Deferral Ratio of the Highly Compensated Employee with the highest Actual Deferral Ratio would have to be reduced to satisfy the Actual Deferral Percentage Test or cause such Actual Deferral Ratio to equal the Actual Deferral Ratio of the Highly Compensated Employee with the next highest Actual Deferral Ratio. If a lesser reduction would enable the Plan to satisfy the Actual Deferral Percentage Test, only this lesser reduction may be made. Second, this process is repeated until the Actual Deferral Percentage Test is satisfied. The amount of Excess 401(k) Contributions is equal to the sum of these hypothetical reductions multiplied, in each case, by the Highly Compensated Employee's Annual Compensation.

Then, the total amount of Excess 401(k) Contributions shall be distributed on the basis of the respective amounts attributable to each Highly Compensated Employee. The Highly Compensated Employees subject to the actual distribution are determined using the "dollar leveling method." The Salary Deferral Contributions of the Highly Compensated Employee with the greatest dollar amount of Salary Deferral Contributions and other contributions treated as Section 401(k) Contributions for the Plan Year are reduced by the amount required to cause that Highly Compensated Employee's Salary Deferral Contributions to equal the dollar amount of the Salary Deferral Contributions and other contributions treated as Section 401(k) Contributions for the Plan Year of the Highly Compensated Employee with the next highest dollar amount. This amount is then distributed to the Highly Compensated Employee with the highest dollar amount. However, if a lesser reduction, when added to the total dollar amount already distributed under this Section A.3.2, would equal the total Excess 401(k) Contributions, the lesser reduction amount shall be distributed. This process shall be continued until the amount of the Excess 401(k) Contributions have been distributed.

QNECs will be treated as Section 401(k) Contributions only if: (a) the conditions described in Regulation section 1.401(k)-1(b)(5) are satisfied and (b) they are allocated to Participants' Accounts as of a date within that Plan Year and are actually paid to the Trust no later than the end of the 12-month period immediately following the Plan Year to which the contributions relate. If the Employer makes a QNEC that it elects to have treated as a Section 401(k) Contribution, the Contribution will be in an amount necessary to satisfy the Actual Deferral Percentage test and will be allocated first to those Non-Highly Compensated Employees who had the lowest Actual Deferral Ratio.

Any distributions of the Excess 401(k) Contributions for any Plan Year are to be made to Highly Compensated Employees on the basis of the amount of contributions by, or on behalf of, each Highly Compensated Employee. The amount of Excess 401(k) Contributions to be distributed for any Plan Year must be reduced by any excess Salary Deferral Contributions previously distributed for the taxable year ending in the same Plan Year. To the extent that Excess Section 401(k) Contributions are distributed pursuant to this Section A.3.2, the Matching Contributions made with respect to those Excess Section 401(k) Contributions shall be forfeited.

A.3.3 **Contribution Percentage Fail Safe Provision**. If the limitation set forth in Section A.2.4 would be exceeded for any Plan Year any one or more of the following corrective action shall be taken before the close of the following Plan Year as determined by the Committee in its sole discretion: (a) the amount of the Excess Aggregate 401(m) Contributions for that Plan Year (and any income allocable to those Contributions as calculated in the manner set forth in Section A.3.5) shall be forfeited or (b) the Employer may make a QNEC which it elects to have treated as a Section 401(m) Contribution. However a QNEC shall not be taken into account for purposes of the test set forth in section 401(m) of the Code and Section A.2.4 for such Plan Year unless it is made and allocated by the close of such Plan Year.

The amount of Excess Aggregate 401(m) Contributions to be distributed shall be determined in the following manner:

First, the Plan will determine how much the Actual Contribution Ratio of the Highly Compensated Employee with the highest Actual Contribution Ratio would have to be reduced to satisfy the Actual Contribution Percentage Test or cause such Actual Contribution Ratio to equal the Actual Contribution Ratio of the Highly Compensated Employee with the next highest Actual Contribution Ratio. If a lesser reduction would enable the Plan to satisfy the Actual Contribution Percentage Test, only this lesser reduction may be made. Second, this process is repeated until the Actual Contribution Test is satisfied. The amount of Excess Aggregate 401(m) Contributions is equal to the sum of these hypothetical reductions multiplied, in each case, by the Highly Compensated Employee's Annual Compensation.

Then, the total amount of Excess Aggregate 401(m) Contributions shall be forfeited on the basis of the respective amounts attributable to each Highly Compensated Employee. The Highly Compensated Employees subject to the forfeitures are determined using the "dollar leveling method." The After-Tax Contributions and Matching Contributions of the Highly Compensated Employee with the greatest dollar amount of After-Tax Contributions and Matching Contributions and other contributions treated as matching contributions for the Plan Year are reduced by the amount required to cause that Highly Compensated Employee's After-Tax Contributions and Matching Contributions and other contributions treated as Section 401(m) Contributions for the Plan Year to equal the dollar amount of the After-Tax Contributions and Matching Contributions and other contributions treated as Section 401(m) Contributions for the Plan Year of the Highly Compensated Employee with the next highest dollar amount. This amount is then forfeited from the Account of the Highly Compensated Employee with the highest dollar amount. However, if a lesser reduction, when added to the total dollar amount already forfeited under this Section, would equal the total Excess Aggregate 401(m) Contributions, the lesser reduction amount shall be forfeited. This process shall be continued until the amount of the Excess Aggregate 401(m) Contributions have been forfeited.

A.3.4 **Alternative Limitation Fail Safe**. As soon as practicable after the close of each Plan Year, the Committee shall determine whether the alternative limitation would be exceeded. If the limitation would be exceeded for any Plan Year, before the close of the following Plan Year the Actual Deferral Percentage or Contribution Percentage of the eligible Highly Compensated Employees, or a combination of both, shall be reduced by distributions made in the manner described in the Regulations. These distributions shall be in addition to and not in lieu of distributions required for Excess 401(k) Contributions and Excess Aggregate 401(m) Contributions.

A.3.5 **Income Allocable to Excess 401(k) Contributions and Excess Aggregate 401(m) Contributions**. The income allocable to Excess 401(k) Contributions for the Plan Year shall be determined by multiplying the income for the Plan Year allocable to Section 401(k) Contributions by a fraction. The numerator of the fraction shall be the amount of Excess 401(k) Contributions made on behalf of the Participant for the Plan Year. The denominator of the fraction shall be the Participant's total Account balance attributable to Section 401(k) Contributions as of the beginning of the Plan Year plus the Participant's Section 401(k) Contributions for the Plan Year. The income allocable to Excess Aggregate 401(m) Contributions for a Plan Year shall be determined by multiplying the income for the Plan Year allocable to Section 401(m) Contributions by a fraction. The numerator of the fraction shall be the amount of Excess Aggregate 401(m) Contributions made on behalf of the Participant for the Plan Year. The denominator of the fraction shall be the Participant's total Account balance attributable to Section 401(m) Contributions as of the beginning of the Plan Year plus the Participant's Section 401(m) Contributions for the Plan Year.

**PART A.4** ***Limitation on Allocations***

A.4.1 **Basic Limitation on Allocations**. The Annual Additions which may be credited to a Participant's Accounts under the Plan for any Limitation Year will not exceed the Maximum Permissible Amount reduced by the Annual Additions credited to a Participant's Account for the same Limitation Year under any other qualified defined contribution plans maintained by any Affiliated Employer. If the Annual Additions with respect to the Participant under such other qualified defined contribution plans are less than the Maximum Permissible Amount and the Employer Contribution that would otherwise be contributed or allocated to the Participant's Accounts under the Plan would cause the Annual Additions for the Limitation Year to exceed this limitation, the amount contributed or allocated under the Plan will be reduced so that the Annual Additions under all qualified defined contribution plans maintained by any Affiliated Employer for the Limitation Year will equal the Maximum Permissible Amount. If the Annual Additions with respect to the Participant under such other qualified defined contribution plans maintained by any Affiliated Employer in the aggregate are equal to or greater than the Maximum Permissible Amount, no amount will be contributed or allocated to the Participant's Account under the Plan for the Limitation Year.

A.4.2 **Estimation of Maximum Permissible Amount**. Prior to determining the Participant's actual Annual Compensation for the Limitation Year, the Employer may determine the Maximum Permissible Amount on the basis of a reasonable estimation of the Participant's Annual Compensation for such Limitation Year, uniformly determined for all Participants similarly situated. As soon as is administratively feasible after the end of the Limitation Year, the Maximum Permissible Amount for the Limitation Year shall be determined on the basis of the Participant's actual Annual Compensation for such Limitation Year.

A.4.3 **Attribution of Excess Amounts**. If a Participant's Annual Additions under the Plan and all other qualified defined contribution plans maintained by any Affiliated Employer result in an Excess Amount, the total Excess Amount shall be attributed to the Plan.

A.4.4 **Treatment of Excess Amounts**. If an Excess Amount attributed to the Plan is held or contributed as a result of or because of (i) the allocation of forfeitures, (ii) reasonable error in estimating a Participant's Considered Compensation, (iii) reasonable error in calculating the maximum Salary Deferral Contribution that may be made with respect to a Participant under section 415 of the Code or (iv) any other facts and circumstances which the Commissioner of Internal Revenue finds to be justified, the Excess Amount shall be reduced as follows:

(a) First, the Excess Amount shall be reduced to the extent necessary by distributing to the Participant all Salary Deferral Contributions together with their earnings. These distributed amounts are disregarded for purposes of the testing and limitations contained in this Appendix A.

(b) Second, if the Participant is still employed by the Employer at the end of the Limitation Year, then such Excess Amounts shall not be distributed to the Participant, but shall be reallocated to a suspense account and shall be reapplied to reduce future Employer Contributions (including any allocation of forfeitures) under the Plan for such Participant in the next Limitation Year, and for each succeeding Limitation Year, if necessary.

(c) If, after application of paragraph (b) of this Section, an Excess Amount still exists, and the Participant is not still employed by the Employer at the end of the Limitation Year, then such Excess Amounts in the Participant's Accounts shall not be distributed to the Participant, but shall be reallocated to a suspense account and shall be reapplied to reduce future Employer Contributions (including allocation of any forfeitures), for all remaining Participants in the next Limitation Year and each succeeding Limitation Year if necessary.

(d) If a suspense account is in existence at any time during the Limitation Year pursuant to this Section, it will not participate in the allocation of the Trust Fund's investment gains and losses. If a suspense account is in existence at any time during a particular Limitation Year, all amounts in the suspense account must be allocated and reallocated to Participants' Accounts before any Employer Contribution may be made to the Plan for that Limitation Year. Excess Amounts may not be distributed to Participants or former Participants. If the Plan is terminated while a suspense account described in this Section is in existence, the amount in such suspense account shall revert to the Employer(s) to which it is attributable.

**Appendix B**

**TOP-HEAVY REQUIREMENTS**

**PART B.1** ***Definitions***

Definitions. As used herein, the following words and phrases have the meaning attributed to them below:

B.1.1 ***"Aggregate Accounts"*** means the total of all account balances.

B.1.2 ***"Aggregation Group"*** means (a) each plan of the Employer or any Affiliated Employer in which a Key Employee is a Participant and (b) each other plan of the Employer or any Affiliated Employer which enables any plan in (a) to meet the requirements of either section 401(a)(4) or 410 of the Code. Any Employer may treat a plan not required to be included in the Aggregation Group as being a part of the group if the group would continue to meet the requirements of section 401(a)(4) and 410 of the Code with that plan being taken into account.

B.1.3 ***"Determination Date"*** means for a given Plan Year the last day of the preceding Plan Year or in the case of the first Plan Year the last day of that Plan Year.

B.1.4 ***"Key Employee"*** means "Key Employee" means an Employee or former Employee (including a deceased Employee) who at any time during the Plan Year is (a) an officer of any Affiliated Employer having Annual Compensation greater than $130,000.00 (as adjusted by the Secretary of Treasury from time to time for increases in the cost of living), (b) a Five Percent Owner of any Affiliated Employer, treated separately, or (c) a One Percent Owner of any Affiliated Employer, treated separately, having Annual Compensation greater than $150,000.00. For this purpose no more than fifty (50) employees or, if lesser, the greater of three (3) employees or ten percent (10%) of the employees shall be treated as officers.

For purposes of determining the number of officers taken into account, the following employees shall be excluded: (1) employees who have not completed six (6) months of Vesting Service, (2) employees who normally work less than seventeen and one-half (17-1/2) hours per week, (3) employees who normally work not more than six (6) months during any year, (4) employees who have not attained the age of twenty-one (21), and (5) except to the extent provided in Regulations, employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and an Affiliated Employer. Section 416(i) of the Code shall be used to determine percentage of ownership.

The determination of who is a Key Employee will be made in accordance with section 416(i) of the Code and applicable Regulations.

B.1.5 ***"Non-Key Employee"*** means any Employee who is not a Key Employee.

B.1.6 ***"Top-Heavy Plan"*** means any plan which has been determined to be top-heavy under the test described in Appendix B of the Plan.

**PART B.2** ***Application***

B.2.1 **Application**. The requirements described in this Appendix B shall apply to each Plan Year that the Plan is determined to be a Top-Heavy Plan.

B.2.2 **Top-Heavy Test**. If on the Determination Date the Aggregate Accounts of Key Employees in the Plan exceed 60 percent of the Aggregate Accounts of all Employees in the Plan, the Plan shall be a Top-Heavy Plan for that Plan Year. In addition, if the Plan is required to be included in an Aggregation Group and that group is a top-heavy group, the Plan shall be treated as a Top-Heavy Plan. An Aggregation Group is a top-heavy group if on the Determination Date the sum of (a) the present value of the cumulative accrued benefits for Key Employees under all defined benefit plans in the Aggregation Group which contains the Plan, plus (b) the total of all of the accounts of Key Employees under all defined contribution plans included in the Aggregation Group (which contains the Plan) is more than 60 percent of a similar sum determined for all employees covered in the Aggregation Group which contains the Plan.

In applying the above tests, the following rules shall apply:

(a) in determining the present value of the accumulated accrued benefits for any Employee or the amount in the account of any Employee, the value or amount shall be increased by all distributions made to or for the benefit of the Employee under the Plan after his Separation From Service and during the one-year period ending on the Determination Date;

(b) in determining the present value of the accumulated accrued benefits for any Employee or the amount in the account of any Employee, the value or amount shall be increased by all distributions made to or for the benefit of the Employee under the Plan prior to his Separation From Service and during the five-year period ending on the Determination Date;

(c) all rollover contributions made by the Employee to the Plan shall not be considered by the Plan for either test;

(d) if an Employee is a Non-Key Employee under the Plan for the Plan Year but was a Key Employee under the Plan for a prior Plan Year, his Account shall not be considered; and

(e) notwithstanding any other provision of the Plan, benefits shall not be taken into account in determining the top-heavy ratio for any Employee who has not performed services for the Employer during the last one-year period ending upon the Determination Date.

B.2.3 **Vesting Restrictions if Plan Becomes Top-Heavy**. If a Participant has at least one Hour of Service during a Plan Year when the Plan is a Top-Heavy Plan, he shall either vest under each of the normal vesting provisions of the Plan or under the following vesting schedule, whichever is more favorable:

| Completed Years of Active Service | Vested Percentage of Amount In Accounts Containing Employer Contributions |
|---|---|
| Less than two years | 0 |
| Two years but less than three years | 20 |
| Three years but less than four years | 40 |
| Four years but less than five years | 60 |
| Five years but less than six years | 80 |
| Six years or more | 100 |

If the Plan ceases to be a Top-Heavy Plan, this requirement shall no longer apply. After that date, the normal vesting provisions of the Plan shall be applicable to all subsequent Contributions by the Employer.

For purposes of this Section B.2.3 Years of Active Service shall be determined under the rules of section 411(a)(4), (5) and (6) of the Code except that Years of Active Service beginning prior to January 1, 1984 and Years of Active Service for any Plan Year for which the Plan was not top-heavy shall be disregarded. Also, any Year of Active Service shall be disregarded to the extent that such Year of Active Service occurs during a Plan Year when the Plan benefits (within the meaning of section 410(b) of the Code) no Key Employee for former Key Employee.

B.2.4 **Minimum Contributions if Plan Becomes Top-Heavy**. If the Plan is a Top-Heavy Plan and the normal allocation of the Employer Contribution and forfeitures is less than five percent of any Non-Key Employee Participant's Annual Compensation, the Committee, without regard to the normal allocation procedures, shall allocate the Employer Contribution and the forfeitures among the Participants who are Non-Key Employees and who are in the employ of the Employer at the end of the Plan Year in proportion to each such Participant's Annual Compensation until each Non-Key Employee Participant has had an amount equal to five percent of his Annual Compensation allocated to his Account. At that time, any more Employer Contributions or forfeitures shall be allocated under the normal allocation procedures described earlier in the Plan. Amounts that may be treated as Section 401(k) Contributions made on behalf of Non-Key Employees may not be included in determining the minimum contribution required under this Section to the extent that they are treated as Section 401(k) Contributions for purposes of the Actual Deferral Percentage test.

In applying this restriction, the following rules shall apply:

(a) Each Employee who is eligible for participation (without regard to whether he has made mandatory contributions, if any are required, or whether his compensation is less than a stated amount) shall be entitled to receive an allocation under this Section; and

(b) All defined contribution plans required to be included in the Aggregation Group shall be treated as one plan for purposes of meeting the three percent maximum; this required aggregation shall not apply if the Plan is also required to be included in an Aggregation Group which includes a defined benefit plan and the Plan enables that defined benefit plan to meet the requirements of sections 401(a)(4) or 410 of the Code.

B.2.5 **Disregard of Government Programs**. If the Plan is a Top-Heavy Plan, it must meet the vesting and benefit requirements described in this Article without taking into account contributions or benefits under Chapter 2 of the Code (relating to the tax on self-employment income), Chapter 21 of the Code (relating to the Federal Insurance Contributions Act), Title II of the Social Security Act, or any other Federal or State law.

## Appendix C

## ADMINISTRATION OF THE PLAN

C.1 **Appointment, Term, Resignation, and Removal**. The Board shall appoint a Committee of not less than two persons, the members of which shall serve until their resignation, death, or removal. The Sponsor shall notify the Trustee in writing of its composition from time to time. Any member of the Committee may resign at any time by giving written notice of such resignation to the Sponsor. Any member of the Committee may be removed by the Board, with or without cause. Vacancies in the Committee arising by resignation, death, removal, or otherwise shall be filled by such persons as may be appointed by the Board.

C.2 **Powers**. The Committee shall have exclusive responsibility for the administration of the Plan, according to the terms and provisions of this document, and shall have all powers necessary to accomplish such purposes, including, but not by way of limitation, the right, power, and authority:

(a) to make rules and regulations for the administration of the Plan which are not inconsistent with the terms and provisions thereof, provided such rules and regulations are evidenced in writing;

(b) to construe all terms, provisions, conditions, and limitations of the Plan; and its construction thereof made in good faith and without discrimination in favor of or against any Participant or former Participant shall be final and conclusive on all parties at interest;

(c) to correct any defect, supply any omission, or reconcile any inconsistency which may appear in the Plan in such manner and to such extent as it shall deem expedient to carry the Plan into effect for the greatest benefit of all parties at interest, and its judgment in such matters shall be final and conclusive as to all parties at interest;

(d) to select, employ, and compensate from time to time such consultants, actuaries, accountants, attorneys, and other agents and employees as the Committee may deem necessary or advisable for the proper and efficient administration of the Plan, and any agent, firm, or employee so selected by the Committee may be a disqualified person, but only if the requirements of section 4975(d) of the Code have been met;

(e) to resolve all questions relating to the eligibility of Employees to become Participants, and to determine the period of Active Service and the amount of Considered Compensation upon which the benefits of each Participant shall be calculated;

(f) to resolve all controversies relating to the administration of the Plan, including but not limited to (1) differences of opinion arising between the Employer and a Participant or former Participant, and (2) any questions it deems advisable to determine in order to promote the uniform and nondiscriminatory administration of the Plan for the benefit of all parties at interest;

(g) to direct and instruct or to appoint an investment manager or managers which would have the power to direct and instruct the Trustee in all matters relating to the preservation, investment, reinvestment, management, and disposition of the Trust assets; provided, however, that the Committee shall have no authority that would prevent the Trustee from being an "agent independent of the issuer," as that term is defined in Rule 10b-18 promulgated under the Securities Exchange Act of 1934, at any time that the Trustee's failure to maintain such status would result in the Sponsor or any other person engaging in a "manipulative or deceptive device or contrivance" under the provisions of Rule 10b-6 of such Act;

(h) to direct and instruct the Trustee in all matters relating to the payment of Plan benefits and to determine a Participant's or former Participant's entitlement to a benefit should he appeal a denial of his claim for a benefit or any portion thereof; and

(i) to delegate such of its clerical and recordation duties under the Plan as it may deem necessary or advisable for the proper and efficient administration of the Plan.

C.3 **Organization**. The Committee shall select from among its members a chairman, who shall preside at all of its meetings, and shall select a secretary, without regard as to whether that person is a member of the Committee, who shall keep all records, documents, and data pertaining to its supervision of the administration of the Plan.

C.4 **Quorum and Majority Action**. A majority of the members of the Committee shall constitute a quorum for the transaction of business, and the vote of a majority of the members present at any meeting will decide any question brought before that meeting. In addition, the Committee may decide any question by a vote, taken without a meeting, of a majority of its members.

C.5 **Signatures**. The chairman, the secretary, and any one or more of the members of the Committee to which the Committee has delegated the power, shall each, severally, have the power to execute any document on behalf of the Committee, and to execute any certificate or other written evidence of the action of the Committee. The Trustee, after being notified of any such delegation of power in writing, shall thereafter accept and may rely upon any document executed by such member or members as representing the action of the Committee until the Committee files with the Trustee a written revocation of that delegation of power.

C.6 **Disqualification of Committee Members**. A member of the Committee who is also a Participant of the Plan shall not vote or act upon any matter relating solely to himself.

C.7 **Disclosure to Participants**. The Committee shall make available to each Participant, former Participant, and Beneficiary for his examination such records, documents, and other data as are required under ERISA, but only at reasonable times during business hours. No Participant, former Participant, or Beneficiary shall have the right to examine any data or records reflecting the compensation paid to any other Participant, former Participant, or Beneficiary, and the Committee shall not be required to make any data or records available other than those required by ERISA.

C.8 **Standard of Performance**. The Committee and each of its members shall use the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in conducting his business as the administrator of the Plan; shall, when exercising its power to direct investments, diversify the investments of the Plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and shall otherwise act in accordance with the provisions of the Plan and ERISA.

C.9 **Liability of Administrative Committee and Liability Insurance**. No member of the Committee shall be liable for any act or omission of any other member of the Committee, the Trustee, any investment manager, or any Participant or former Participant who directs the investment of his Account or other agent appointed by the Committee except to the extent required by the terms of ERISA, and any other applicable state or federal law, which liability cannot be waived. No Participant of the Committee shall be liable for any act or omission on his own part except to the extent required by the terms of ERISA, and any other applicable state or federal law, which liability cannot be waived. In this connection, each provision hereof is severable and if any provision is found to be void as against public policy, it shall not affect the validity of any other provision hereof.

Further, it is specifically provided that the Trustee may, at the direction of the Committee, purchase out of the Trust assets insurance for the members of the Committee and any other fiduciaries appointed by the Committee, and for the Trust itself to cover liability or losses occurring by reason of the act or omission of any one or more of the members of the Committee or any other fiduciary appointed by them under the Plan, provided such insurance permits recourse by the insurer against the members of the Committee or the other fiduciaries concerned in the case of a breach of a fiduciary obligation by one or more members of the Committee or other fiduciary covered thereby.

C.10 **Bonding**. No member of the Committee shall be required to give bond for the performance of his duties hereunder unless required by a law which cannot be waived.

C.11 **Compensation**. The Committee shall serve without compensation for their services, but shall be reimbursed by the Employers for all expenses properly and actually incurred in the performance of their duties under the Plan unless the Employers elect to have such expenses paid out of the Trust assets.

C.12 **Persons Serving in Dual Fiduciary Roles**. Any person, group of persons, corporations, firm, or other entity may serve in more than one fiduciary capacity with respect to the Plan, including the ability to serve both as a successor trustee and as a member of the Committee.

C.13 **Administrator**. For all purposes of ERISA, the administrator of the Plan within the meaning of ERISA shall be the Sponsor. The Sponsor shall have final responsibility for compliance with all reporting and disclosure requirements imposed with respect to the Plan under any federal or state law, or any regulations promulgated thereunder.

C.14 **Named Fiduciary**. The members of the Committee shall be the "named fiduciary" for purposes of section 402(a)(1) of ERISA, and as such shall have the authority to control and manage the operation and administration of the Plan, except to the extent such authority and control is allocated or delegated to other parties pursuant to the terms of the Plan.

C.15 **Standard of Judicial Review of Committee Actions**. The Committee has full and absolute discretion in the exercise of each and every aspect of its authority under the Plan, including without limitation, the authority to determine any person's right to benefits under the Plan, the correct amount and form of any such benefits; the authority to decide any appeal; the authority to review and correct the actions of any prior administrative committee; and all of the rights, powers, and authorities specified in this Appendix and elsewhere in the Plan. Notwithstanding any provision of law or any explicit or implicit provision of this document, any action taken, or ruling or decision made, by the Committee in the exercise of any of its powers and authorities under the Plan will be final and conclusive as to all parties other than the Sponsor or Trustee, including without limitation all Participants, former Participants and Beneficiaries, regardless of whether the Committee or one or more members thereof may have an actual or potential conflict of interest with respect to the subject matter of such action, ruling, or decision. No such final action, ruling, or decision of the Committee will be subject to de novo review in any judicial proceeding; and no such final action, ruling, or decision of the Committee may be set aside unless it is held to have been arbitrary and capricious by a final judgment of a court having jurisdiction with respect to the issue.

C.16 **Indemnification of Committee by the Sponsor**. The Sponsor shall indemnify and hold harmless the Committee, the Committee members, and any persons to whom the Committee has allocated or delegated its responsibilities in accordance with the provisions hereof, as well as any other fiduciary who is also an officer, director, or Employee of an Employer, and hold each of them harmless from and against all claims, loss, damages, expense, and liability arising from their responsibilities in connection with the administration of the Plan which is not otherwise paid or reimbursed by insurance, unless the same shall result from their own willful misconduct.

## Appendix D

## FUNDING

D.1 **Benefits Provided Solely by Trust**. All benefits payable under the Plan shall be paid or provided for solely from the Trust, and the Employer assumes no liability or responsibility therefor.

D.2 **Funding of Plan**. The Plan shall be funded by one or more separate Trusts. If more than one Trust is used, each Trust shall be designated by the name of the Plan followed by a number assigned by the Committee at the time the Trust is established.

D.3 **Incorporation of Trust**. Each Trust is a part of the Plan. All rights or benefits which accrue to a person under the Plan shall be subject also to the terms of the agreements creating the Trust or Trusts and any amendments to them which are not in direct conflict with the Plan.

D.4 **Authority of Trustee**. Each Trustee shall have full title and legal ownership of the assets in the separate Trust which, from time to time, are in his separate possession. No other Trustee shall have joint title to or joint legal ownership of any asset in one of the other Trusts held by another Trustee. Each Trustee shall be governed separately by the trust agreement entered into between the Employer and that Trustee and the terms of the Plan without regard to any other agreement entered into between any other Trustee and the Employer as a part of the Plan.

D.5 **Allocation of Responsibility**. To the fullest extent permitted under section 405 of ERISA, the agreements entered into between the Employer and each of the Trustees shall be interpreted to allocate to each Trustee its specific responsibilities, obligations and duties so as to relieve all other Trustees from liability either through the agreement, Plan or ERISA, for any act of any other Trustee which results in a loss to the Plan because of his act or failure to act.

D.6 **Trustee's Fees and Expenses**. The Trustee shall receive for its services as Trustee hereunder the compensation which from time to time may be agreed upon by the Sponsor and the Trustee. All of such compensation, together with the expenses incurred by the Trustee in connection with the administration of this Trust, including fees for legal services rendered to the Trustee, all other charges and disbursements of the Trustee, and all other expenses of the Plan shall be charged to and deducted from the Trust Fund, unless the Sponsor elects in writing to have any part or all of such compensation, expenses, charges, and disbursements paid directly by the Sponsor. The Trustee shall deduct from and charge against the Trust assets any and all taxes paid by it which may be levied or assessed upon or in respect of the Trust hereunder or the income thereof, and shall equitably allocate the same among the several Participants and former Participants.

**Exhibit 10.2**

**FIRST AMENDMENT TO THE**
**QUANEX CORPORATION EMPLOYEES' 401(K) SAVINGS PLAN**

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

**W I T N E S S E T H:**

**WHEREAS**, the Sponsor maintains the Quanex Corporation Employees' 401(k) Savings Plan, as amended and restated effective January 1, 2007 (the "*Plan*");

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

**WHEREAS**, the Sponsor has determined to amend the Plan;

**WHEREAS**, the Plan is required to be amended to comply with certain provisions of the Final Regulations under sections 401(k) and 401(m) of the Internal Revenue Code of 1986, as amended, that were published on December 29, 2004.

**NOW THEREFORE**, the Plan is hereby amended, effective January 1, 2006, to include all required regulatory and statutory changes enacted under sections 401(k) and 401(m) of the Code and the Regulations issued thereunder, as follows:

**Appendix E**

**FINAL 401(K)/401(M) REGULATIONS AMENDMENT**

E.1.1 **Preamble**

(a) **Adoption and Effective Date of Amendment**. This Amendment of the Plan is adopted to reflect certain provisions of the Final Regulations under Code sections 401(k) and 401(m) that were published on December 29, 2004 (the "Final 401(k) Regulations"). This Amendment is intended as good faith compliance with the requirements of the Final 401(k) Regulations and is to be construed in accordance with the Final 401(k) Regulations and guidance issued thereunder. Except as otherwise provided, this Amendment shall be effective as of the first day of the first Plan Year beginning after December 31, 2005.

(b) **Supersession of Inconsistent Provisions**. This Amendment shall supersede the provisions of the Plan to the extent those provisions are inconsistent with the provisions of this Amendment.

E.1.2 **General Rules**

(a) **Deferral Elections**. A cash or deferred arrangement ("CODA") is an arrangement under which eligible Employees may make elective deferral elections. Such elections cannot relate to compensation that is currently available prior to the adoption or effective date of the CODA. In addition, except for occasional, bona fide administrative considerations, contributions made pursuant to such an election cannot precede the earlier of (1) the performance of services relating to the contribution and (2) when the compensation that is subject to the election would be currently available to the Employee in the absence of an election to defer.

(b) **Vesting Provisions**. Elective contributions are always fully vested and nonforfeitable. The Plan shall disregard elective contributions in applying the vesting provisions of the Plan to other contributions or benefits under Code section 411(a)(2). However, the Plan shall otherwise take a Participant's elective contributions into account in determining the Participant's vested benefits under the Plan. Thus, for example, the Plan shall take elective contributions into account in determining whether a Participant has a nonforfeitable right to contributions under the Plan for purposes of forfeitures, and for applying provisions permitting the repayment of distributions to have forfeited amounts restored, and the provisions of Code sections 410(a)(5)(D)(iii) and 411(a)(6)(D)(iii) permitting a plan to disregard certain service completed prior to breaks-in-service (sometimes referred to as "the rule of parity").

E.1.3 **Hardship Distributions**

(a) **Hardship Events**. A distribution under the Plan is hereby deemed to be on account of an immediate and heavy financial need of an Employee if the distribution is for one of the following or any other item permitted under Treasury Regulation section 1.401(k)-1(d)(3)(iii)(B):

(i) Expenses for (or necessary to obtain) medical care that would be deductible under Code section 213(d) (determined without regard to whether the expenses exceed 7.5 percent of adjusted gross income);

(ii) Costs directly related to the purchase of a principal residence for the Employee (excluding mortgage payments);

(iii) Payment of tuition, related educational fees, and room and board expenses, for up to the next twelve (12) months of post-secondary education for the Employee, the Employee's spouse, children, or dependents (as defined in Code section 152, and, for taxable years beginning on or after January 1, 2005, without regard to Code section 152(b)(l), (b)(2), and (d)(l)(B));

(iv) Payments necessary to prevent the eviction of the Employee from the Employee's principal residence or foreclosure on the mortgage on that residence;

(v) Payments for burial or funeral expenses for the Employee's deceased parent, spouse, children or dependents (as defined in Code section 152, and, for taxable years beginning on or after January 1, 2005, without regard to Code section 152(d)(l)(B)); or

(vi) Expenses for the repair of damage to the Employee's principal residence that would qualify for the casualty deduction under Code section 165 (determined without regard to whether the loss exceeds 10 percent of adjusted gross income).

(b) **Reduction of Code Section 402(g) Limit Following Hardship Distribution**. If the Plan provides for hardship distributions upon satisfaction of the safe harbor standards set forth in Treasury Regulation sections 1.401(k)-1(d)(3)(iii)(B) (deemed immediate and heavy financial need) and 1.401(k)-1(d)(3)(iv)(E) (deemed necessary to satisfy immediate need), then there shall be no reduction in the maximum amount of elective deferrals that a Participant may make pursuant to Code section 402(g) solely because of a hardship distribution made by this Plan or any other plan of the Employer.

E.1.4 **Actual Deferral Percentage Test**

(a) **Targeted Contribution Limit**. Qualified nonelective contributions (as defined in Treasury Regulation section 1.401(k)-6) cannot be taken into account in determining the actual deferral ratio ("ADR") for a Plan Year for a Non-Highly Compensated Employee ("NHCE") to the extent such contributions exceed the product of that NHCE's Code section 414(s) compensation and the greater of five percent (5%) or two (2) times the Plan's "representative contribution rate." Any qualified nonelective contribution taken into account under an actual contribution percentage test under Treasury Regulation section 1.401(m)-2(a)(6) (including the determination of the representative contribution rate for purposes of Treasury Regulation section 1.401(m)-2(a)(6)(v)(B)), is not permitted to be taken into account for purposes of this Section E.1.4(a) (including the determination of the "representative contribution rate" under this Section E.1.4(a)). For purposes of this Section E.1.4(a):

(i) The Plan's "representative contribution rate" is the lowest "applicable contribution rate" of any eligible NHCE among a group of eligible NHCEs that consists of half of all eligible NHCEs for the Plan Year (or, if greater, the lowest "applicable contribution rate" of any eligible NHCE who is in the group of all eligible NHCEs for the Plan Year and who is employed by the Employer on the last day of the Plan Year), and

(ii) The "applicable contribution rate" for an eligible NHCE is the sum of the qualified matching contributions (as defined in Treasury Regulation section 1.401(k)-6) taken into account in determining the ADR for the eligible NHCE for the Plan Year and the qualified nonelective contributions made for the eligible NHCE for the Plan Year, divided by the eligible NHCE's Code section 414(s) compensation for the same period.

Notwithstanding the above, qualified nonelective contributions that are made in connection with an Employer's obligation to pay prevailing wages under the Davis-Bacon Act (46 Stat. 1494), Public Law 71-798, Service Contract Act of 1965 (79 Stat. 1965), Public Law 89-286, or similar legislation can be taken into account for a Plan Year for an NHCE to the extent such contributions do not exceed 10 percent (10%) of that NHCE's Code section 414(s) compensation.

Qualified matching contributions may only be used to calculate an ADR to the extent that such qualified matching contributions are matching contributions that are not precluded from being taken into account under the actual contribution percentage test for the Plan Year under the rules of Tresasury Regulation section 1.401(m)-2(a)(5)(ii) and as set forth in Section E.1.6(a).

(b) **Limitation on QNECs and QMACs**. Qualified nonelective contributions and qualified matching contributions cannot be taken into account to determine an ADR to the extent such contributions are taken into account for purposes of satisfying any other actual deferral percentage test, any actual contribution percentage test, or the requirements of Treasury Regulation sections 1.401(k)-3, 1.401(m)-3, or 1.401(k)-4. Thus, for example, matching contributions that are made pursuant to Treasury Regulation section 1.401(k)-3(c) cannot be taken into account under the actual deferral percentage test. Similarly, if a plan switches from the current year testing method to the prior year testing method pursuant to Treasury Regulation section 1.401(k)-2(c), qualified nonelective contributions that are taken into account under the current year testing method for a year may not be taken into account under the prior year testing method for the next year.

(c) **ADR of HCE if Multiple Plans**. The actual deferral ratio ("ADR") of any Participant who is a highly compensated employee ("HCE") for the Plan Year and who is eligible to have elective contributions (as defined in Treasury Regulation section 1.401(k)-6) (and qualified nonelective contributions and/or qualified matching contributions, if treated as elective contributions for purposes of the actual deferral percentage test) allocated to such Participant's accounts under two (2) or more cash or deferred arrangements described in Code section 401(k), that are maintained by the same Employer, shall be determined as if such elective contributions (and, if applicable, such qualified nonelective contributions and/or qualified matching contributions) were made under a single arrangement. If an HCE participates in two or more cash or deferred arrangements of the Employer that have different Plan Years, then all elective contributions made during the Plan Year being tested under all such cash or deferred arrangements shall be aggregated, without regard to the plan years of the other plans. However, for Plan Years beginning before January 1, 2006, if the plans have different Plan Years, then all such cash or deferred arrangements ending with or within the same calendar year shall be treated as a single cash or deferred arrangement. Notwithstanding the foregoing, certain plans shall be treated as separate if mandatorily disaggregated under the Regulations of Code section 401(k).

(d) **Plans Using Different Testing Methods for the Actual Deferral Percentage and Actual Contribution Percentage Test**. Except as otherwise provided in this Section E.1.4(d), the Plan may use the current year testing method or prior year testing method for the actual deferral percentage test for a Plan Year without regard to whether the current year testing method or prior year testing method is used for the actual contribution percentage test for that Plan Year. However, if different testing methods are used, then the Plan cannot use:

(i) The recharacterization method of Treasury Regulation section 1.401(k)-2(b)(3) to correct excess contributions for a Plan Year;

(ii) The rules of Treasury Regulation section 1.401(m)-2(a)(6)(ii) to take elective contributions into account under the actual contribution percentage test (rather than the actual deferral percentage test); or

(iii) The rules of Treasury Regulation section 1.401(k)-2(a)(6)(v) to take qualified matching contributions into account under the actual deferral percentage test (rather than the actual contribution percentage test).

E.1.5 **Adjustment to Actual Deferral Percentage Test**

(a) **Distribution of Income Attributable to Excess Contributions**. Distributions of excess contributions must be adjusted for income (gain or loss), including an adjustment for income for the period between the end of the Plan Year and the date of the distribution (the "gap period"). The Plan Administrator has the discretion to determine and allocate income using any of the methods set forth below:

(i) Reasonable method of allocating income. The Plan Administrator may use any reasonable method for computing the income allocable to excess contributions, provided that the method does not violate Code section 401(a)(4), is used consistently for all Participants and for all corrective distributions under the Plan for the Plan Year, and is used by the Plan for allocating income to Participants' accounts. A Plan will not fail to use a reasonable method for computing the income allocable to excess contributions merely because the income allocable to excess contributions is determined on a date that is no more than seven (7) days before the distribution.

(ii) Alternative method of allocating income. The Plan Administrator may allocate income to excess contributions for the Plan Year by multiplying the income for the Plan Year allocable to the elective contributions and other amounts taken into account under the actual deferral percentage test (including contributions made for the Plan Year), by a fraction, the numerator of which is the excess contributions for the Employee for the Plan Year. and the denominator of which is the sum of the:

(1) Account balance attributable to elective contributions and other amounts taken into account under the actual deferral percentage test as of the beginning of the Plan Year, and

(2) Any additional amount of such contributions made for the Plan Year.

(iii) Safe harbor method of allocating gap period income. The Plan Administrator may use the safe harbor method in this paragraph to determine income on excess contributions for the gap period. Under this safe harbor method, income on excess contributions for the gap period is equal to ten percent (10%) of the income allocable to excess contributions for the Plan Year that would be determined under paragraph (ii) above, multiplied by the number of calendar months that have elapsed since the end of the Plan Year. For purposes of calculating the number of calendar months that have elapsed under the safe harbor method, a corrective distribution that is made on or before the fifteenth (15th) day of a month is treated as made on the last day of the preceding month and a distribution made after the fifteenth day of a month is treated as made on the last day of the month.

(iv) Alternative method of allocating Plan Year and gap period income. The Plan Administrator may determine the income for the aggregate of the Plan Year and the gap period, by applying the alternative method provided by paragraph (ii) above to this aggregate period. This is accomplished by (1) substituting the income for the Plan Year and the gap period, for the income for the Plan Year, and (2) substituting the amounts taken into account under the actual deferral percentage test for the Plan Year and the gap period, for the amounts taken into account under the actual deferral percentage test for the Plan Year in determining the fraction that is multiplied by that income.

(b) **Corrective Contributions**. If a failed actual deferral percentage test is to be corrected by making an Employer contribution, then the provisions of the Plan for the corrective contributions shall be applied by limiting the contribution made on behalf of any NHCE pursuant to such provisions to an amount that does not exceed the targeted contribution limits of Section E.1.4(a), above, or in the case of a corrective contribution that is a qualified matching contribution, the targeted contribution limit of Section E.1.6(a), below.

E.1.6 **Actual Contribution Percentage Test**

(a) **Targeted Matching Contribution Limit**. A matching contribution with respect to an elective contribution for a Plan Year is not taken into account under the actual contribution percentage test for an NHCE to the extent it exceeds the greatest of:

(i) five percent (5%) of the NHCE's Code section 414(s) compensation for the Plan Year;

(ii) the NHCE's elective contributions for the Plan Year; and

(iii) the product of two (2) times the Plan's "representative matching rate" and the NHCE's elective contributions for the Plan Year.

For purposes of this Section E.1.6(a), the Plan's "representative matching rate" is the lowest "matching rate" for any eligible NHCE among a group of NHCEs that consists of half of all eligible NHCEs in the Plan for the Plan Year who make elective contributions for the Plan Year (or, if greater, the lowest "matching rate" for all eligible NHCEs in the Plan who are employed by the Employer on the last day of the Plan Year and who make elective contributions for the Plan Year).

For purposes of this Section E.1.6(a), the "matching rate" for an Employee generally is the matching contributions made for such Employee divided by the Employee's elective contributions for the Plan Year. If the matching rate is not the same for all levels of elective contributions for an Employee, then the Employee's "matching rate" is determined assuming that an Employee's elective contributions are equal to six percent (6%) of Code section 414(s) compensation.

If the Plan provides a match with respect to the sum of the Employee's after-tax Employee contributions and elective contributions, then for purposes of this Section E.1.6(a), that sum is substituted for the amount of the Employee's elective contributions in subsections (ii) & (iii) above and in determining the "matching rate," and Employees who make either after-tax Employee contributions or elective contributions are taken into account in determining the Plan's "representative matching rate." Similarly, if the Plan provides a match with respect to the Employee's after-tax Employee contributions, but not elective contributions, then for purposes of this subsection, the Employee's after-tax Employee contributions are substituted for the amount of the Employee's elective contributions in subsections (ii) & (iii) above and in determining the "matching rate," and Employees who make after-tax Employee contributions are taken into account in determining the Plan's "representative matching rate."

(b) **Targeted QNEC Limit**. Qualified nonelective contributions (as defined in Treasury Regulation section 1.401(k)-6) cannot be taken into account under the actual contribution percentage test for a Plan Year for an NHCE to the extent such contributions exceed the product of that NHCE's Code section 414(s) compensation and the greater of five percent (5%) or two (2) times the Plan's "representative contribution rate." Any qualified nonelective contribution taken into account under an actual deferral percentage test under Treasury Regulation section 1.401(k)-2(a)(6) (including the determination of the "representative contribution rate" for purposes of Treasury Regulation section 1.401(k)-2(a)(6)(iv)(B)) is not permitted to be taken into account for purposes of this Section E.1.6(b) (including the determination of the "representative contribution rate" for purposes of subsection (i) below). For purposes of this Section E.1.6(b):

(i) The Plan's "representative contribution rate" is the lowest "applicable contribution rate" of any eligible NHCE among a group of eligible NHCEs that consists of half of all eligible NHCEs for the Plan Year (or, if greater, the lowest "applicable contribution rate" of any eligible NHCE who is in the group of all eligible NHCEs for the Plan Year and who is employed by the Employer on the last day of the Plan Year), and

(ii) The "applicable contribution rate" for an eligible NHCE is the sum of the matching contributions (as defined in Treasury Regulation section 1.401(m)-1(a)(2)) taken into account in determining the ACR for the eligible NHCE for the Plan Year and the qualified nonelective contributions made for that NHCE for the Plan Year, divided by that NHCE's Code section 414(s) compensation for the Plan Year.

Notwithstanding the above, qualified nonelective contributions that are made in connection with an Employer's obligation to pay prevailing wages under the Davis-Bacon Act (46 Stat. 1494), Public Law 71-798, Service Contract Act of 1965 (79 Stat. 1965), Public Law 89-286, or similar legislation can be taken into account for a Plan Year for an NHCE to the extent such contributions do not exceed 10 percent (10%) of that NHCE's Code section 414(s) compensation.

(c) **ACR of HCE if Multiple Plans**. The actual contribution ratio ("ACR") for any Participant who is a highly compensated employee ("HCE") and who is eligible to have matching contributions or after-tax Employee contributions allocated to his or her account under two (2) or more plans described in Code section 401(a), or arrangements described in Code section 401(k) that are maintained by the same Employer, shall be determined as if the total of such contributions was made under each plan and arrangement. If an HCE participates in two (2) or more such plans or arrangements that have different plan years, then all matching contributions and after-tax Employee contributions made during the Plan Year being tested under all such plans and arrangements shall be aggregated, without regard to the plan years of the other plans. For plan years beginning before January 1, 2006, all such plans and arrangements ending with or within the same calendar year shall be treated as a single plan or arrangement. Notwithstanding the foregoing, certain plans shall be treated as separate if mandatorily disaggregated under the Regulations of Code section 401(m).

(d) **Plans Using Different Testing Methods for the Actual Contribution Percentage and Actual Deferral Percentage Test**. Except as otherwise provided in this Section E.1.6(d), the Plan may use the current year testing method or prior year testing method for the actual contribution percentage test for a Plan Year without regard to whether the current year testing method or prior year testing method is used for the actual deferral percentage test for that Plan Year. However, if different testing methods are used, then the Plan cannot use:

(i) The recharacterization method of Treasury Regulation section 1.401(k)-2(b)(3) to correct excess contributions for a Plan Year;

(ii) The rules of Treasury Regulation section 1.401(m)-2(a)(6)(ii) to take elective contributions into account under the actual contribution percentage test (rather than the actual deferral percentage test); or

(iii) The rules of Treasury Regulation section 1.401(k)-2(a)(6) to take qualified matching contributions into account under the actual deferral percentage test (rather than the actual contribution percentage test).

E.1.7 **Adjustment to Actual Contribution Percentage Test**

(a) **Distribution of Income Attributable to Excess Aggregate Contributions**. Distributions of excess aggregate contributions must be adjusted for income (gain or loss), including an adjustment for income for the period between the end of the Plan Year and the date of the distribution (the "gap period"). For purposes of this Section E.1.7(a), "income" shall be determined and allocated in accordance with the provisions of Section E.1.5(a), above, except that such Section E.1.5(a) shall be applied by substituting "excess contributions" with "excess aggregate contributions" and by substituting amounts taken into account under the actual contribution percentage test for amounts taken into account under the actual deferral percentage test.

(b) **Corrective Contributions**. If a failed actual contribution percentage test is to be corrected by making an Employer contribution, then the provisions of the Plan for the corrective contributions shall be applied by limiting the contribution made on behalf of any NHCE pursuant to such provisions to an amount that does not exceed the targeted contribution limits of Sections E.1.6(a) and E.1.6(b).

**IN WITNESS WHEREOF**, the Sponsor has caused this Agreement to be executed on the 26th day of October, 2006.

**QUANEX CORPORATION**

By: /s/ Kevin P. Delaney
Title: Senior Vice President –General Counsel
and Secretary

**Exhibit 10.3**

**FIFTH AMENDMENT TO THE**
**QUANEX CORPORATION 401(k) SAVINGS PLAN**
**FOR HOURLY EMPLOYEES**

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

**W I T N E S S E T H:**

**WHEREAS**, the Sponsor maintains the Quanex Corporation 401(k) Savings Plan for Hourly Employees, as amended and restated effective January 1, 1998 (the "*Plan*");

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

**WHEREAS**, the Sponsor has determined to amend the Plan;

**WHEREAS**, the Plan is required to be amended to comply with certain provisions of the Final Regulations under sections 401(k) and 401(m) of the Internal Revenue Code of 1986, as amended, that were published on December 29, 2004.

**NOW THEREFORE**, the Plan is hereby amended, effective January 1, 2006, to (i) include all required regulatory and statutory changes enacted under sections 401(k) and 401(m) of the Code and the Regulations issued thereunder, and (ii) as follows:

**APPENDIX D**

**FINAL 401(K)/401(M) REGULATIONS AMENDMENT**

D.1 **Preamble**

(a) **Adoption and Effective Date of Amendment**. This Amendment of the Plan is adopted to reflect certain provisions of the Final Regulations under Code sections 401(k) and 401(m) that were published on December 29, 2004 (the "Final 401(k) Regulations"). This Amendment is intended as good faith compliance with the requirements of the Final 401(k) Regulations and is to be construed in accordance with the Final 401(k) Regulations and guidance issued thereunder. Except as otherwise provided, this Amendment shall be effective as of the first day of the first Plan Year beginning after December 31, 2005.

(b) **Supersession of Inconsistent Provisions**. This Amendment shall supersede the provisions of the Plan to the extent those provisions are inconsistent with the provisions of this Amendment.

D.2 **General Rules**

(a) **Deferral Elections**. A cash or deferred arrangement ("CODA") is an arrangement under which eligible Employees may make elective deferral elections. Such elections cannot relate to compensation that is currently available prior to the adoption or effective date of the CODA. In addition, except for occasional, bona fide administrative considerations, contributions made pursuant to such an election cannot precede the earlier of (1) the performance of services relating to the contribution and (2) when the compensation that is subject to the election would be currently available to the Employee in the absence of an election to defer.

(b) **Vesting Provisions**. Elective contributions are always fully vested and nonforfeitable. The Plan shall disregard elective contributions in applying the vesting provisions of the Plan to other contributions or benefits under Code section 411(a)(2). However, the Plan shall otherwise take a Participant's elective contributions into account in determining the Participant's vested benefits under the Plan. Thus, for example, the Plan shall take elective contributions into account in determining whether a Participant has a nonforfeitable right to contributions under the Plan for purposes of forfeitures, and for applying provisions permitting the repayment of distributions to have forfeited amounts restored, and the provisions of Code sections 410(a)(5)(D)(iii) and 411(a)(6)(D)(iii) permitting a plan to disregard certain service completed prior to breaks-in-service (sometimes referred to as "the rule of parity").

D.3 **Hardship Distributions**

(a) **Hardship Events**. A distribution under the Plan is hereby deemed to be on account of an immediate and heavy financial need of an Employee if the distribution is for one of the following or any other item permitted under Treasury Regulation section 1.401(k)-1(d)(3)(iii)(B):

(i) Expenses for (or necessary to obtain) medical care that would be deductible under Code section 213(d) (determined without regard to whether the expenses exceed 7.5 percent of adjusted gross income);

(ii) Costs directly related to the purchase of a principal residence for the Employee (excluding mortgage payments);

(iii) Payment of tuition, related educational fees, and room and board expenses, for up to the next twelve (12) months of post-secondary education for the Employee, the Employee's spouse, children, or dependents (as defined in Code section 152, and, for taxable years beginning on or after January 1, 2005, without regard to Code section 152(b)(l), (b)(2), and (d)(l)(B));

(iv) Payments necessary to prevent the eviction of the Employee from the Employee's principal residence or foreclosure on the mortgage on that residence;

(v) Payments for burial or funeral expenses for the Employee's deceased parent, spouse, children or dependents (as defined in Code section 152, and, for taxable years beginning on or after January 1, 2005, without regard to Code section 152(d)(l)(B)); or

(vi) Expenses for the repair of damage to the Employee's principal residence that would qualify for the casualty deduction under Code section 165 (determined without regard to whether the loss exceeds 10 percent of adjusted gross income).

(b) **Reduction of Code Section 402(g) Limit Following Hardship Distribution**. If the Plan provides for hardship distributions upon satisfaction of the safe harbor standards set forth in Treasury Regulation sections 1.401(k)-1(d)(3)(iii)(B) (deemed immediate and heavy financial need) and 1.401(k)-1(d)(3)(iv)(E) (deemed necessary to satisfy immediate need), then there shall be no reduction in the maximum amount of elective deferrals that a Participant may make pursuant to Code section 402(g) solely because of a hardship distribution made by this Plan or any other plan of the Employer.

D.4 **Actual Deferral Percentage Test**

(a) **Targeted Contribution Limit**. Qualified nonelective contributions (as defined in Treasury Regulation section 1.401(k)-6) cannot be taken into account in determining the actual deferral ratio ("ADR") for a Plan Year for a Non-Highly Compensated Employee ("NHCE") to the extent such contributions exceed the product of that NHCE's Code section 414(s) compensation and the greater of five percent (5%) or two (2) times the Plan's "representative contribution rate." Any qualified nonelective contribution taken into account under an actual contribution percentage test under Treasury Regulation section 1.401(m)-2(a)(6) (including the determination of the representative contribution rate for purposes of Treasury Regulation section 1.401(m)-2(a)(6)(v)(B)), is not permitted to be taken into account for purposes of this Section D.4(a) (including the determination of the "representative contribution rate" under this Section D.4(a)). For purposes of this Section D.4(a):

(i) The Plan's "representative contribution rate" is the lowest "applicable contribution rate" of any eligible NHCE among a group of eligible NHCEs that consists of half of all eligible NHCEs for the Plan Year (or, if greater, the lowest "applicable contribution rate" of any eligible NHCE who is in the group of all eligible NHCEs for the Plan Year and who is employed by the Employer on the last day of the Plan Year), and

(ii) The "applicable contribution rate" for an eligible NHCE is the sum of the qualified matching contributions (as defined in Treasury Regulation section 1.401(k)-6) taken into account in determining the ADR for the eligible NHCE for the Plan Year and the qualified nonelective contributions made for the eligible NHCE for the Plan Year, divided by the eligible NHCE's Code section 414(s) compensation for the same period.

Notwithstanding the above, qualified nonelective contributions that are made in connection with an Employer's obligation to pay prevailing wages under the Davis-Bacon Act (46 Stat. 1494), Public Law 71-798, Service Contract Act of 1965 (79 Stat. 1965), Public Law 89-286, or similar legislation can be taken into account for a Plan Year for an NHCE to the extent such contributions do not exceed 10 percent (10%) of that NHCE's Code section 414(s) compensation.

Qualified matching contributions may only be used to calculate an ADR to the extent that such qualified matching contributions are matching contributions that are not precluded from being taken into account under the actual contribution percentage test for the Plan Year under the rules of Treasury Regulation section 1.401(m)-2(a)(5)(ii) and as set forth in Section D.6(a).

(b) **Limitation on QNECs and QMACs**. Qualified nonelective contributions and qualified matching contributions cannot be taken into account to determine an ADR to the extent such contributions are taken into account for purposes of satisfying any other actual deferral percentage test, any actual contribution percentage test, or the requirements of Treasury Regulation sections 1.401(k)-3, 1.401(m)-3, or 1.401(k)-4. Thus, for example, matching contributions that are made pursuant to Treasury Regulation section 1.401(k)-3(c) cannot be taken into account under the actual deferral percentage test. Similarly, if a plan switches from the current year testing method to the prior year testing method pursuant to Treasury Regulation section 1.401(k)-2(c), qualified nonelective contributions that are taken into account under the current year testing method for a year may not be taken into account under the prior year testing method for the next year.

(c) **ADR of HCE if Multiple Plans**. The actual deferral ratio ("ADR") of any Participant who is a highly compensated employee ("HCE") for the Plan Year and who is eligible to have elective contributions (as defined in Treasury Regulation section 1.401(k)-6) (and qualified nonelective contributions and/or qualified matching contributions, if treated as elective contributions for purposes of the actual deferral percentage test) allocated to such Participant's accounts under two (2) or more cash or deferred arrangements described in Code section 401(k), that are maintained by the same Employer, shall be determined as if such elective contributions (and, if applicable, such qualified nonelective contributions and/or qualified matching contributions) were made under a single arrangement. If an HCE participates in two or more cash or deferred arrangements of the Employer that have different Plan Years, then all elective contributions made during the Plan Year being tested under all such cash or deferred arrangements shall be aggregated, without regard to the plan years of the other plans. However, for Plan Years beginning before January 1, 2006, if the plans have different Plan Years, then all such cash or deferred arrangements ending with or within the same calendar year shall be treated as a single cash or deferred arrangement. Notwithstanding the foregoing, certain plans shall be treated as separate if mandatorily disaggregated under the Regulations of Code section 401(k).

(d) **Plans Using Different Testing Methods for the Actual Deferral Percentage and Actual Contribution Percentage Test**. Except as otherwise provided in this Section D.4(d), the Plan may use the current year testing method or prior year testing method for the actual deferral percentage test for a Plan Year without regard to whether the current year testing method or prior year testing method is used for the actual contribution percentage test for that Plan Year. However, if different testing methods are used, then the Plan cannot use:

(i) The recharacterization method of Treasury Regulation section 1.401(k)-2(b)(3) to correct excess contributions for a Plan Year;

(ii) The rules of Treasury Regulation section 1.401(m)-2(a)(6)(ii) to take elective contributions into account under the actual contribution percentage test (rather than the actual deferral percentage test); or

(iii) The rules of Treasury Regulation section 1.401(k)-2(a)(6)(v) to take qualified matching contributions into account under the actual deferral percentage test (rather than the actual contribution percentage test).

D.5 **Adjustment to Actual Deferral Percentage Test**

(a) **Distribution of Income Attributable to Excess Contributions**. Distributions of excess contributions must be adjusted for income (gain or loss), including an adjustment for income for the period between the end of the Plan Year and the date of the distribution (the "gap period"). The Plan Administrator has the discretion to determine and allocate income using any of the methods set forth below:

(i) Reasonable method of allocating income. The Plan Administrator may use any reasonable method for computing the income allocable to excess contributions, provided that the method does not violate Code section 401(a)(4), is used consistently for all Participants and for all corrective distributions under the Plan for the Plan Year, and is used by the Plan for allocating income to Participants' accounts. A Plan will not fail to use a reasonable method for computing the income allocable to excess contributions merely because the income allocable to excess contributions is determined on a date that is no more than seven (7) days before the distribution.

(ii) Alternative method of allocating income. The Plan Administrator may allocate income to excess contributions for the Plan Year by multiplying the income for the Plan Year allocable to the elective contributions and other amounts taken into account under the actual deferral percentage test (including contributions made for the Plan Year), by a fraction, the numerator of which is the excess contributions for the Employee for the Plan Year. and the denominator of which is the sum of the:

(1) Account balance attributable to elective contributions and other amounts taken into account under the actual deferral percentage test as of the beginning of the Plan Year, and

(2) Any additional amount of such contributions made for the Plan Year.

(iii) Safe harbor method of allocating gap period income. The Plan Administrator may use the safe harbor method in this paragraph to determine income on excess contributions for the gap period. Under this safe harbor method, income on excess contributions for the gap period is equal to ten percent (10%) of the income allocable to excess contributions for the Plan Year that would be determined under paragraph (ii) above, multiplied by the number of calendar months that have elapsed since the end of the Plan Year. For purposes of calculating the number of calendar months that have elapsed under the safe harbor method, a corrective distribution that is made on or before the fifteenth (15th) day of a month is treated as made on the last day of the preceding month and a distribution made after the fifteenth day of a month is treated as made on the last day of the month.

(iv) Alternative method of allocating Plan Year and gap period income. The Plan Administrator may determine the income for the aggregate of the Plan Year and the gap period, by applying the alternative method provided by paragraph (ii) above to this aggregate period. This is accomplished by (1) substituting the income for the Plan Year and the gap period, for the income for the Plan Year, and (2) substituting the amounts taken into account under the actual deferral percentage test for the Plan Year and the gap period, for the amounts taken into account under the actual deferral percentage test for the Plan Year in determining the fraction that is multiplied by that income.

(b) **Corrective Contributions**. If a failed actual deferral percentage test is to be corrected by making an Employer contribution, then the provisions of the Plan for the corrective contributions shall be applied by limiting the contribution made on behalf of any NHCE pursuant to such provisions to an amount that does not exceed the targeted contribution limits of Section D.4(a), above, or in the case of a corrective contribution that is a qualified matching contribution, the targeted contribution limit of Section D.6(a), below.

D.6 **Actual Contribution Percentage Test**

(a) **Targeted Matching Contribution Limit**. A matching contribution with respect to an elective contribution for a Plan Year is not taken into account under the actual contribution percentage test for an NHCE to the extent it exceeds the greatest of:

(i) five percent (5%) of the NHCE's Code section 414(s) compensation for the Plan Year;

(ii) the NHCE's elective contributions for the Plan Year; and

(iii) the product of two (2) times the Plan's "representative matching rate" and the NHCE's elective contributions for the Plan Year.

For purposes of this Section D.6(a), the Plan's "representative matching rate" is the lowest "matching rate" for any eligible NHCE among a group of NHCEs that consists of half of all eligible NHCEs in the Plan for the Plan Year who make elective contributions for the Plan Year (or, if greater, the lowest "matching rate" for all eligible NHCEs in the Plan who are employed by the Employer on the last day of the Plan Year and who make elective contributions for the Plan Year).

For purposes of this Section D.6(a), the "matching rate" for an Employee generally is the matching contributions made for such Employee divided by the Employee's elective contributions for the Plan Year. If the matching rate is not the same for all levels of elective contributions for an Employee, then the Employee's "matching rate" is determined assuming that an Employee's elective contributions are equal to six percent (6%) of Code section 414(s) compensation.

If the Plan provides a match with respect to the sum of the Employee's after-tax Employee contributions and elective contributions, then for purposes of this Section D.6(a), that sum is substituted for the amount of the Employee's elective contributions in subsections (ii) & (iii) above and in determining the "matching rate," and Employees who make either after-tax Employee contributions or elective contributions are taken into account in determining the Plan's "representative matching rate." Similarly, if the Plan provides a match with respect to the Employee's after-tax Employee contributions, but not elective contributions, then for purposes of this subsection, the Employee's after-tax Employee contributions are substituted for the amount of the Employee's elective contributions in subsections (ii) & (iii) above and in determining the "matching rate," and Employees who make after-tax Employee contributions are taken into account in determining the Plan's "representative matching rate."

(b) **Targeted QNEC Limit**. Qualified nonelective contributions (as defined in Treasury Regulation section 1.401(k)-6) cannot be taken into account under the actual contribution percentage test for a Plan Year for an NHCE to the extent such contributions exceed the product of that NHCE's Code section 414(s) compensation and the greater of five percent (5%) or two (2) times the Plan's "representative contribution rate." Any qualified nonelective contribution taken into account under an actual deferral percentage test under Treasury Regulation section 1.401(k)-2(a)(6) (including the determination of the "representative contribution rate" for purposes of Treasury Regulation section 1.401(k)-2(a)(6)(iv)(B)) is not permitted to be taken into account for purposes of this Section D.6(b) (including the determination of the "representative contribution rate" for purposes of subsection (i) below). For purposes of this Section D.6(b):

(i) The Plan's "representative contribution rate" is the lowest "applicable contribution rate" of any eligible NHCE among a group of eligible NHCEs that consists of half of all eligible NHCEs for the Plan Year (or, if greater, the lowest "applicable contribution rate" of any eligible NHCE who is in the group of all eligible NHCEs for the Plan Year and who is employed by the Employer on the last day of the Plan Year), and

(ii) The "applicable contribution rate" for an eligible NHCE is the sum of the matching contributions (as defined in Treasury Regulation section 1.401(m)-1(a)(2)) taken into account in determining the ACR for the eligible NHCE for the Plan Year and the qualified nonelective contributions made for that NHCE for the Plan Year, divided by that NHCE's Code section 414(s) compensation for the Plan Year.

Notwithstanding the above, qualified nonelective contributions that are made in connection with an Employer's obligation to pay prevailing wages under the Davis-Bacon Act (46 Stat. 1494), Public Law 71-798, Service Contract Act of 1965 (79 Stat. 1965), Public Law 89-286, or similar legislation can be taken into account for a Plan Year for an NHCE to the extent such contributions do not exceed 10 percent (10%) of that NHCE's Code section 414(s) compensation.

(c) **ACR of HCE if Multiple Plans**. The actual contribution ratio ("ACR") for any Participant who is a highly compensated employee ("HCE") and who is eligible to have matching contributions or after-tax Employee contributions allocated to his or her account under two (2) or more plans described in Code section 401(a), or arrangements described in Code section 401(k) that are maintained by the same Employer, shall be determined as if the total of such contributions was made under each plan and arrangement. If an HCE participates in two (2) or more such plans or arrangements that have different plan years, then all matching contributions and after-tax Employee contributions made during the Plan Year being tested under all such plans and arrangements shall be aggregated, without regard to the plan years of the other plans. For plan years beginning before January 1, 2006, all such plans and arrangements ending with or within the same calendar year shall be treated as a single plan or arrangement. Notwithstanding the foregoing, certain plans shall be treated as separate if mandatorily disaggregated under the Regulations of Code section 401(m).

(d) **Plans Using Different Testing Methods for the Actual Contribution Percentage and Actual Deferral Percentage Test**. Except as otherwise provided in this Section D.6(d), the Plan may use the current year testing method or prior year testing method for the actual contribution percentage test for a Plan Year without regard to whether the current year testing method or prior year testing method is used for the actual deferral percentage test for that Plan Year. However, if different testing methods are used, then the Plan cannot use:

(i) The recharacterization method of Treasury Regulation section 1.401(k)-2(b)(3) to correct excess contributions for a Plan Year;

(ii) The rules of Treasury Regulation section 1.401(m)-2(a)(6)(ii) to take elective contributions into account under the actual contribution percentage test (rather than the actual deferral percentage test); or

(iii) The rules of Treasury Regulation section 1.401(k)-2(a)(6) to take qualified matching contributions into account under the actual deferral percentage test (rather than the actual contribution percentage test).

D.7 **Adjustment to Actual Contribution Percentage Test**

(a) **Distribution of Income Attributable to Excess Aggregate Contributions**. Distributions of excess aggregate contributions must be adjusted for income (gain or loss), including an adjustment for income for the period between the end of the Plan Year and the date of the distribution (the "gap period"). For purposes of this Section D.7(a), "income" shall be determined and allocated in accordance with the provisions of Section D.5(a), above, except that such Section D.5(a) shall be applied by substituting "excess contributions" with "excess aggregate contributions" and by substituting amounts taken into account under the actual contribution percentage test for amounts taken into account under the actual deferral percentage test.

(b) **Corrective Contributions**. If a failed actual contribution percentage test is to be corrected by making an Employer contribution, then the provisions of the Plan for the corrective contributions shall be applied by limiting the contribution made on behalf of any NHCE pursuant to such provisions to an amount that does not exceed the targeted contribution limits of Sections 1.6(a) and 1.6(b).

**IN WITNESS WHEREOF**, the Sponsor has caused this Agreement to be executed on the 26th day of October, 2006.

**QUANEX CORPORATION**

By: /s/ Kevin P. Delaney
Title: Senior Vice President –General Counsel
and Secretary

**Exhibit 10.4**

**SIXTH AMENDMENT TO THE**
**QUANEX CORPORATION HOURLY BARGAINING UNIT EMPLOYEE SAVINGS PLAN**

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

**W I T N E S S E T H:**

**WHEREAS**, the Sponsor maintains the Quanex Corporation Hourly Bargaining Unit Employee Savings Plan, as amended and restated effective January 1, 1998 (the "*Plan*");

**WHEREAS**, pursuant to Section 12.01 of the Plan, the Sponsor has the right to amend the Plan;

**WHEREAS**, the Plan is required to be amended to comply with certain provisions of the Final Regulations under sections 401(k) and 401(m) of the Internal Revenue Code of 1986, as amended, that were published on December 29, 2004.

**NOW THEREFORE**, the Plan is hereby amended, effective January 1, 2006, to include all required regulatory and statutory changes enacted under sections 401(k) and 401(m) of the Code and the Regulations issued thereunder, as follows:

**APPENDIX D**
**FINAL 401(K)/401(M) REGULATIONS AMENDMENT**

D.1.1 **Preamble**

(a) **Adoption and Effective Date of Amendment**. This Amendment of the Plan is adopted to reflect certain provisions of the Final Regulations under Code sections 401(k) and 401(m) that were published on December 29, 2004 (the "Final 401(k) Regulations"). This Amendment is intended as good faith compliance with the requirements of the Final 401(k) Regulations and is to be construed in accordance with the Final 401(k) Regulations and guidance issued thereunder. Except as otherwise provided, this Amendment shall be effective as of the first day of the first Plan Year beginning after December 31, 2005.

(b) **Supersession of Inconsistent Provisions**. This Amendment shall supersede the provisions of the Plan to the extent those provisions are inconsistent with the provisions of this Amendment.

D.1.2 **General Rules**

(a) **Deferral Elections**. A cash or deferred arrangement ("CODA") is an arrangement under which eligible Employees may make elective deferral elections. Such elections cannot relate to compensation that is currently available prior to the adoption or effective date of the CODA. In addition, except for occasional, bona fide administrative considerations, contributions made pursuant to such an election cannot precede the earlier of (1) the performance of services relating to the contribution and (2) when the compensation that is subject to the election would be currently available to the Employee in the absence of an election to defer.

(b) **Vesting Provisions**. Elective contributions are always fully vested and nonforfeitable. The Plan shall disregard elective contributions in applying the vesting provisions of the Plan to other contributions or benefits under Code section 411(a)(2). However, the Plan shall otherwise take a Participant's elective contributions into account in determining the Participant's vested benefits under the Plan. Thus, for example, the Plan shall take elective contributions into account in determining whether a Participant has a nonforfeitable right to contributions under the Plan for purposes of forfeitures, and for applying provisions permitting the repayment of distributions to have forfeited amounts restored, and the provisions of Code sections 410(a)(5)(D)(iii) and 411(a)(6)(D)(iii) permitting a plan to disregard certain service completed prior to breaks-in-service (sometimes referred to as "the rule of parity").

D.1.3 **Hardship Distributions**

(a) **Hardship Events**. A distribution under the Plan is hereby deemed to be on account of an immediate and heavy financial need of an Employee if the distribution is for one of the following or any other item permitted under Treasury Regulation section 1.401(k)-1(d)(3)(iii)(B):

(i) Expenses for (or necessary to obtain) medical care that would be deductible under Code section 213(d) (determined without regard to whether the expenses exceed 7.5 percent of adjusted gross income);

(ii) Costs directly related to the purchase of a principal residence for the Employee (excluding mortgage payments);

(iii) Payment of tuition, related educational fees, and room and board expenses, for up to the next twelve (12) months of post-secondary education for the Employee, the Employee's spouse, children, or dependents (as defined in Code section 152, and, for taxable years beginning on or after January 1, 2005, without regard to Code section 152(b)(l), (b)(2), and (d)(l)(B));

(iv) Payments necessary to prevent the eviction of the Employee from the Employee's principal residence or foreclosure on the mortgage on that residence;

(v) Payments for burial or funeral expenses for the Employee's deceased parent, spouse, children or dependents (as defined in Code section 152, and, for taxable years beginning on or after January 1, 2005, without regard to Code section 152(d)(l)(B)); or

(vi) Expenses for the repair of damage to the Employee's principal residence that would qualify for the casualty deduction under Code section 165 (determined without regard to whether the loss exceeds 10 percent of adjusted gross income).

(b) **Reduction of Code Section 402(g) Limit Following Hardship Distribution**. If the Plan provides for hardship distributions upon satisfaction of the safe harbor standards set forth in Treasury Regulation sections 1.401(k)-1(d)(3)(iii)(B) (deemed immediate and heavy financial need) and 1.401(k)-1(d)(3)(iv)(E) (deemed necessary to satisfy immediate need), then there shall be no reduction in the maximum amount of elective deferrals that a Participant may make pursuant to Code section 402(g) solely because of a hardship distribution made by this Plan or any other plan of the Employer.

D.1.4 **Actual Deferral Percentage Test**

(a) **Targeted Contribution Limit**. Qualified nonelective contributions (as defined in Treasury Regulation section 1.401(k)-6) cannot be taken into account in determining the actual deferral ratio ("ADR") for a Plan Year for a Non-Highly Compensated Employee ("NHCE") to the extent such contributions exceed the product of that NHCE's Code section 414(s) compensation and the greater of five percent (5%) or two (2) times the Plan's "representative contribution rate." Any qualified nonelective contribution taken into account under an actual contribution percentage test under Treasury Regulation section 1.401(m)-2(a)(6) (including the determination of the representative contribution rate for purposes of Treasury Regulation section 1.401(m)-2(a)(6)(v)(B)), is not permitted to be taken into account for purposes of this Section D.1.4(a) (including the determination of the "representative contribution rate" under this Section D.1.4(a)). For purposes of this Section D.1.4(a):

(i) The Plan's "representative contribution rate" is the lowest "applicable contribution rate" of any eligible NHCE among a group of eligible NHCEs that consists of half of all eligible NHCEs for the Plan Year (or, if greater, the lowest "applicable contribution rate" of any eligible NHCE who is in the group of all eligible NHCEs for the Plan Year and who is employed by the Employer on the last day of the Plan Year), and

(ii) The "applicable contribution rate" for an eligible NHCE is the sum of the qualified matching contributions (as defined in Treasury Regulation section 1.401(k)-6) taken into account in determining the ADR for the eligible NHCE for the Plan Year and the qualified nonelective contributions made for the eligible NHCE for the Plan Year, divided by the eligible NHCE's Code section 414(s) compensation for the same period.

Notwithstanding the above, qualified nonelective contributions that are made in connection with an Employer's obligation to pay prevailing wages under the Davis-Bacon Act (46 Stat. 1494), Public Law 71-798, Service Contract Act of 1965 (79 Stat. 1965), Public Law 89-286, or similar legislation can be taken into account for a Plan Year for an NHCE to the extent such contributions do not exceed 10 percent (10%) of that NHCE's Code section 414(s) compensation.

Qualified matching contributions may only be used to calculate an ADR to the extent that such qualified matching contributions are matching contributions that are not precluded from being taken into account under the actual contribution percentage test for the Plan Year under the rules of Tresasury Regulation section 1.401(m)-2(a)(5)(ii) and as set forth in Section D.1.6(a).

(b) **Limitation on QNECs and QMACs**. Qualified nonelective contributions and qualified matching contributions cannot be taken into account to determine an ADR to the extent such contributions are taken into account for purposes of satisfying any other actual deferral percentage test, any actual contribution percentage test, or the requirements of Treasury Regulation sections 1.401(k)-3, 1.401(m)-3, or 1.401(k)-4. Thus, for example, matching contributions that are made pursuant to Treasury Regulation section 1.401(k)-3(c) cannot be taken into account under the actual deferral percentage test. Similarly, if a plan switches from the current year testing method to the prior year testing method pursuant to Treasury Regulation section 1.401(k)-2(c), qualified nonelective contributions that are taken into account under the current year testing method for a year may not be taken into account under the prior year testing method for the next year.

(c) **ADR of HCE if Multiple Plans**. The actual deferral ratio ("ADR") of any Participant who is a highly compensated employee ("HCE") for the Plan Year and who is eligible to have elective contributions (as defined in Treasury Regulation section 1.401(k)-6) (and qualified nonelective contributions and/or qualified matching contributions, if treated as elective contributions for purposes of the actual deferral percentage test) allocated to such Participant's accounts under two (2) or more cash or deferred arrangements described in Code section 401(k), that are maintained by the same Employer, shall be determined as if such elective contributions (and, if applicable, such qualified nonelective contributions and/or qualified matching contributions) were made under a single arrangement. If an HCE participates in two or more cash or deferred arrangements of the Employer that have different Plan Years, then all elective contributions made during the Plan Year being tested under all such cash or deferred arrangements shall be aggregated, without regard to the plan years of the other plans. However, for Plan Years beginning before January 1, 2006, if the plans have different Plan Years, then all such cash or deferred arrangements ending with or within the same calendar year shall be treated as a single cash or deferred arrangement. Notwithstanding the foregoing, certain plans shall be treated as separate if mandatorily disaggregated under the Regulations of Code section 401(k).

(d) **Plans Using Different Testing Methods for the Actual Deferral Percentage and Actual Contribution Percentage Test**. Except as otherwise provided in this Section D.1.4(d), the Plan may use the current year testing method or prior year testing method for the actual deferral percentage test for a Plan Year without regard to whether the current year testing method or prior year testing method is used for the actual contribution percentage test for that Plan Year. However, if different testing methods are used, then the Plan cannot use:

(i) The recharacterization method of Treasury Regulation section 1.401(k)-2(b)(3) to correct excess contributions for a Plan Year;

(ii) The rules of Treasury Regulation section 1.401(m)-2(a)(6)(ii) to take elective contributions into account under the actual contribution percentage test (rather than the actual deferral percentage test); or

(iii) The rules of Treasury Regulation section 1.401(k)-2(a)(6)(v) to take qualified matching contributions into account under the actual deferral percentage test (rather than the actual contribution percentage test).

D.1.5 **Adjustment to Actual Deferral Percentage Test**

(a) **Distribution of Income Attributable to Excess Contributions**. Distributions of excess contributions must be adjusted for income (gain or loss), including an adjustment for income for the period between the end of the Plan Year and the date of the distribution (the "gap period"). The Plan Administrator has the discretion to determine and allocate income using any of the methods set forth below:

(i) Reasonable method of allocating income. The Plan Administrator may use any reasonable method for computing the income allocable to excess contributions, provided that the method does not violate Code section 401(a)(4), is used consistently for all Participants and for all corrective distributions under the Plan for the Plan Year, and is used by the Plan for allocating income to Participants' accounts. A Plan will not fail to use a reasonable method for computing the income allocable to excess contributions merely because the income allocable to excess contributions is determined on a date that is no more than seven (7) days before the distribution.

(ii) Alternative method of allocating income. The Plan Administrator may allocate income to excess contributions for the Plan Year by multiplying the income for the Plan Year allocable to the elective contributions and other amounts taken into account under the actual deferral percentage test (including contributions made for the Plan Year), by a fraction, the numerator of which is the excess contributions for the Employee for the Plan Year. and the denominator of which is the sum of the:

(1) Account balance attributable to elective contributions and other amounts taken into account under the actual deferral percentage test as of the beginning of the Plan Year, and

(2) Any additional amount of such contributions made for the Plan Year.

(iii) Safe harbor method of allocating gap period income. The Plan Administrator may use the safe harbor method in this paragraph to determine income on excess contributions for the gap period. Under this safe harbor method, income on excess contributions for the gap period is equal to ten percent (10%) of the income allocable to excess contributions for the Plan Year that would be determined under paragraph (ii) above, multiplied by the number of calendar months that have elapsed since the end of the Plan Year. For purposes of calculating the number of calendar months that have elapsed under the safe harbor method, a corrective distribution that is made on or before the fifteenth (15th) day of a month is treated as made on the last day of the preceding month and a distribution made after the fifteenth day of a month is treated as made on the last day of the month.

(iv) Alternative method of allocating Plan Year and gap period income. The Plan Administrator may determine the income for the aggregate of the Plan Year and the gap period, by applying the alternative method provided by paragraph (ii) above to this aggregate period. This is accomplished by (1) substituting the income for the Plan Year and the gap period, for the income for the Plan Year, and (2) substituting the amounts taken into account under the actual deferral percentage test for the Plan Year and the gap period, for the amounts taken into account under the actual deferral percentage test for the Plan Year in determining the fraction that is multiplied by that income.

(b) **Corrective Contributions**. If a failed actual deferral percentage test is to be corrected by making an Employer contribution, then the provisions of the Plan for the corrective contributions shall be applied by limiting the contribution made on behalf of any NHCE pursuant to such provisions to an amount that does not exceed the targeted contribution limits of Section D.1.4(a), above, or in the case of a corrective contribution that is a qualified matching contribution, the targeted contribution limit of Section D.1.6(a), below.

D.1.6 **Actual Contribution Percentage Test**

(a) **Targeted Matching Contribution Limit**. A matching contribution with respect to an elective contribution for a Plan Year is not taken into account under the actual contribution percentage test for an NHCE to the extent it exceeds the greatest of:

(i) five percent (5%) of the NHCE's Code section 414(s) compensation for the Plan Year;

(ii) the NHCE's elective contributions for the Plan Year; and

(iii) the product of two (2) times the Plan's "representative matching rate" and the NHCE's elective contributions for the Plan Year.

For purposes of this Section D.1.6(a), the Plan's "representative matching rate" is the lowest "matching rate" for any eligible NHCE among a group of NHCEs that consists of half of all eligible NHCEs in the Plan for the Plan Year who make elective contributions for the Plan Year (or, if greater, the lowest "matching rate" for all eligible NHCEs in the Plan who are employed by the Employer on the last day of the Plan Year and who make elective contributions for the Plan Year).

For purposes of this Section D.1.6(a), the "matching rate" for an Employee generally is the matching contributions made for such Employee divided by the Employee's elective contributions for the Plan Year. If the matching rate is not the same for all levels of elective contributions for an Employee, then the Employee's "matching rate" is determined assuming that an Employee's elective contributions are equal to six percent (6%) of Code section 414(s) compensation.

If the Plan provides a match with respect to the sum of the Employee's after-tax Employee contributions and elective contributions, then for purposes of this Section D.1.6(a), that sum is substituted for the amount of the Employee's elective contributions in subsections (ii) & (iii) above and in determining the "matching rate," and Employees who make either after-tax Employee contributions or elective contributions are taken into account in determining the Plan's "representative matching rate." Similarly, if the Plan provides a match with respect to the Employee's after-tax Employee contributions, but not elective contributions, then for purposes of this subsection, the Employee's after-tax Employee contributions are substituted for the amount of the Employee's elective contributions in subsections (ii) & (iii) above and in determining the "matching rate," and Employees who make after-tax Employee contributions are taken into account in determining the Plan's "representative matching rate."

(b) **Targeted QNEC Limit**. Qualified nonelective contributions (as defined in Treasury Regulation section 1.401(k)-6) cannot be taken into account under the actual contribution percentage test for a Plan Year for an NHCE to the extent such contributions exceed the product of that NHCE's Code section 414(s) compensation and the greater of five percent (5%) or two (2) times the Plan's "representative contribution rate." Any qualified nonelective contribution taken into account under an actual deferral percentage test under Treasury Regulation section 1.401(k)-2(a)(6) (including the determination of the "representative contribution rate" for purposes of Treasury Regulation section 1.401(k)-2(a)(6)(iv)(B)) is not permitted to be taken into account for purposes of this Section D.1.6(b) (including the determination of the "representative contribution rate" for purposes of subsection (i) below). For purposes of this Section D.1.6(b):

(i) The Plan's "representative contribution rate" is the lowest "applicable contribution rate" of any eligible NHCE among a group of eligible NHCEs that consists of half of all eligible NHCEs for the Plan Year (or, if greater, the lowest "applicable contribution rate" of any eligible NHCE who is in the group of all eligible NHCEs for the Plan Year and who is employed by the Employer on the last day of the Plan Year), and

(ii) The "applicable contribution rate" for an eligible NHCE is the sum of the matching contributions (as defined in Treasury Regulation section 1.401(m)-1(a)(2)) taken into account in determining the ACR for the eligible NHCE for the Plan Year and the qualified nonelective contributions made for that NHCE for the Plan Year, divided by that NHCE's Code section 414(s) compensation for the Plan Year.

Notwithstanding the above, qualified nonelective contributions that are made in connection with an Employer's obligation to pay prevailing wages under the Davis-Bacon Act (46 Stat. 1494), Public Law 71-798, Service Contract Act of 1965 (79 Stat. 1965), Public Law 89-286, or similar legislation can be taken into account for a Plan Year for an NHCE to the extent such contributions do not exceed 10 percent (10%) of that NHCE's Code section 414(s) compensation.

(c) **ACR of HCE if Multiple Plans**. The actual contribution ratio ("ACR") for any Participant who is a highly compensated employee ("HCE") and who is eligible to have matching contributions or after-tax Employee contributions allocated to his or her account under two (2) or more plans described in Code section 401(a), or arrangements described in Code section 401(k) that are maintained by the same Employer, shall be determined as if the total of such contributions was made under each plan and arrangement. If an HCE participates in two (2) or more such plans or arrangements that have different plan years, then all matching contributions and after-tax Employee contributions made during the Plan Year being tested under all such plans and arrangements shall be aggregated, without regard to the plan years of the other plans. For plan years beginning before January 1, 2006, all such plans and arrangements ending with or within the same calendar year shall be treated as a single plan or arrangement. Notwithstanding the foregoing, certain plans shall be treated as separate if mandatorily disaggregated under the Regulations of Code section 401(m).

(d) **Plans Using Different Testing Methods for the Actual Contribution Percentage and Actual Deferral Percentage Test**. Except as otherwise provided in this Section D.1.6(d), the Plan may use the current year testing method or prior year testing method for the actual contribution percentage test for a Plan Year without regard to whether the current year testing method or prior year testing method is used for the actual deferral percentage test for that Plan Year. However, if different testing methods are used, then the Plan cannot use:

(i) The recharacterization method of Treasury Regulation section 1.401(k)-2(b)(3) to correct excess contributions for a Plan Year;

(ii) The rules of Treasury Regulation section 1.401(m)-2(a)(6)(ii) to take elective contributions into account under the actual contribution percentage test (rather than the actual deferral percentage test); or

(iii) The rules of Treasury Regulation section 1.401(k)-2(a)(6) to take qualified matching contributions into account under the actual deferral percentage test (rather than the actual contribution percentage test).

D.1.7 **Adjustment to Actual Contribution Percentage Test**

(a) **Distribution of Income Attributable to Excess Aggregate Contributions**. Distributions of excess aggregate contributions must be adjusted for income (gain or loss), including an adjustment for income for the period between the end of the Plan Year and the date of the distribution (the "gap period"). For purposes of this Section D.1.7(a), "income" shall be determined and allocated in accordance with the provisions of Section D.1.5(a), above, except that such Section D.1.5(a) shall be applied by substituting "excess contributions" with "excess aggregate contributions" and by substituting amounts taken into account under the actual contribution percentage test for amounts taken into account under the actual deferral percentage test.

(b) **Corrective Contributions**. If a failed actual contribution percentage test is to be corrected by making an Employer contribution, then the provisions of the Plan for the corrective contributions shall be applied by limiting the contribution made on behalf of any NHCE pursuant to such provisions to an amount that does not exceed the targeted contribution limits of Sections D.1.6(a) and D.1.6(b).

**IN WITNESS WHEREOF**, the Sponsor has caused this Agreement to be executed on the 26th day of October, 2006.

**QUANEX CORPORATION**

By: /s/ Kevin P. Delaney

Title: Senior Vice President –General Counsel
and Secretary

**Exhibit 31.1**

**CHIEF EXECUTIVE OFFICER CERTIFICATION**

I, Raymond A. Jean, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Quanex Corporation (the "Registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures [as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)] and internal control over financial reporting [as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)] for the Registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

February 28, 2007

/s/ Raymond A. Jean

Raymond A. Jean
Chairman of the Board, President and
Chief Executive Officer
(Principal Executive Officer)

**Exhibit 31.2**

**CHIEF FINANCIAL OFFICER CERTIFICATION**

I, Thomas M. Walker, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Quanex Corporation (the "Registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures [as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)] and internal control over financial reporting [as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)] for the Registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

February 28, 2007

/s/ Thomas M. Walker

Thomas M. Walker
Senior Vice President — Finance and Chief Financial Officer
(Principal Financial Officer)

**Exhibit 32.1**

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

We hereby certify that the accompanying Quarterly Report of Quanex Corporation on Form 10-Q for the quarter ended January 31, 2007 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Report fairly presents, in all material respects, the financial condition and results of operations of Quanex Corporation.

February 28, 2007

| /s/ Raymond A. Jean | /s/ Thomas M. Walker |
|---|---|
| Raymond A. Jean | Thomas M. Walker |
| *Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)* | *Senior Vice President—Finance and Chief Financial Officer (Principal Financial Officer)* |