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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended October 31, 2003

or

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

Commission file number 1-5725

QUANEX CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**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)	(Zip code)

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

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

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

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

NONE

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No o

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

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

The aggregate market value of the voting common equity held by non-affiliates as of April 30, 2003, computed by reference to the closing price for the Common Stock on the New York Stock Exchange, Inc. on that date, was $457,577,134. Such calculation assumes only the registrant's officers and directors were affiliates of the registrant.

At December 12, 2003, there were outstanding 16,526,059 shares of the registrant's Common Stock, $.50 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement, to be filed with the Commission within 120 days of October 31, 2003, for its Annual Meeting of Stockholders to be held on February 26, 2004, are incorporated herein by reference in Items 10, 11, 12, and 13 of Part III of this Annual Report.

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PART I

Item 1. *Business*

General

Quanex was organized in 1927 as a Michigan corporation under the name Michigan Seamless Tube Company. The Company reincorporated in Delaware in 1968 under the same name and then changed its name to Quanex Corporation in 1977. The Company's executive offices are located at 1900 West Loop South, Suite 1500, Houston, Texas 77027. References made to the "Company" or "Quanex" include Quanex Corporation and its subsidiaries unless the context indicates otherwise.

The Company's businesses are managed on a decentralized basis. Each operating division has administrative, operating and marketing functions. The Company measures each division's return on investment and seeks to reward superior performance with incentive compensation, which is a significant portion of total compensation for salaried employees. Intercompany sales are conducted on an arms-length basis. Operational activities and policies are managed by corporate officers and key division executives. Also, a small corporate staff provides corporate accounting, financial and treasury management, tax, legal and human resource services to the operating divisions.

Quanex is a technological leader in the production of engineered carbon and alloy steel bars, aluminum flat-rolled products, and precision-formed metal and wood products which primarily serve the vehicular products and building products markets. The Company uses state-of-the-art manufacturing technologies, low-cost production processes, and engineering and metallurgical expertise to provide customers with specialized products for specific applications. Quanex believes these capabilities also provide the Company with unique competitive advantages. The Company's growth strategy is focused on the continued penetration of its two target markets, vehicular products and building products, and protecting, nurturing and growing its two core businesses, MACSTEEL and Engineered Products, that serve those markets.

Business Developments

In the Company's MACSTEEL operations, rotary centrifugal continuous casters are used with an in-line manufacturing process to produce bearing grade quality, seam-free, engineered carbon and alloy steel bars that enable Quanex to participate in the higher margin portions of its vehicular products market. Since 1990, the Company has invested approximately $300 million to enhance its steel bar manufacturing and refining processes, to improve rolling and finishing capability, and to expand shipping capacity at its MACSTEEL operations to approximately 720,000 tons per year. Phases I through VI of the MACSTEEL expansions have been completed. The Company installed additional equipment at each of the MACSTEEL plants in Jackson, Michigan, and Ft. Smith, Arkansas to increase their bar cutting capability and value-added turning capacity. This project increased MACPLUS engineered steel bar shipping capacity by approximately 50% to 270,000 tons annually with the installation of two additional bar turning and polishing lines, one at the plant in Jackson, which was completed in December of 2001 and the other at the Ft. Smith plant, which was completed in December 2002. MACSTEEL now has a total of six value-added MACPLUS lines. Phase VII of the expansion was announced in February 2003. By allowing for the more efficient processing of small diameter bars, this $10 million capital project will add 20,000 tons to MACSTEEL's current shipping capacity of 720,000 tons once the project is completed mid-2004.

Beginning in August 2002, the Company signed various agreements with Sanyo Special Steel Company, LTD, covering technology exchanges in the production of free machining lead free steels, advanced production methods and the sharing of manufacturing competencies. These collaborative efforts are intended to position MACSTEEL to more effectively compete among the New American Manufacturers.

On September 30, 2003, Quanex announced that it had signed a definitive purchase agreement with North Star Steel, a subsidiary of Cargill, Inc., to purchase the net assets of North Star's Monroe, Michigan-based manufacturing facility in a cash transaction. The Company expects to close the transaction in the first quarter of fiscal 2004. This facility is a scrap-based mini-mill producer of special bar quality and engineered steel bars primarily serving the light vehicle and heavy duty truck markets. The facility can produce approximately 500,000 tons annually, in diameters from 0.5625" to 3.52". The acquisition will further enhance MACSTEEL's product offerings and significantly increase annual capacity.

On November 21, 2003, the Company announced that it had signed a definitive purchase agreement with Kirtland Capital Partners and other stockholders to purchase the stock of TruSeal Technologies, Inc. in a cash transaction. The Company expects to close the transaction in the first quarter of fiscal 2004. TruSeal, headquartered in Beachwood, Ohio, manufactures and markets a full line of patented, flexible insulating glass spacer systems and sealants for wood, vinyl and aluminum windows. The acquisition will compliment Quanex's building products segment by providing its window and door customers a broader range of products.

Manufacturing Processes, Markets, and Product Sales by Business Segment

Quanex operates 19 manufacturing facilities in 11 states in the United States. These facilities feature efficient plant design and flexible manufacturing processes, enabling the Company to produce a wide variety of custom engineered products and materials for the vehicular products and building products markets. The Company is able to maintain minimal levels of finished goods inventories at most locations because it typically manufactures products upon order to customer specifications.

The majority of the Company's products are sold into the vehicular products and building products markets, with minimal sales to the industrial machinery and capital equipment markets.

For financial information regarding each of Quanex's business segments, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein and Note 12 to the Consolidated Financial Statements. For net sales of the Company by major product lines see Note 12 to the Consolidated Financial Statements. For the years ended October 31, 2003, 2002, and 2001, no one customer accounted for 10% or more of the Company's sales.

Vehicular Products Segment

The vehicular products segment is comprised of MACSTEEL, NitroSteel, Piper Impact and Temroc Metals. The segment includes engineered steel bar operations, impact-extrusion operations, steel bar and tube heat-treating services, steel bar and tube corrosion and wear resistant finishing services, and aluminum extrusion and fabricated metal products.

MACSTEEL

The Company's engineered steel bar operations, which represent the majority of the segment's sales and operating income, are conducted through its MACSTEEL division. MACSTEEL includes two plants, one located in Ft. Smith, Arkansas, and the other in Jackson, Michigan, which in the aggregate are capable of shipping up to 720,000 tons annually of hot finished, precision engineered, carbon and alloy steel bars. The Company believes that MACSTEEL has the only two plants in North America using scrap-fed continuous rotary centrifugal casting technology. This casting process produces seam-free bars, without surface defects or inclusions, thereby reducing the need for subsequent surface conditioning. The continuous casting and automated in-line manufacturing operations at the MACSTEEL plants substantially reduce labor and energy costs by eliminating the intermittent steps that characterize manufacturing operations at most larger integrated steel mills. The Company typically sells only complete heat lots, or batches, which are made to specific customer requirements.

MACSTEEL produces various grades of customized, engineered steel bars by melting steel scrap and casting it in a rotary centrifugal continuous caster. MACSTEEL's molten steel is further processed through secondary refining processes that include argon stirring, ladle injection, and vacuum arc degassing prior to casting. These processes enable MACSTEEL to produce higher quality, "cleaner" steel. The Company believes that MACSTEEL is the lowest cost producer of engineered carbon and alloy steel bars in North America. The Company believes that energy costs at MACSTEEL are significantly lower than those of its competitors because its bars are moved directly from the caster to the rolling mill before cooling, reducing the need for costly reheating. MACSTEEL's low unit labor costs are achieved with its highly automated manufacturing process, enabling it to produce finished steel bars using less than two man-hours of labor per ton compared with an estimated industry average of four man-hours per ton for U.S. integrated steel producers.

MACSTEEL products are custom manufactured primarily for the vehicular product markets serving the passenger car, light truck, sport utility vehicle, heavy truck, anti-friction bearing, off-road and farm equipment industries. These industries use engineered steel bars in critical applications such as camshafts, crankshafts, transmission gears, wheel spindles and hubs, bearing components, steering components, hydraulic mechanisms and seamless tube production. Also, MACSTEEL engineered steel bars are used in the manufacture of components for steel air bag inflators at the Company's Piper Impact plant in New Albany, Mississippi.

The MACSTEEL division also includes a heat treating plant in Huntington, Indiana ("Heat Treat"). The Heat Treat facility uses custom designed, in-line equipment to provide tube and bar heat-treating and related services, such as quench and temper, stress relieving, normalizing, "cut-to-length", and metallurgical testing. This plant primarily serves customers in the vehicular products and energy markets.

NitroSteel

NitroSteel, located in Pleasant Prairie, Wisconsin, processes steel bars and tubes using the patented Nitrotec treatment to improve their corrosion and wear resistance properties while providing a more environmentally friendly, non-toxic alternative to chrome plating. NitroSteel's products are made for specific customer applications and are used for fluid power applications primarily in the vehicular products markets.

Piper Impact

Piper Impact includes two impact-extrusion facilities in New Albany, Mississippi, dedicated to aluminum and steel impact-extruded products.

Piper Impact is a manufacturer of custom designed, impact extruded aluminum and steel parts for use in vehicular and defense applications, in addition to high-pressure cylinders used in medical and other applications. Piper Impact's operations use impact extrusion technology to produce highly engineered near-net shaped components from aluminum and steel slugs. The pressure resulting from the impact of the extrusion presses causes metal to flow into the desired shape. This cost efficient cold forming of the metal results in a high quality, work-hardened product with a superior finish. Products may be further processed with heat-treating and precision machining. The parts are then delivered to customers' assembly lines, requiring little or no additional processing. Though down from the level of prior years, one customer purchases a majority of Piper's production for use in the manufacture of automotive air bag systems.

Temroc Metals

Temroc Metals, located in Hamel, Minnesota is an aluminum extruder and fabricator of metal products. The single facility manufactures engineered products that primarily serve the recreational vehicle products market.

Building Products Segment

The building products segment is comprised of the Engineered Products and Nichols Aluminum divisions. The segment includes four fabricated metal components operations, two wood fenestration product operations, two aluminum sheet casting operations and three stand-alone finishing operations.

Engineered Products

The Engineered Products division, which includes AMSCO in Rice Lake, Wisconsin, HOMESHIELD, with two plants in Chatsworth, Illinois, and one in Hood River, Oregon, IMPERIAL PRODUCTS in Richmond, Indiana, and COLONIAL CRAFT with locations in Mounds View, Minnesota and Luck, Wisconsin, produces various engineered products for the building products markets. These products include window and patio door screens, window outer frames, residential exterior products, custom wood window grilles and accessories, and a broad line of custom designed, roll-formed aluminum products and stamped aluminum shapes for manufacturers of windows for the home improvement, residential, and light commercial construction markets. AMSCO combines strong product design and development expertise with reliable, just-in-time delivery. HOMESHIELD also coats and/or paints aluminum sheet in many colors, sizes, and finishes, and fabricates aluminum coil into rain carrying systems, soffit, exterior housing trim and roofing products. IMPERIAL PRODUCTS produces sophisticated residential exterior door thresholds, astragals, patio door systems and other miscellaneous door components. COLONIAL CRAFT produces custom hardwood architectural moulding, flooring, and window and door accessories for premium wood window manufacturers.

Nichols Aluminum

Nichols Aluminum manufactures mill finished and coated aluminum sheet for the building products market and the food packaging market. The division comprises five plants: a thin-slab casting and hot rolling mill ("NAC") located in Davenport, Iowa, three cold rolling and finishing plants located in Davenport, Iowa ("NAD"), Lincolnshire, Illinois ("NAL"), and Decatur, Alabama ("NAA"), and Nichols Aluminum-Golden ("NAG"), a thin-slab casting and hot rolling mill located in Fort Lupton, Colorado.

NAC's mini-mill uses an in-line casting process that can produce 400 million pounds of reroll (hot-rolled aluminum sheet) annually. The mini-mill converts aluminum scrap to reroll through melting, continuous casting, and in-line hot rolling processes. NAC has shredding and blending capabilities, including two rotary barrel furnaces and a dross recovery system that broaden its sources of raw material, allow it to melt cheaper grades of scrap, and improve raw material

yields. Delacquering equipment improves the quality of the raw material before it reaches the primary melt furnaces by burning off combustibles in the scrap. Scrap is blended using computerized processes to most economically achieve the desired molten aluminum alloy composition.

The Company believes the combination of base capacity increases and technological enhancements, directed at producing higher quality reroll, results in a significant manufacturing advantage with savings derived from reduced raw material costs, optimized scrap utilization, reduced unit energy cost, reduced cold rolling requirements and lower labor costs.

Further processing of the reroll occurs at NAD, NAL or NAA, where customer specific product requirements can be met through cold rolling to various gauges, annealing for additional mechanical

and formability properties, tension leveling to improve the flatness of the sheet, and slitting to specific widths. Product at the NAD and NAA plants can also be custom painted, an important value-added feature for the applications of certain customers in the building products market.

Operations at NAG include scrap melting and casting aluminum into sheet, cold rolling to specific gauge, annealing, leveling, custom coating and slitting to width. NAG manufactures high quality aluminum sheet from scrap, then finishes the sheet for specialized applications primarily for food packaging markets.

Raw Materials and Supplies

The Company's MACSTEEL plants purchase their principal raw material, steel scrap or substitutes such as pig iron, beach iron and hot briquetted iron on the open market. Collection and transportation of these raw materials to the Company's plants can be adversely affected by extreme weather conditions. Prices for scrap also vary in relation to the general business cycle and global demand.

Temroc Metal's raw material consists primarily of aluminum billet, which it purchases from several suppliers on the open market.

Piper Impact's raw material consists of aluminum bars and slugs that it purchases on the open market, and steel bars that it purchases from MACSTEEL.

AMSCO and HOMESHIELD's primary raw material is coated and uncoated aluminum sheet purchased primarily from Nichols Aluminum. Raw materials utilized at IMPERIAL PRODUCTS include aluminum, wood and vinyl that are available from a number of suppliers. Prices for aluminum are typically set monthly based upon market rates. In addition, IMPERIAL PRODUCTS utilizes two types of wood materials—hardwood and softwood, which it purchases at market prices.

COLONIAL CRAFT's primary raw material is hardwood and softwood lumber. This is purchased from sawmills and lumber concentration yards throughout North America at market prices.

Nichols Aluminum's principal raw material is aluminum scrap purchased on the open market, where availability and delivery can be adversely affected by extreme weather conditions. Nichols purchases and sells aluminum ingot futures contracts on the London Metal Exchange to hedge against fluctuations in the price of the aluminum scrap required to manufacture products for its fixed-price sales contracts.

Backlog

At October 31, 2003, Quanex's backlog of orders to be shipped in the next twelve months was approximately $218 million. This compares to approximately $240 million at October 31, 2002. Because many of the markets in which Quanex operates have short lead times, the Company does not believe that backlog figures are reliable indicators of annual sales volume or operating results.

Competition

The Company's products are sold under highly competitive conditions. Quanex competes with a number of companies, some of which have greater financial resources. Competitive factors include product quality, price, delivery, and the ability to manufacture to customer specifications. The amounts of engineered steel bars, aluminum mill sheet products, engineered products and impact extruded products manufactured by the Company represent a small percentage of annual domestic production.

MACSTEEL competes with several large integrated and non-integrated steel producers. Although these producers may be larger and have greater resources than the Company, Quanex believes that the technology used at MACSTEEL facilities permits it to compete effectively in the markets it serves.

Piper Impact competes with several other impact extrusion companies, and companies that offer other technologies that can provide similar products, on the basis of design, quality, price and service. Temroc Metals competes largely with other small aluminum extrusion and machining facilities.

Engineered Products competes with many small and midsize metal and wood fabricators and wood moulding facilities, primarily on the basis of custom engineering, product development, quality, service and price. The division also competes with in-house operations of vertically integrated fenestration (door and window) original equipment manufacturers ("OEM"s).

Nichols Aluminum competes with many small and large aluminum sheet manufacturers. Some of these competitors are divisions or subsidiaries of major corporations with substantially greater resources than the Company. The Company also competes with major aluminum producers in coil-coated and mill finished products, primarily on the basis of the breadth of product lines, the quality and responsiveness of its services, and price.

Sales and Distribution

The Company has sales organizations with sales representatives in many parts of the United States. MACSTEEL sells engineered steel bars primarily to tier-one or tier-two suppliers through its direct sales organization and a limited number of manufacturers' representatives. Piper Impact and Temroc Metals sell directly to OEMs. The Engineered Products division's products are sold primarily to OEMs, except for some residential building products, which are sold through distributors. Nichols Aluminum products are sold directly to OEMs and through distributors.

Seasonal Nature of Business

Sales for Engineered Products and Nichols Aluminum are seasonal. The primary markets for these divisions are in the Northeast and Midwest regions of the United States, where winter weather typically reduces homebuilding and home improvement activity. These divisions typically experience their lowest sales during the Company's first fiscal quarter. Profits tend to be lower in quarters with lower sales because a high percentage of their manufacturing overhead and operating expense is due to labor and other costs that are generally semi-variable throughout the year.

Sales for the other businesses in which the Company competes are generally not seasonal. However, due to the number of holidays in the Company's first fiscal quarter, sales have historically been lower in this period as some customers reduce production schedules. As a result of reduced production days, combined with the effects of seasonality, the Company generally expects that, absent unusual activity, its lowest sales will occur in the first fiscal quarter.

Service Marks, Trademarks, Trade Names, and Patents

The Company's Quanex, Quanex design, Seam-Free design, NitroSteel, MACGOLD, MACSTEEL, MACSTEEL design, MACPLUS, Ultra-Bar, Homeshield, Homeshield design, and "The Best Alloy & Specialty Bars" marks are registered trademarks or service marks. The Company's Piper Impact name is used as a service mark, but is not yet registered in the United States. The trade name Nichols-Homeshield and the Homeshield design trademarks are used in connection with the sale of the Company's aluminum mill sheet products and residential building products. The Homeshield, Piper Impact, Colonial Craft, MACSTEEL and Quanex word and design marks and associated trade names are considered valuable in the conduct of the Company's business. The businesses conducted by the Company generally do not depend upon patent protection. Although the Company holds numerous patents, in many cases, the proprietary technology that the Company has developed for using the patents is more important than the patents themselves.

Research and Development

Expenditures for research and development of new products or services during the last three years were not significant. Although not technically defined as research and development, a significant amount of time, effort and expense is devoted to (a) custom engineering which qualifies the Company's products for specific customer applications, and to (b) developing superior, proprietary process technology.

Environmental Matters

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 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 or financial condition.

Under applicable state and federal laws, the Company may be responsible for, among other things, all or part of the costs required to remove or remediate wastes or hazardous substances at locations Quanex has owned or operated at any time. The Company is currently involved in environmental investigations or remediation at several such locations.

From time to time, Quanex also has been alleged to be liable for all or part of the costs incurred to clean up third-party sites where it is alleged to have arranged for disposal of hazardous substances. The Company's allocable share of liability at those sites, taking into account the likelihood that other parties will pay their shares, has not been material to its operations or financial condition.

Total remediation reserves, at October 31, 2003, for Quanex's current plants, former operating locations, and disposal facilities were approximately $16.8 million. Of that, approximately 80% is allocated to the cleanup of historical soil and groundwater contamination and other corrective measures at the Piper Impact division in New Albany, Mississippi. Depending upon such factors as the nature and extent of contamination, the cleanup technologies employed, and regulatory concurrences, final remediation costs may be more or less than amounts accrued; however, management believes it has established adequate reserves for all probable and reasonably estimable remediation liabilities.

Environmental agencies continue to develop regulations implementing the Federal Clean Air Act. Depending on the nature of the regulations adopted, Quanex may be required to incur additional capital and other expenditures sometime in the next several years for air pollution control equipment, to maintain or obtain operating permits and approvals, and to address other air emission-related issues. In fiscal 2004, the Company plans to have capital expenditures for equipment upgrades in order to comply with secondary aluminum production emissions standards at two of its Nichols Aluminum facilities. Based upon its analysis and experience to date, Quanex does not believe that its compliance with Clean Air Act requirements will have a material adverse effect on its operations or financial condition.

Quanex incurred expenses of approximately $3.5 million and $4 million during fiscal 2003 and 2002, respectively, in order to comply with existing environmental regulations. For 2004, the Company estimates expenses at its facilities (excluding pending acquisitions) will be approximately $3.7 million for continuing environmental compliance. In addition, capital expenditures for compliance with existing or proposed environmental regulations were approximately $1.7 million and $1.5 million during fiscal 2003 and 2002, respectively. For fiscal 2004, the Company estimates that capital expenditures for environmental compliance will be approximately $1.5 million, which includes amounts for upgrades related to the coating systems emission compliance standards at two of its Nichols Aluminum facilities. Future expenditures relating to environmental matters will necessarily depend upon the application to

Quanex and its facilities of future regulations and government decisions. Quanex will continue to have expenditures in connection with environmental matters beyond 2004, but it is not possible at this time to reasonably estimate the amount of those expenditures.

Employees

At October 31, 2003, the Company employed 3,153 persons. Of the total employed, 33% were covered by collective bargaining agreements. A five-year collective bargaining agreement for Temroc Metals was ratified by the United Automobile Workers International Union of America in February, 2002. A five year collective bargaining agreement for Nichols Aluminum Casting and Nichols Aluminum Davenport was ratified by the International Brotherhood of Teamsters in November 2002. A five year collective bargaining agreement for MACSTEEL Arkansas was ratified by the United Steel Workers of America in February 2003. Nichols Aluminum Lincolnshire's collective bargaining agreement expires January 12, 2004 and negotiations for the renewal of that agreement are already underway. MACSTEEL Michigan's collective bargaining agreement expires February 29, 2004 and negotiations for the renewal of that agreement will begin in January.

Financial Information about Foreign and Domestic Operations

For financial information on the Company's foreign and domestic operations, see Note 12 of the Financial Statements contained in this Annual Report on Form 10-K.

Website

The Company's required Securities Exchange Act filings such as Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K are accessible free of charge on its website at *www.quanex.com.*

Item 2. ***Properties***

The following table lists Quanex's principal properties together with their locations, general character and the industry segment which uses the facility. Listed facilities are owned by the Company, unless indicated otherwise. (See Item 1, "Business", for discussion of capacity of various facilities.)

Location	Plant/Office	Square Footage
Vehicular Products Segment		
Fort Smith, Arkansas	MACSTEEL	614,000
Jackson, Michigan	MACSTEEL	386,000
Huntington, Indiana	Heat Treating	99,821
Pleasant Prairie, Wisconsin	NitroSteel	35,000
New Albany, Mississippi	Piper Impact (two plants)	683,000
Hamel, Minnesota	Temroc Metals	240,000
Building Products Segment		
Lincolnshire, Illinois	Nichols Aluminum Lincolnshire	142,000
Davenport, Iowa	Nichols Aluminum Davenport	236,000
Davenport, Iowa	Nichols Aluminum Casting	300,000
Fort Lupton, Colorado	Nichols Aluminum Golden	240,400
Rice Lake, Wisconsin	AMSCO	336,000
Chatsworth, Illinois	HOMESHIELD (two plants)	218,000
Hood River, Oregon	HOMESHIELD	37,000
Richmond, Indiana	IMPERIAL PRODUCTS	92,000
Luck, Wisconsin	COLONIAL CRAFT	105,000
Mounds View, Minnesota *Leased (expires 2008)*	COLONIAL CRAFT	125,000
Decatur, Alabama *Leased (leases expiring 2004, 2005 and 2018)*	Nichols Aluminum Alabama	410,000
Executive Offices		
Houston, Texas *Leased (expires 2010)*	Quanex Corporation	21,000

Item 3. ***Legal Proceedings***

The Company believes there are no material legal proceedings to which Quanex, its subsidiaries, or their property is subject. See Note 18 to the Consolidated Financial Statements.

Item 4. ***Submission of Matters to Vote of Security Holders***

None.

PART II

Item 5. ***Market for Registrant's Common Equity and Related Stockholder Matters***

Quanex's common stock, $.50 par value, is traded on the New York Stock Exchange, under the ticker symbol: NX. Quarterly stock price information and annual dividend information for the common stock is as follows:

Quarterly Common Stock Dividends

Quarter Ended	2003	2002	2001
January	$ .17	$ .16	.$ 16
April	.17	.16	.16
July	.17	.16	.16
October	.17	.16	.16
Total	$ .68	$ .64	$ .64

Quarterly Common Stock Sales Price (High & Low)

Quarter Ended	2003	2002	2001
January	$ 37.55	$ 29.64	$ 21.00
	29.12	25.71	16.38
April	33.49	38.35	21.15
	27.93	28.63	17.35
July	33.49	44.19	27.55
	28.59	31.01	20.70
October	40.60	40.55	27.48
	29.94	33.18	20.75

The terms of Quanex's revolving credit agreement does not specifically limit the total amount of dividends and other distribution on its stock. However, the covenant to maintain a certain fixed charge coverage ratio indirectly impacts the Company's ability to pay dividends(1). As of October 31, 2003, the aggregate amount available for dividends under the credit facility was approximately $43 million.

(1) The fixed charge component of the ratio is comprised of consolidated interest expense, principal payments due on consolidated debt and dividends declared. Increasing the dividend impacts the fixed charge coverage ratio and thus indirectly limits the amount of dividends that could be declared and satisfy the covenant.

There were 4,754 holders of Quanex common stock (excluding individual participants in securities positions listings) on record as of November 30, 2003.

The following table summarizes as of October 31, 2003, certain information regarding equity compensation to our employees, officers, directors and other persons under our equity compensation plans.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	768,970	$ 25	1,309,343
Equity compensation plans not approved by security holders(1)	213,660	28	39,290
Total	982,630	$ 26	1,348,633

(1) The Quanex Corporation 1997 Key Employee Stock Plan was approved by the Company's Board of Directors in October 1997. This plan provides for the granting of stock options to eligible persons employed by the Company who are not executive officers of the Company. Under the plan, the total number

of stock options which may be granted is 400,000 shares. Stock options may be granted at not less than the fair market value (as defined in the plan) on the date the options are granted and generally become exercisable after one year in one-third annual increments. The options expire ten years after the date of grant. The Board of Directors may amend, terminate or suspend the plan at any time.

Item 6. ***Selected Financial Data***

Glossary of Terms

The exact definitions of commonly used financial terms and ratios vary somewhat among different companies and investment analysts. The following list gives the definition of certain financial terms that are used in this report:

Asset turnover: Net sales divided by average total assets.

Book value per common share: Stockholders' equity less the stated value of preferred stock divided by the number of common shares outstanding.

Current ratio: Current assets divided by current liabilities.

Return on common stockholders' equity: Net income attributable to common stockholders divided by average common stockholders' equity.

Return on investment: The sum of net income and the after-tax effect of interest expense less capitalized interest divided by the sum of the averages for short and long-term debt and stockholders' equity.

Working Capital: Current assets less current liabilities.

Financial Summary 1999-2003

	Fiscal years ended October 31,				
	2003	2002	2001	2000	1999
	(thousands, except per share data)				
Revenues and Earnings					
Net sales(2)	$ 1,031,215	$ 994,387	$ 924,353	$ 964,518	$ 834,902
Cost of sales including operating depreciation and amortization	912,534	855,177	809,027	841,047	706,607
Gross profit	118,681	139,210	115,326	123,471	128,295
Piper Impact Asset Impairment Charge	—	—	—	56,300(1)	—
Loss on sale of Piper Impact Europe	—	—	—	14,280(1)	—
Other depreciation and amortization	1,314	1,502	3,808	3,308	3,434
Selling, general and administrative expenses	53,572	54,408	54,202	53,545	53,104
Operating income (loss)	63,795	83,300	57,316	(3,962)	71,757
Percent of net sales(2)	6.2%	8.4%	6.2%	(0.4)%	8.6%
Retired executive life insurance benefit(3)	2,152	9,020	—	—	—
Other income—net	2,393(4)	2,227	3,195	2,420	2,021
Interest expense—net	2,517	12,933	14,889	13,314	12,791
Income (loss) before income taxes	65,823	81,614	45,622	(14,856)	60,987
Income tax expense (benefit)	22,936	26,132	16,428	(5,191)	21,271
Net income (loss)	$ 42,887	$ 55,482	$ 29,194	$ (9,665)	$ 39,716
Percent of net sales(2)	% 4.2(4)	5.6%	3.2%	(1.0)%(1)	4.8%
Per Share Data					
Basic Earnings (loss)	$ 2.65(4)	$ 3.74	$ 2.18	$ (0.70)(1)	$ 2.79
Diluted Earnings (loss)	$ 2.62	$ 3.52	$ 2.07	$ (0.70)	$ 2.59
Cash dividends declared	$ 0.68	$ 0.64	$ 0.64	$ 0.64	$ 0.64
Book value	$ 27.52	$ 25.67	$ 20.88	$ 19.90	$ 21.24
Market closing price range:					
High	$ 40.60	$ 44.15	$ 27.38	$ 26.56	$ 28.94
Low	$ 27.93	$ 25.89	$ 17.00	$ 14.38	$ 15.50
Average shares outstanding (thousands)	16,154	14,823	13,399	13,727	14,234

Financial Summary 1999-2003 (continued)

	Fiscal years ended October 31,				
	2003	2002	2001	2000	1999
	(thousands, except Other Data)				
Financial Position—Year End					
Working capital	$ 92,783	$ 100,997	$ 102,288	$ 104,944	$ 76,247
Property, plant and equipment—net	335,904	353,132	357,635	338,248	406,841
Total assets	665,863	689,140	697,631	645,859	690,446
Noncurrent deferred income taxes	$ 34,895	$ 29,210	$ 29,282	$ 27,620	$ 43,910
Total debt	19,770	75,565	220,028	191,913	189,666
Stockholders' equity	445,159	421,395	279,977	266,497	301,061
Total capitalization	464,929	496,960	500,005	458,410	490,727
Cash provided by operating activities	$ 102,840	$ 81,111	$ 84,950	$ 77,870	$ 77,688
Depreciation and amortization	46,415	43,987	43,910	48,445	45,883
Capital expenditures	28,888	34,513	55,640	42,355	60,934
Backlog for shipment in next 12 months	218,000	240,000	165,000	157,830	164,128
Other Data					
Total debt percent of capitalization	4.3	15.2	44.0	41.9	38.7
Asset turnover(2)	1.5	1.4	1.4	1.4	1.2
Current ratio	1.7 to 1	1.7 to 1	1.8 to 1	1.8 to 1	1.6 to 1
Return on investment-percent	9.3	12.8	8.1	(0.2)(1)	10.0
Return on common stockholders' equity-percent	9.9	15.8	10.7	(3.4)(1)	13.9
Number of stockholders	4,780	5,030	5,313	5,697	5,113
Average number of employees	3,295	3,378	3,340	3,361	3,393
Sales (thousands) per employee(2)	$ 313	$ 294	$ 277	$ 287	$ 246

(1) Includes effects in fiscal 2000 of Piper Impact's $56.3 million (pretax) asset impairment charge in accordance with SFAS No. 121 and/or the $14.3 million (pretax) loss on sale of Piper Impact Europe, net of gain on related range forward foreign currency agreement.

(2) Beginning in fiscal 2001, freight costs are no longer netted against sales; they are included in cost of sales. Prior year's net sales and sales ratios have been restated to conform to this presentation.

(3) Represents the excess of life insurance proceeds over (a) the cash surrender value and (b) liabilities to beneficiaries of deceased executives, on whom the Company held life insurance policies.

(4) Includes effects in fiscal 2003 of $0.4 million gain on sale of Piper, Utah property.

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

General

The discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Selected Financial Data and the Consolidated Financial Statements of the Company and the accompanying notes.

Private Securities Litigation Reform Act

Certain of the statements contained in this document and in documents incorporated by reference herein, including those made under the caption "Management's Discussion and Analysis of Results of Operations and Financial Condition" are "forward-looking" statements as defined under the Private Securities Litigation Reform Act of 1995. Generally, the words "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 our Company's forward-looking statements. Such factors include domestic and international economic activity, prevailing prices of steel and aluminum scrap and other raw material costs, 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.

Results of Operations

Overview

Summary Information as % of Sales

	Fiscal Year Ended October 31,					
	2003		2002		2001	
	Dollar Amount	% of Sales	Dollar Amount	% of Sales	Dollar Amount	% of Sales
	(Dollars in millions)					
Net Sales	$ 1,031.2	100%	$ 994.4	100%	$ 924.3	100%
Cost of Sales	867.8	84	813.0	82	769.3	83
Selling, general and admin.	53.6	5	54.4	6	54.2	6
Depreciation and amortization	46.1	5	43.7	4	43.5	5
Operating Income	63.7	6%	83.3	8%	57.3	6%
Interest Expense	(2.5)	0	(14.8)	(1)	(16.6)	(1)
Capitalized Interest	—	0	1.9	0	1.7	0
Retired executive life insurance benefit	2.2	0	9.0	1	—	0
Other, net	2.4	0	2.2	0	3.2	0
Income tax expense	(22.9)	(2)	(26.1)	(2)	(16.4)	(2)
Net income	$ 42.9	4%	$ 55.5	6%	$ 29.2	3%

The Company achieved record level net sales in fiscal 2003 and demonstrated its ability to generate healthy results notwithstanding the somewhat weak broad-based economic climate. The reduction in total debt to $19.8 million at the end of fiscal 2003 from $75.6 million in fiscal 2002 produced an equally significant reduction in interest expense. Interest expense was $2.5 million in 2003 compared to $14.8 million in 2002. The Company also ended the year with a strong balance sheet as the total debt to capitalization ratio was 4.3% at October 31, 2003, which is a decrease from 15.2% as of October 31, 2002.

Business Segments

Business segments are reported in accordance with Statement of Financial Accounting Standards ("SFAS") No. 131. SFAS No. 131 requires that the Company disclose certain information about its operating segments where operating segments are defined as "components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance". Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments.

The vehicular products segment is comprised of MACSTEEL, Piper Impact and Temroc. The segment's main driver is North American light vehicle builds and to a lesser extent, heavy duty truck builds. The building products segment is comprised of Engineered Products and Nichols Aluminum. The main drivers of this segment are residential housing starts and remodeling expenditures.

The following table sets forth selected operating data for the Company's two business segments:

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Vehicular Products:(1)			
Net sales	$ 468,506	$ 459,531	$ 439,307
Operating income	48,208	57,606	47,466
Depreciation and amortization	29,573	27,849	25,905
Identifiable assets	$ 350,767	$ 363,559	$ 362,442
Building Products:(2)			
Net sales	$ 562,709	$ 534,856	$ 485,046
Operating income	35,648	37,985	23,662

Depreciation and amortization	16,152	15,492	17,061
Identifiable assets	$ 278,629	$ 283,475	$ 269,387

(1) Fiscal 2003, 2002 and 2001 results include Temroc operations, acquired November 30, 2000. See Note 2 to the consolidated financial statements.

(2) Fiscal 2003 and 2002 results include Colonial Craft operations, acquired February 12, 2002. See Note 2 to the consolidated financial statements.

Within the vehicular products segment automotive builds continued to drive demand, exceeding 16 million annualized units for fiscal 2003. While the pace was not record setting, MACSTEEL's capacity utilization rates were higher than experienced in fiscal 2002. MACSTEEL's strongest market presence is with the "Big 3" automakers, where builds were down for fiscal 2003. MACSTEEL continues to work with the New American Manufacturers ("NAMs"), or non "Big 3" automakers, on domestic part sourcing and the Company's business with them is growing. Qualification efforts with the NAMs require time consuming evaluation periods. Beginning in August 2002, the Company has signed various agreements with Sanyo Special Steel Company, LTD, covering technology exchanges in the production of free-machining lead-free steels, advanced production methods and the sharing of manufacturing competencies. These collaborative efforts are intended to position MACSTEEL to more effectively compete among the NAMs.

At Piper Impact, sales were down for fiscal 2003 compared to the previous fiscal year, with the largest drop in business coming from a reduction in airbag component sales. While recognizing this erosion in demand for aluminum and steel airbag components, Piper Impact has developed new outlets for its capacity, and has experienced significant growth in the high-pressure cylinder markets. However, this growth has not been fast enough to replace airbag component sales. Piper Impact continues to lose money on many of its traditional product lines.

Within the building products segment residential housing starts and remodeling expenditures remained brisk, allowing Engineered Products and Nichols Aluminum to post a combined 5% increase in net sales over the prior fiscal year. However, the segment's operating income declined by 6% for fiscal 2003, primarily as a result of increased aluminum scrap prices absorbed by Nichols Aluminum.

The Company continues to see strong demand for its door and window components. Housing starts for the month of October 2003 were nearly 2 million units, on a seasonally adjusted annual basis. With demand for new residential homes at record levels, we expect customer activity to remain at high levels dampened only by inclement winter weather conditions in the Northeast and Midwest regions of the United States.

Outlook

Operating results for the Company's vehicular products segment are tied to North American light vehicle builds and heavy duty truck builds. For calendar 2004, the Company expects light vehicle builds to be at or slightly above the 2003 level. A concern to the Company continues to be the loss of market share by the "Big 3" to the NAMs. While MACSTEEL sells steel bar products to the NAMs and continues to make inroads with them, MACSTEEL remains closely linked to the "Big 3". Heavy duty truck builds, which have been at cyclical lows for several years, are expected to recover in calendar 2004 with builds expected to top 200,000 units, up from the 175,000 units estimated to be built in 2003.

Operating results for the Company's building products segment are tied to U.S. housing starts and remodeling activity. For calendar 2004, the Company expects housing starts to drop about 5% from 2003's very strong level. Quanex expects remodeling expenditures to remain at robust levels for calendar 2004.

The Company's primary raw materials are steel and aluminum scrap, which supplies our MACSTEEL and Nichols Aluminum businesses. Throughout fiscal 2003, steel scrap prices rose approximately 20% and aluminum scrap prices rose approximately 8%. The Company expects higher scrap prices at least through the first half of fiscal 2004. Over time, MACSTEEL recovers the majority of these cost increases through the use of scrap surcharges, but it does experience quarterly margin compression as the surcharge is based on a three month trailing index. Nichols Aluminum has no such surcharge and it attempts to cover rising scrap costs through a higher selling price.

Quanex's first fiscal quarter (November, December and January) is historically the Company's least profitable as there are fewer production days due to the holidays, customer managed year-end inventories and reduced building activity during the winter. The Company expects fiscal first quarter volumes at MACSTEEL to be essentially flat to the year ago quarter, but operating income is expected to be down as they absorb last quarter's sharp increase in scrap costs. Operating income at Engineered Products is expected to be down compared to their excellent year ago results. Volume at Nichols Aluminum is expected to be up somewhat from a year ago, however, operating income is expected to be flat as they continue to absorb higher raw material costs in the absence of sales price relief. Taken together, Quanex expects its first quarter diluted earnings per share to be lower compared to the same period a year ago.

The Company's outlook is based on "same store sales" and excludes any potential benefits that may accrue from its acquisitions of the North Star Steel Monroe facility and TruSeal Technologies. Although the Company expects minimal contributions to earnings from pending acquisitions in its first quarter, Quanex does expect a considerable earnings contribution for the full year.

2003 Compared to 2002

Net Sales—Consolidated net sales for fiscal 2003 were $1,031.2 million representing an increase of $36.8 million, or 3.7%, when compared to consolidated net sales for fiscal 2002. Both the vehicular and building products segments experienced increased net sales.

Net sales from the Company's vehicular products segment for fiscal 2003 were $468.5 million representing an increase of $9 million, or 2%, when compared to the prior year due to increases at MACSTEEL, offset somewhat by lower net sales at both Piper and Temroc. MACSTEEL's net sales increase was due to a 5% increase in prices and a 2% increase in shipments. Piper experienced lower net sales as aluminum airbag component sales declined from its prior year levels. This decline was only partially offset by sales of new products; however, growth from new products has not been fast enough to replace airbag component sales.

Net sales from the Company's building products segment for fiscal 2003 were $562.7 million, representing an increase of $27.9 million, or 5%, when compared to fiscal 2002. Engineered Products' net sales increase was due primarily to three additional months of sales from COLONIAL CRAFT which was acquired in February 2002. Excluding Colonial Craft, combined net sales for the other engineered products business units were down slightly versus prior year due to the harsh winter weather in the first half of 2003. Nichols Aluminum's net sales increased 5% from the prior year, primarily due to slightly higher average selling prices.

Operating income—Consolidated operating income for fiscal 2003 was $63.8 million, a decrease of $19.5 million, or 23%, when compared to last year. Both the vehicular and building products segments experienced decreased operating income.

Operating income from the Company's vehicular products segment for fiscal 2003 was $48.2 million, representing a decrease of $9.4 million, or 16%, when compared to last year. This decrease was due to lower operating income at MACSTEEL, Piper and Temroc compared to the prior year's results. Although MACSTEEL experienced higher net sales and improved conversion costs, they were more than offset by the impact of approximately 20% higher scrap steel prices. Piper and Temroc had lower operating income for the periods due largely to lower net sales. Depreciation expense for the vehicular products segment was higher with the completion of MACSTEEL capital projects.

Operating income from the Company's building products segment for fiscal year 2003 was $35.6 million, representing a decrease of $2.3 million, or 6%, when compared to the prior year. This decrease was a result of lower operating income at Nichols Aluminum partially offset by improved results at Engineered Products. Engineered Products benefited from a full year's results for COLONIAL CRAFT which was acquired in February 2002, partially offset by lower sales volumes due to harsh winter weather in the first half of 2003. The lower results for Nichols Aluminum were due to higher aluminum scrap, energy and outside processing costs and production and quality problems at the Alabama facility, which more than offset the higher volumes and prices.

Corporate level operating expenses for fiscal 2003 increased approximately $7.8 million primarily as a result of a $6.1 million LIFO inventory reserve adjustment. Corporate and other expenses are reported outside of the two operating segments. Included in corporate and other are the consolidated LIFO inventory reserve adjustments, corporate office expenses and inter-segment eliminations.

Selling, general and administrative expense was $53.6 million for fiscal 2003, representing an increase of $0.8 million, or 2%, when compared to last year. The increase results primarily from including a full year's results from Colonial Craft which was acquired in February 2002.

Depreciation and amortization—Depreciation and amortization expense increased $2.4 million in fiscal 2003 as compared to the prior year. Most of the increase came from the vehicular products segment due largely to recently completed capital projects at MACSTEEL.

Interest expense for fiscal 2003 was $2.5 million compared to $14.8 million last year. The decrease in interest expense is due to: (a) lower bank revolver balances, (b) conversion of the 6.88% convertible subordinated debentures to Company stock in June of 2002, (c) redemption of subordinated debentures, and (d) the Company paying down principal on other interest bearing debt and notes.

Another factor that contributed to the decrease in interest expense was the interest rate swap agreement which was terminated on July 29, 2003. With the execution of the Bank Agreement in November 2002 (see "Debt Structure and Activity" below), the interest rate swaps no longer qualified as a hedge. As a result, the Company discontinued hedge accounting under SFAS No. 133 on the swaps after the effective date of the Bank Agreement and reclassified the related portion of other comprehensive income to interest expense in the fiscal quarter ended October 31, 2002. In fiscal 2002, losses related to the swap agreement were reclassified out of other comprehensive income into interest expense as interest payments were made. This reclassification did not impact fiscal 2003.

Capitalized interest was zero for fiscal 2003 compared to $1.9 million for 2002. The capitalized interest in 2002 was due to the long-term capital expansion programs that were underway at MACSTEEL. These capital projects have been completed and the capitalization of interest ceased after the third fiscal quarter of 2002. Interest capitalization for the ongoing Phase VII at MACSTEEL is expected to be insignificant.

Other, net increased $0.2 million from fiscal 2002. Fiscal 2002 included a loss of $0.9 million associated with early extinguishment of debt as a result of the redemption of the Company's subordinated debentures in June 2002. Also included in other, net is investment income and the amortization of debt issuance costs.

Net income was $42.9 million for fiscal 2003 compared to $55.5 million for fiscal 2002. In addition to the factors mentioned above, fiscal 2003 and 2002 included a non-taxable $2.2 million and $9.0 million benefit from retired executive life insurance claims, respectively.

2002 Compared to 2001

Net Sales—Consolidated net sales for fiscal 2002 were $994.4 million representing an increase of $70.0 million, or 8%, when compared to consolidated net sales for fiscal 2001. Both the vehicular and building products segments experienced increased net sales.

Net sales from the Company's vehicular products segment for fiscal 2002 were $459.5 million representing an increase of $20.2 million, or 5%, when compared to the prior year due to increases at MACSTEEL, offset somewhat by lower net sales at both Piper and Temroc. MACSTEEL's net sales increase was due largely to a 13% increase in volume, which more than offset lower selling prices compared to the fiscal 2001. Over half of MACSTEEL's business is based on fixed contracts, so their ability to change pricing was limited on a near term basis. Piper experienced lower net sales as aluminum airbag component sales declined from its prior year levels. This decline was only partially offset by sales of new products, as meaningful sales volumes of these products have been slower to materialize than expected.

Net sales from the Company's building products segment for fiscal 2002 were $534.9 million, representing an increase of $49.8 million, or 10%, when compared to fiscal 2001. Engineered Products' net sales increases were due largely to the acquisition of COLONIAL CRAFT in February. Nichols Aluminum's net sales also increased from the prior year due to increased volume resulting from continuing strength in the building construction markets, despite lower selling prices.

Operating income—Consolidated operating income for fiscal 2002 was $83.3 million, representing an increase of $26.0 million, or 45%, when compared to 2001. Both the vehicular and building products segments experienced increased operating income.

Operating income from the Company's vehicular products segment for fiscal 2002 was $57.6 million, representing an increase of $10.1 million, or 21%, when compared to 2001. This increase was due to higher operating income at MACSTEEL compared to the prior year's results, partially offset by lower operating income at Piper and Temroc. The higher net sales volume combined with productivity gains and lower conversion costs at MACSTEEL more than offset the impact of lower spreads between selling prices and scrap prices. Piper and Temroc had lower operating income for the periods due largely to lower net sales and volume. Depreciation expense for the vehicular products segment was higher with the completion of MACSTEEL capital projects.

Also contributing to the improvement in the vehicular products segment is the elimination of goodwill amortization in accordance with the adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" effective the beginning of fiscal 2002. The vehicular products segment had goodwill amortization of approximately $500 thousand in the prior year ended October 31, 2001.

Operating income from the Company's building products segment for fiscal year 2002 was $38.0 million, representing an increase of $14.3 million, or 61%, when compared to the prior year. This increase was a result of record operating income at Engineered Products, as well as improved results at Nichols Aluminum. Engineered Products benefited from the acquisition of COLONIAL CRAFT in February 2002; however it achieved record operating income levels without COLONIAL CRAFT's contribution due largely to strong demand for its products, productivity improvements and new product development and cost reduction efforts. Nichols Aluminum also had increased operating income. This increase was largely a result of increased volume and cost reduction initiatives, as well as a $1.6 million business interruption insurance recovery collected during the year. Although spreads between selling price and raw material costs improved during the second half of the year, as compared to the same prior year period, for the year ended October 31, 2002, margins were lower as scrap prices rose more quickly than Nichol's ability to raise selling prices.

Also contributing to the improvement in the building products segment is the elimination of goodwill amortization in accordance with the adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" effective the beginning of fiscal 2002. The building products segment had goodwill amortization of approximately $1.8 million in the prior year ending October 31, 2001.

Corporate level operating expenses for fiscal 2002 decreased approximately $1.5 million versus 2001. Corporate and Other expenses are reported outside of the two operating segments (See Note 12 to the Consolidated Financial Statements). Included in Corporate and Other are the consolidated inventory LIFO adjustments, corporate office expenses and inter-segment eliminations.

Selling, general and administrative expense was $54.4 million for fiscal 2002, representing an increase of $206 thousand, less than 1%, when compared to the prior year. This increase results primarily from the acquisition of COLONIAL in February 2002.

Depreciation and amortization—Depreciation and amortization expense (excluding goodwill amortization) increased $2.5 million in fiscal 2002 as compared to the prior year. Most of the increase came from the vehicular products segment due largely to recently completed capital projects at MACSTEEL.

Effective November 1, 2001, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets". Under SFAS No. 142, goodwill is no longer amortized. Accordingly, goodwill amortization, on a consolidated basis, was zero for 2002 and $2.3 million for the year ended October 31, 2001. (See Note 4 to the Consolidated Financial Statements for further information.)

Interest expense for fiscal 2002 was $14.8 million compared to $16.6 million in fiscal 2001. The decrease in interest expense was due largely to the Company's outstanding debt balance substantially decreasing year over year as 1) the 6.88% convertible subordinated debentures were converted to Company stock or redeemed in June of 2002 and 2) the Company paid down its bank revolver and other interest bearing debt and notes. See Note 10 to the Consolidated Financial Statements for further information.

Another factor affecting interest expense was the discontinuance of hedge accounting under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" for the interest swap agreements. Based on future cash flow projections that were prepared during the second fiscal quarter ended April 30, 2002, it was determined there was a high likelihood the Company would pay down its variable rate debt under the Bank Agreement Revolver to approximately $65 million by the end of fiscal 2002. Based on these projections, a portion of the future projected cash flow being hedged (interest payments) would not occur. Therefore, during the period ended April 30, 2002, the Company discontinued hedge accounting under SFAS 133 for $35 million of the interest swap agreement and reclassified the related portion of other comprehensive income, a loss of $1.3 million, to interest

expense. Additionally, during the fourth fiscal quarter ended October 31, 2002, the timing of the finalization of the new bank agreement was determined. Since the swaps were designated as hedges of the Bank Agreement Revolver, which was expected to terminate upon completion of the new bank agreement, the swap no longer qualified as a hedge, as those specific forecasted transactions would not occur (future interest payments). As a result, the Company discontinued hedge accounting under SFAS No. 133 on the swaps based on the projected new bank agreement date and reclassified the related portion of other comprehensive income, a loss of $2.1 million, to interest expense. The Company terminated the $100 million swap agreement on July 29, 2003 and therefore no longer reflected it on the balance sheet effective after this date.

Capitalized interest increased $213 thousand for fiscal 2002 compared to 2001. The entire amount of capitalized interest was due to the long-term capital expansion programs that were underway at MACSTEEL. These capital projects have been completed and the capitalization of interest ceased after the third fiscal quarter of 2002.

Other, net decreased $968 thousand from fiscal 2001 to 2002. As a result of the redemption of the subordinated debentures, a loss of $922 thousand was recognized during fiscal 2002 due to the early extinguishment of debt. This loss resulted from the write-off of the remaining debt issuance costs associated with the subordinated debentures, as well as the .688% premium paid on the $1.3 million of debentures which were redeemed. Fiscal 2001 included a $573 thousand gain on the early extinguishment of debt. In accordance with SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections", which was adopted by the Company in the period ended July 31, 2002, these early extinguishment of debt items were classified as ordinary instead of extraordinary items, net of tax. Also included in other, net was investment income and the amortization of debt issuance costs.

Net income was $55.5 million for fiscal 2002 compared to $29.2 million for fiscal 2001. In addition to the factors mentioned above, fiscal 2002 included a non-taxable $9.0 million retired executive life insurance benefit which did not occur in 2001.

Liquidity and Capital Resources

Sources of Funds

The Company's principal sources of funds are cash on hand, cash flow from operations, and borrowings under its secured $200 million Revolving Credit Agreement ("Bank Agreement"). At October 31, 2003, the Company had $10 million borrowed under the Bank Agreement. This represents a $55 million decrease from October 31, 2002 borrowing levels.

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

On December 19, 2003, subsequent to the 2003 fiscal year end, Quanex executed an agreement with our credit facility banks to increase the Bank Agreement revolver to $310 million to provide funds necessary for the North Star and TruSeal acquisitions. Assuming we close these acquisitions as scheduled, we expect our debt level to be between $200 million and $250 million at the end of our fiscal quarter ended January 31, 2004.

The Company's working capital was $92.8 million at October 31, 2003 compared to $101.0 million at October 31, 2002. The decrease in working capital resulted from (a) an $11.4 million decrease in inventory across both segments as a result of a Company wide focus on inventory reduction, (b) a $3.1 million increase in accounts payable and accrued liabilities, (c) a reduction of $5.5 million related

to deferred taxes and taxes payable, offset by (d) an increase in accounts receivable of $7.1 million and (e) a net increase of $4.3 million in other working capital balances. Changes in other working capital balances were due to timing of payments and other obligations.

Operating Activities

Cash provided by operating activities during the year ended October 31, 2003 was $102.8 million compared to $81.1 million for the same period of 2002. This increase is due to (a) lower working capital requirements compared to the same prior year period as discussed above, (b) reduced pension contributions and tax payments, partially offset by (c) lower operating income.

Investment Activities

Net cash used for investment activities during the year ended October 31, 2003 was $22.5 million compared to $29.8 million for the same period of 2002. Investment activities for the year ended October 31, 2002 included the acquisition of COLONIAL CRAFT for $17.3 million. Additionally, capital expenditures decreased from $34.3 million in fiscal 2002 to $28.7 million in fiscal 2003. This decline was largely due to reduced spending at MACSTEEL, partially offset by increased spending at Nichols Aluminum and Engineered Products. The Company estimates that fiscal 2004 capital expenditures will be approximately $35 million. At October 31, 2003, the Company had commitments of approximately $6 million for the purchase or construction of capital assets. The Company plans to fund these capital expenditures through cash flow from operations. Cash used for investment activities detailed above was offset by cash provided for investment activities including (a) the receipt of $6.4 million and $26.1 million in retired executive life insurance proceeds for fiscal 2003 and 2002 respectively, and (b) the receipt of $2.8 million in proceeds from the sale of Piper Utah in fiscal 2003.

Financing Activities

Net cash used for financing activities for the year ended October 31, 2003 was $76.5 million compared to $62.6 million during the prior year. The Company repaid $55 million on the bank revolver in the year ended October 31, 2003, compared to repaying $75 million during fiscal 2002. Additionally, the Company paid off a note payable of $7.0 million in fiscal 2002. During the year ended October 31, 2003, the Company paid $13.5 million to repurchase 438,600 shares of its common stock. Additionally, Quanex received $5.2 million in the year ended October 31, 2003 for the issuance of common stock ($4.2 million of this was from option exercises). In the year ended October 31, 2002, the Company received $33.9 million for the issuance of common stock ($26.6 million from option exercises).

On February 26, 2003, the board of directors of the Company increased the annual dividend from $0.64 to $0.68 per common share outstanding. This increase was effective with the Company's first quarter dividend paid on March 31, 2003 to shareholders of record on March 14, 2003. This increased cash used for financing activities by $1.2 million for 2003.

Debt Structure and Activity

Current Bank Agreement "Revolver"—In November 2002, the Company entered into a secured $200 million Revolving Credit Agreement ("Bank Agreement"). The Bank Agreement is secured by all Company assets, excluding land and buildings. This Bank Agreement expires November 2005 and provides for up to $25 million for standby letters of credit, limited to the undrawn amount available under the new Bank Agreement. All borrowings under this bank agreement bear interest, at the option of the Company, at either (a) the prime rate or federal funds rate plus one percent, whichever is higher, or (b) a Eurodollar based rate. The Bank Agreement requires facility fees, which are not significant, maintenance of certain financial ratios and maintenance of a minimum consolidated tangible net worth. As of October 31, 2003, the Company was in compliance with all Bank Agreement

covenants. The Bank Agreement was amended on December 19, 2003, to increase this line to $310 million.

Previous Bank Agreement "Revolver"—In July 1996, the Company entered into an unsecured $250 million Revolving Credit and Term Loan Agreement ("Bank Agreement"). At October 31, 2002 and 2001, this Bank Agreement consisted of a revolving line of credit ("Revolver") under which the Company had $65 and $140 million, respectively, in borrowings. This Bank Agreement was replaced with a new Bank Agreement which is described above. The intent and ability to refinance the outstanding balance on this bank agreement on a long-term basis was evidenced by the signing of the new bank agreement in November 2002. Therefore, the outstanding balance under the old bank agreement revolver was classified as non-current as of October 31, 2002.

Convertible Subordinated Debentures—The Company accepted unsolicited block offers to buy back $4.6 and $10.4 million principal amount of the 6.88% Convertible Subordinated Debentures for $3.9 and $9.6 million in cash during the years ended October 31, 2001 and 2000, respectively.

On May 9, 2002, the Company announced that it would redeem the remaining $58.7 million principal amount of its 6.88% Convertible subordinated debentures. The Company set a redemption date of June 12, 2002 for all debentures outstanding. Notice of the redemption was mailed on May 10, 2002 to the current holders. The redemption price was 100.688% of the principal amount plus accrued interest to the redemption date. Holders of the debentures had the right, as an alternative to redemption, to convert the debentures into shares of common stock of Quanex Corporation at a conversion price of $31.50 per share of common stock. The right to convert the debentures expired at the close of business on June 5, 2002. As of June 5, 2002, $57.4 million aggregate principal amount of the subordinated debentures were converted to 1.8 million shares of Company stock and $1.3 million aggregate principal amount of the subordinated debentures was redeemed on June 12, 2002.

Other Debt—During the year ended October 31, 2002, the Company made an early payment in the amount of $7.0 million on a contingent note payable as well as an early retirement in the amount of $1.6 million for one of the industrial revenue and economic development bonds.

Stock Purchase Program

In December 1999, Quanex announced that its Board of Directors approved a program to repurchase up to 2 million shares of the Company's common stock in the open market or in privately negotiated transactions.

During the fiscal year ended October 31, 2001, the Company repurchased 119,000 shares at a cost of $2.2 million. The cost of treasury shares of $12.7 million at October 31, 2001 was reflected as a reduction of stockholders' equity in the balance sheet.

The stock purchase program was suspended and no treasury shares were purchased during fiscal 2002. A majority of the 633,935 shares held in treasury at October 31, 2001 were reissued through stock option exercises or other compensation plans during fiscal 2002, leaving no shares in treasury as of October 31, 2002.

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

Contractual Obligations and Commercial Commitments

The following tables set forth certain information concerning the Company's unconditional obligations and commitments to make future payments under contracts with remaining terms in excess of one year, such as debt and lease agreements, and under contingent commitments.

Payments Due by Period

Contractual Cash Obligations	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
			(In thousands)		
Long-Term Debt	$ 19,620	$ 3,727	$ 10,908	$ 911	$ 4,074
Operating Leases	6,883	2,063	2,698	1,660	462
Unconditional Purchase Obligations	7,035	1,607	4,454	974	—
Total Contractual Cash Obligations	$ 33,538	$ 7,397	$ 18,060	$ 3,545	$ 4,536

Amount of Commitment Expiration per Period

Other Commercial Commitments	Total Amounts Committed	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
			(In thousands)		
Standby Letters of Credit	$ 4,452	$ 4,398	$ 54	$ —	$ —
Guarantees	1,050	—	—	—	1,050
Total Commercial Commitments	$ 5,502	$ 4,398	$ 54	$ —	$ 1,050

Additionally, the Company's borrowings under its Bank Agreement are expected to increase significantly upon closing of the North Star and TruSeal acquisitions in the first quarter of fiscal 2004.

Effects of Inflation

Inflation has not had a significant effect on earnings and other financial statement items.

Critical Accounting Policies

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

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

Revenue Recognition and Allowance for Doubtful Accounts

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

Inventory

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

Risk Management and Derivative Instruments

The Company's current risk management strategies include the use of derivative instruments to reduce certain risks. The critical strategies include: (1) the use of commodity futures and options to fix the price of a portion of anticipated future purchases of certain raw materials and energy to offset the effect of fluctuations in the costs of those commodities, and (2) the use of interest rate swaps to fix the rate of interest on a portion of floating rate debt. These hedges have been designated as cash flow hedges. The effective portion of gains and losses is recorded in the accumulated other comprehensive income (loss) component of stockholders' equity in accordance with SFAS No. 133. The Company evaluates all derivative instruments each quarter to determine if they are highly effective. Any ineffectiveness (as defined by SFAS No. 133) is recorded in the statement of income. If the anticipated future transactions are no longer expected to occur, the unrealized gains and losses on the related hedge are reclassified to the consolidated statement of income. (See Note 16 to the financial statements for further explanation.)

Long-Lived Assets

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

Income Taxes

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

Retirement and Pension Plans

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

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141 "Business Combinations". SFAS No. 141 addresses financial accounting and reporting for business combinations. The provisions of this statement apply to all business combinations initiated after June 30, 2001. This statement also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001, or later. The Company followed the guidance of this statement for the business acquisition completed in fiscal 2002. See Note 2 to the consolidated financial statements.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement addresses financial accounting and reporting for acquired goodwill and other intangible assets. It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Under SFAS No. 142, goodwill is no longer amortized, but reviewed for impairment annually, or more frequently if certain indicators arise. The Company adopted this statement on November 1, 2001 for its fiscal year ended October 31, 2002. In accordance with SFAS 142, the Company completed the transitional impairment test of goodwill during the second quarter ended April 30, 2002, which indicated that goodwill was not impaired. The Company again reviewed goodwill for impairment as of August 31, 2002, which indicated that goodwill was not impaired. The Company plans to perform this impairment test as of August 31 each year or more frequently if certain indicators arise. The assessments were based on assumptions regarding estimated future cash flows and other factors, including the discount rate. If these estimates or their related assumptions change in the future, because of changes in events and circumstances, the Company may be required to record impairment charge in a future period.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible, long-lived assets and the associated asset retirement costs. This Statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period

in which it is incurred by capitalizing it as part of the carrying amount of the long-lived assets. The provisions of this statement are required to be applied starting with fiscal years beginning after June 15, 2002 (Quanex's fiscal year beginning November 1, 2002). The Company does not anticipate any material impact on the Company's financial position, results of operations, or cash flows as a result of adoption.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This Statement establishes a single accounting model for the impairment or disposal of long-lived assets. The provisions of this Statement are effective for financial statements issued for fiscal years beginning after December 15, 2001 (Quanex's fiscal year beginning November 1, 2002). The Company does not anticipate any material impact on the Company's financial position, results of operations, or cash flows as a result of adoption.

In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections". The rescission of Statement 4 is the only portion of this SFAS which currently has an impact on the Company. Under Statement 4, all gains and losses from extinguishment of debt were required to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. SFAS No. 145 eliminates Statement 4. As a result, gains and losses from extinguishment of debt should be classified as extraordinary items only if they meet the criteria in Accounting Principles Board Opinion 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary Unusual and Infrequently Occurring Events and Transactions". The provisions of SFAS No. 145 related to the rescission of Statement 4 shall be applied in fiscal years beginning after May 15, 2002. Any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented that does not meet the criteria in Opinion 30 for classification as an extraordinary item shall be reclassified. Early application of the provisions of this Statement related to the rescission of Statement 4 was encouraged. The Company adopted this pronouncement effective the third quarter ended July 31, 2002 and restated prior periods.

In June 2002, the FASB issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The Company does not anticipate any material impact on the Company's financial position, results of operations, or cash flows as a result of adoption.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure". SFAS No. 148 amends SFAS No. 123 "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted this statement and included the new disclosure requirements in this report.

In April 2003, the FASB issued SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as "derivatives") and for hedging activities under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities". The provisions of this statement are effective for contracts entered into or modified after June 30, 2003, with certain exceptions. The

Company does not anticipate any material impact on the Company's financial position, results of operations, or cash flows as a result of adoption.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities." This interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," addresses consolidation by business enterprises of variable interest entities ("VIE's"), also commonly referred to as special purpose entities ("SPE's"). The objective of this interpretation is to provide guidance on how to identify a VIE and to determine when the assets, liabilities, non-controlling interests, and results of operations of a VIE need to be included in a Company's consolidated financial statements. The

provisions of this interpretation became effective upon issuance, with certain provisions applicable for the first interim or annual period beginning after December 15, 2003. As of October 31, 2003, this statement has no effect on the Company as Quanex does not have any VIEs.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 requires certain financial instruments with characteristics of both liabilities and equity to be classified as liabilities. The provisions of SFAS No. 150 are effective for financial instruments entered into or modified after May 31, 2003, and otherwise are effective in the fourth quarter of the Company's fiscal 2003. The Company's adoption of SFAS No. 150 did not have a material impact on its financial position or results of operations.

Item 7A. ***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. For a description of the Company's significant accounting policies associated with these activities, see Notes 1 and 16 to the Consolidated Financial Statements.

Interest Rate Risk

The Company and its subsidiaries have a Bank Agreement, interest rate swap agreements and other long-term debt which subject the Company to the risk of loss associated with movements in market interest rates.

At October 31, 2003 and 2002, the Company had fixed-rate debt totaling $4.1 million and $4.4 million, respectively. This debt is fixed-rate and, therefore, 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 total $15.7 million and $71.2 million at October 31, 2003 and 2002, respectively. For 2002, the Company had $100 million of swap agreements in place to limit the exposure of this obligation to increases in short-term interest rates. These swap agreements effectively fixed the interest rate, thus limiting the potential impact that increasing interest rates would have on earnings. Under these swap agreements, payments were made based on a fixed rate ($50 million at 7.025%, and $50 million at 6.755%) and received on a LIBOR based variable rate (1.82% at October 31, 2002). At October 31, 2002, the fair market value related to the interest rate swap agreements was a loss of $4.0 million.

To the extent that floating rate obligations are in excess of or less than $100 million, the Company was subject to changes in the underlying interest rates. For the year ended October 31, 2002, the

Company's floating rate obligations were $28.8 million less than the $100 million swap agreement. Increases or decreases in the underlying interest rate of the swap agreement would have a direct impact on interest expense for this differential in balances. For the year ended October 31, 2001, the Company's floating rate obligations exceeded the amount covered by the swap agreements by $47.1 million. Increases or decreases in the underlying interest rates of the obligations would have had a direct impact on interest expense for those uncovered balances.

These swap agreements expired on July 29, 2003 and the final settlement payment was made. The Company has not entered into any other interest swap agreements and as such is subject to the variability of interest rates on its variable rate debt.

Commodity Price Risk

The Company's aluminum mill sheet products segment, Nichols Aluminum, uses various grades of aluminum scrap as well as prime aluminum ingot as a raw material for its manufacturing process. The price of this aluminum raw material is subject to fluctuations due to many factors in the aluminum market. In the normal course of business, Nichols Aluminum enters into firm price sales commitments with its customers. In an effort to reduce the risk of fluctuating raw material prices, the Company enters into firm price raw material purchase commitments as well as forward contracts on the London Metal Exchange ("LME"). The Company's risk management policy as it relates to these LME contracts is to enter into contracts to cover the raw material needs of the Company's committed sales orders, net of fixed price purchase commitments.

With the use of firm price raw material purchase commitments and LME contracts, the Company aims to protect the gross margins from the effects of changing prices of aluminum. To the extent that the raw material costs factored into the firm price sales commitments are matched with firm price raw material purchase commitments, changes in aluminum prices should have no effect on the Company. Where firm price sales commitments are matched with LME contracts, the Company is subject to the ineffectiveness of LME contracts to perfectly hedge raw material prices.

At October 31, 2001, the Company had open futures contracts for aluminum pounds with a fair value of $27.1 million. The contracts had fair value losses of $1.8 million at October 31, 2001 and covered a notional volume of 45.4 million pounds of aluminum. A hypothetical 10% change from the October 31, 2001 average London Metal Exchange ("LME") ingot price on open contracts of $.596 per pound would increase or decrease the unrealized pretax gains/losses related to these contracts by approximately $2.7 million. However, it should be noted that any change in the value of these contracts, real or hypothetical, would be substantially offset by an inverse change in the cost of purchased aluminum scrap.

During the years ended October 31, 2003 and 2002, Nichols Aluminum primarily used firm price raw material purchase commitments instead of LME forward contracts to lock in raw material prices. At October 31, 2002, the Company had no open LME forward contracts and therefore no asset or liability associated with metal exchange derivatives. At October 31, 2003, there were two LME forward contracts associated with metal exchange derivatives covering notional volumes of 1.3 million pounds with a fair value net loss of approximately $46 thousand, which was recorded as part of other current assets and other current liabilities in the financial statements.

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

RESPONSIBILITY FOR FINANCIAL REPORTING

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

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

The Audit Committee, composed solely of outside directors, determines that management is fulfilling its financial responsibilities by meeting periodically with management, the independent auditors, and Quanex's internal auditors, to review internal accounting control and assess the effectiveness of our disclosure controls and procedures. The Audit Committee is responsible for appointing the independent auditors and reviewing the scope of all audits and the accounting principles applied in our financial reporting. Deloitte & Touche LLP has been engaged as independent auditors to audit the accompanying consolidated financial statements and issue the report thereon, which appears on the following page.

To ensure complete independence, our internal auditors and Deloitte & Touche LLP have full and free access to meet with the Audit Committee, without management present, to discuss the results of their audits, the quality of our financial reporting and the adequacy of our internal controls and disclosure controls and procedures.

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

/s/ RAYMOND A. JEAN	/s/ TERRY M. MURPHY
Raymond A. Jean *Chairman of the Board, President and Chief Executive Officer*	Terry M. Murphy *Vice President—Finance and Chief Financial Officer*

INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholders
Quanex Corporation
Houston, Texas

We have audited the accompanying consolidated balance sheets of Quanex Corporation and subsidiaries as of October 31, 2003 and 2002, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended October 31, 2003. Our audits also included the financial statement schedule listed in the index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Quanex Corporation and subsidiaries as of October 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 2003 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP

Deloitte & Touche LLP

Houston, Texas
December 15, 2003

QUANEX CORPORATION

CONSOLIDATED BALANCE SHEETS

	October 31,

	2003	2002
	(In thousands)	
ASSETS		
Current assets:		
Cash and equivalents	$ 22,108	$ 18,283
Accounts and notes receivable, less allowance for doubtful accounts of $7,222,000 in 2003 and $6,877,000 in 2002	123,185	116,122
Inventories	79,322	90,756
Deferred income taxes	6,366	9,302
Other current assets	1,750	1,338
Total current assets	232,731	235,801
Property, plant and equipment, net	335,904	353,132
Goodwill, net	66,436	66,436
Cash surrender value insurance policies, net	24,536	25,799
Intangible assets	2,755	2,870
Other assets	3,501	5,102
	$ 665,863	$ 689,140
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 89,435	$ 80,528
Accrued liabilities	39,209	45,033
Income taxes payable	7,381	4,839
Other current liabilities	46	3,970
Current maturities of long-term debt	3,877	434
Total current liabilities	139,948	134,804
Long-term debt	15,893	75,131
Deferred pension credits	8,323	4,960
Deferred postretirement welfare benefits	7,845	7,928
Deferred income taxes	34,895	29,210
Other liabilities	13,800	15,712
Total liabilities	220,704	267,745
Stockholders' equity:		
Preferred stock, no par value, 1,000,000 shares authorized; issued and outstanding—none in 2003 and 2002	—	—
Common stock, $.50 par value, 50,000,000 shares authorized; 16,519,271 and 16,455,633 shares issued in 2003 and 2002, respectively	8,260	8,227
Additional paid-in capital	187,114	185,972
Retained earnings	264,067	232,074
Unearned compensation	(164)	(418)
Accumulated other comprehensive income	(3,641)	(3,479)
	455,636	422,376
Less common stock held by Rabbi Trust—47,507 and 42,538 shares in 2003 and 2002, respectively	(1,317)	(981)
Less cost of shares of common stock in treasury 294,803 shares in 2003 and no shares in 2002	(9,160)	—
Total stockholders' equity	445,159	421,395
	$ 665,863	$ 689,140

See notes to consolidated financial statements.

QUANEX CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	Years ended October 31,		
	2003	2002	2001

(In thousands, except per share amounts)			
Net sales	$ 1,031,215	$ 994,387	$ 924,353
Costs and expenses:			
Cost of sales	867,782	812,949	769,328
Selling, general and administrative	53,572	54,408	54,202
Depreciation and amortization	46,066	43,730	43,507
Operating income	63,795	83,300	57,316
Other income (expense):			
Interest expense	(2,517)	(14,812)	(16,555)
Capitalized interest	—	1,879	1,666
Retired executive life insurance benefit	2,152	9,020	—
Other, net	2,393	2,227	3,195
Income before income taxes	65,823	81,614	45,622
Income tax expense	(22,936)	(26,132)	(16,428)
Net income attributable to common stockholders	$ 42,887	$ 55,482	$ 29,194
Earnings per common share:			
Basic net earnings	$ 2.65	$ 3.74	$ 2.18
Diluted net earnings	$ 2.62	$ 3.52	$ 2.07
Weighted average number of shares outstanding			
Basic	16,154	14,823	13,399
Diluted	16,384	16,237	15,426

See notes to consolidated financial statements.

QUANEX CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended October 31, 2003, 2002, and 2001	Comprehensive Income	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income: Minimum Pension Liability	Accumulated Other Comprehensive Income: Derivative Gain (Loss)	Treasury Stock and Other	Total Stockholders' Equity
		(in thousands)						
Balance at October 31, 2000		$ 7,110	$ 111,061	$ 165,841	$ (301)	$ —	$ (17,214)	$ 266,497
Comprehensive income:								
Net income	$ 29,194			29,194				29,194
Adjustment for minimum pension liability (net of tax expense of $965)	(1,508)				(1,508)			(1,508)
Derivative transactions:								
Current period hedging transactions (net of taxes of $4,264)	(6,669)					(6,669)		(6,669)
Reclassifications into earnings (net of taxes of $809)	1,266					1,266		1,266
Total comprehensive income	$ 22,283							
Common dividends ($0.64 per share)				(8,621)				(8,621)
Common stock held by Rabbi Trust							2,476	2,476
Cost of common stock in treasury							726	726
Other		(67)	(2,747)	(140)			(430)	(3,384)
Balance at October 31, 2001		$ 7,043	$ 108,314	$ 186,274	$ (1,809)	$ (5,403)	$ (14,442)	$ 279,977
Comprehensive income:								
Net income	$ 55,482			55,482				55,482
Adjustment for minimum pension liability (net of taxes of $798)	(1,247)				(1,247)			(1,247)
Derivative transactions:								
Current period hedging transactions (net of taxes of $511)	(798)					(798)		(798)
Reclassifications into earnings (net of taxes of $3,694)	5,778					5,778		5,778
Total comprehensive income	$ 59,215							
Common dividends ($0.64 per share)				(9,637)				(9,637)
Common stock held by Rabbi Trust							(108)	(108)
Cost of common stock in treasury							12,672	12,672
Other		1,184	77,658	(45)			479	79,276
Balance at October 31, 2002		$ 8,227	$ 185,972	$ 232,074	$ (3,056)	$ (423)	$ (1,399)	$ 421,395

Comprehensive income:								
Net income	$ 42,887			42,887				42,887
Adjustment for minimum pension liability (net of taxes of $372)	(583)				(583)			(583)
Derivative transactions:								
Current period hedging transactions (net of taxes of $1)	(2)					(2)		(2)
Reclassifications into earnings (net of taxes of $270)	423					423		423
Total comprehensive income	$ 42,725							
Common dividends ($0.68 per share)				(10,865)				(10,865)
Common stock held by Rabbi Trust							(336)	(336)
Cost of common stock in treasury							(9,160)	(9,160)
Other		33	1,142	(29)			254	1,400
Balance at October 31, 2003		$ 8,260	$ 187,114	$ 264,067	$ (3,639)	$ (2)	$ (10,641)	$ 445,159

See notes to consolidated financial statements.

QUANEX CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended October 31, 2003, 2002 and 2001

		Common Shares			
	Preferred Shares Issued	Issued	Treasury	Rabbi Trust	Net Outstanding
Balance at October 31, 2000	—	14,220,666	(677,526)	(147,689)	13,395,451
Treasury shares purchased			(119,000)		(119,000)
Stock issued—options exercised (net of trade-ins)			47,960		47,960
Stock issued—compensation plans			84,812		84,812
Rabbi Trust		(135,024)	29,819	105,205	—
Balance at October 31, 2001	—	14,085,642	(633,935)	(42,484)	13,409,223
Stock issued—options exercised (net of trade-ins)		562,926	597,284		1,160,210
Stock issued—compensation plans		(1,902)	22,797		20,895
Stock issued—conversion of subordinated debentures		1,822,594	173		1,822,767
Rabbi Trust		(13,627)	13,681	(54)	—
Balance at October 31, 2002	—	16,455,633	—	(42,538)	16,413,095
Treasury shares purchased		—	(438,600)	—	(438,600)
Stock issued—options exercised (net of trade-ins)		42,333	161,677	—	204,010
Stock issued—compensation plans		1,000	(2,544)	—	(1,544)
Rabbi Trust		20,305	(15,336)	(4,969)	—
Balance at October 31, 2003	—	16,519,271	(294,803)	(47,507)	16,176,961

See notes to consolidated financial statements.

QUANEX CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOW

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Operating Activities:			
Net Income	$ 42,887	$ 55,482	$ 29,194
Adjustments to reconcile net income to cash provided by operating activities:			
Gain on sale of Piper Utah property	(405)	—	—
Loss (gain) on early extinguishment of debt	—	922	(573)
Adjustment for retired executive life insurance benefit	(2,152)	(9,020)	—

Depreciation and amortization	46,415	43,987	43,910
Deferred income taxes	8,992	2,330	4,154
Deferred pension and postretirement benefits	2,034	(4,734)	(1,231)
Changes in assets and liabilities, net of effects from acquisitions and dispositions:			
Increase in accounts and notes receivable	(7,063)	(5,144)	(7,917)
Decrease (increase) in inventory	11,434	(5,249)	20,808
Increase (decrease) in accounts payable	8,907	(857)	(2,569)
Decrease in accrued liabilities	(5,824)	(3,655)	(911)
Other, net (including income tax refund)	(2,385)	7,049	85
Cash provided by operating activities	102,840	81,111	84,950
Investing Activities:			
Acquisition of Colonial Craft, net of cash and equivalents acquired	—	(17,283)	—
Acquisition of Temroc Metals, Inc., net of cash and equivalents acquired	—	—	(17,922)
Proceeds from sale of Piper Utah property	2,832	—	—
Capital expenditures, net of retirements	(28,693)	(34,271)	(55,575)
Retired executive life insurance proceeds	6,442	26,111	—
Other, net	(3,081)	(4,365)	(3,597)
Cash used for investing activities	(22,500)	(29,808)	(77,094)
Financing Activities:			
Bank borrowings (repayments), net	(55,000)	(75,000)	30,000
Repayment of borrowing on insurance policies	—	—	(17,273)
Prepayment of note payable	—	(7,029)	—
Purchase of subordinated debentures	—	(1,314)	(3,942)
Purchase of Quanex common stock	(13,515)	—	(2,226)
Common stock dividends paid	(10,865)	(9,637)	(8,621)
Issuance of common stock, net	5,163	33,948	2,473
Other, net	(2,298)	(3,561)	(1,103)
Cash used for financing activities	(76,515)	(62,593)	(692)
Increase (decrease) in cash and equivalents	3,825	(11,290)	7,164
Cash and equivalents at beginning of period	18,283	29,573	22,409
Cash and equivalents at end of period	$ 22,108	$ 18,283	$ 29,573

See notes to consolidated financial statements.

QUANEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies

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

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

Revenue Recognition and Allowance for Doubtful Accounts

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

Inventory

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

Company's forecasts could require a change in the provision for excess or obsolete inventory.

Risk Management and Derivative Instruments

The Company's current risk management strategies include the use of derivative instruments to reduce certain risks. The critical strategies include: (1) the use of commodity futures and options to fix the price of a portion of anticipated future purchases of certain raw materials and energy to offset the effect of fluctuations in the costs of those commodities, and (2) the use of interest rate swaps to fix the rate of interest on a portion of floating rate debt. These hedges have been designated as cash flow hedges. The effective portion of gains and losses is recorded in the accumulated other comprehensive income component of stockholders' equity in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities". The Company evaluates all derivative instruments each quarter to determine if they are highly effective. Any ineffectiveness is recorded in the statement of income. If the anticipated future transactions are no longer expected to occur, the unrealized gains and losses on the related hedge are reclassified to the consolidated statement of income. (See Note 16 to the financial statements for further explanation.)

Long-Lived Assets

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

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

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

Income Taxes

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

Retirement and Pension Plans

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

Stock Based Employee Compensation

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

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Net income, as reported	$ 42,887	$ 55,482	$ 29,194
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,673)	(1,407)	(1,154)

Pro forma net income	$ 41,214	$ 54,075	$ 28,040
Earnings per common share:			
Basic as reported	$ 2.65	$ 3.74	$ 2.18
Basic pro forma	$ 2.55	$ 3.65	$ 2.09
Diluted as reported	$ 2.62	$ 3.52	$ 2.07
Diluted pro forma	$ 2.52	$ 3.43	$ 2.00

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

	Years Ended October 31,		
	2003	2002	2001
Risk-free interest rate	4.49%	3.58%	4.28%
Dividend yield	1.98%	2.01%	3.10%
Volatility factor	50.21%	44.14%	42.87%
Weighted average expected life	9.5 years	5 years	5 years

Principles of Consolidation

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

Earnings per Share Data

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

Scope of Operations

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

Statements of Cash Flows

The Company generally considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Similar investments with original maturities beyond three months are considered short-term investments. For fiscal years 2003, 2002, and 2001, cash paid for income taxes was $10,909,000, $17,666,000 and $11,324,000, respectively. These amounts are before refunds of $527,000, $135,000 and $219,000, respectively. Cash paid for interest for fiscal 2003, 2002, and 2001 was $2,562,000, $13,070,000 and $15,894,000, respectively.

Reclassification

Certain amounts for prior periods have been reclassified in the accompanying consolidated financial statements to conform to fiscal 2003 presentations.

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141 "Business Combinations". SFAS No. 141 addresses financial accounting and reporting for business combinations. The provisions of this statement apply to all business combinations initiated after June 30, 2001. This statement also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001, or later. The Company followed the guidance of this statement for the business acquisition completed in fiscal 2002. See Note 2.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement addresses financial accounting and reporting for acquired goodwill and other intangible assets. It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Under SFAS No. 142, goodwill is no longer amortized, but reviewed for impairment annually, or more frequently if certain indicators arise. The Company adopted this statement on November 1, 2001 for its fiscal year ended October 31, 2002. In accordance with SFAS 142, the Company completed the transitional impairment test of goodwill during the second quarter ended April 30, 2002, which indicated that goodwill was not impaired. The Company again reviewed goodwill for impairment as of August 31, 2002 and 2003, which indicated that goodwill was not impaired. The Company plans to perform this impairment test as of August 31 each year or more frequently if certain indicators arise. The assessments were based on assumptions regarding estimated future cash flows and other factors, including the discount rate. If these estimates or their related assumptions change in the future, because of changes in events and circumstances, the Company may be required to record impairment charges in a future period.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the

retirement of tangible, long-lived assets and the associated asset retirement costs. This Statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred by capitalizing it as part of the carrying amount of the long-lived assets. The Company adopted SFAS No. 143 during fiscal 2003, which did not have a material impact on the Company's financial position, results of operations, or cash flows.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This Statement establishes a single accounting model for the impairment or disposal of long-lived assets. The Company adopted this Statement effective for fiscal 2003. The adoption of SFAS No. 144 did not have any material impact on the Company's financial position, results of operations, or cash flows.

In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections". The rescission of Statement 4 is the only portion of this SFAS which currently has an impact on the Company. Under Statement 4, all gains and losses from extinguishment of debt were required to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. SFAS No. 145 eliminates Statement 4. As a result, gains and losses from extinguishment of debt should be classified as extraordinary items only if they meet the criteria in Accounting Principles Board Opinion 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary Unusual and Infrequently Occurring Events and Transactions". The provisions of SFAS No. 145 related to the rescission of Statement 4 shall be applied in fiscal years beginning after May 15, 2002. Any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented that does not meet the criteria in Opinion 30 for classification as an extraordinary item shall be reclassified. Early application of the provisions of this Statement related to the rescission of Statement 4 was encouraged. The Company adopted this pronouncement effective the third quarter ended July 31, 2002 and restated prior periods.

In June 2002, the FASB issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The Company does not anticipate any material impact on the Company's financial position, results of operations, or cash flows as a result of adoption.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure". SFAS No. 148 amends SFAS No. 123 "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted this statement and included the new disclosure requirements in this report.

In April 2003, the FASB issued SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as "derivatives") and for hedging activities under SFAS No. 133

"Accounting for Derivative Instruments and Hedging Activities". The provisions of this statement are effective for contracts entered into or modified after June 30, 2003, with certain exceptions. The Company does not anticipate any material impact on the Company's financial position, results of operations, or cash flows as a result of adoption.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities." This interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," addresses consolidation by business enterprises of variable interest entities ("VIE's"), also commonly referred to as special purpose entities ("SPE's"). The objective of this interpretation is to provide guidance on how to identify a VIE and to determine when the assets, liabilities, non-controlling interests, and results of operations of a VIE need to be included in a Company's consolidated financial statements. The provisions of this interpretation became effective upon issuance, with certain provisions applicable for the first interim or annual period beginning after December 15, 2003. As of October 31, 2003, this statement has no effect on the Company as Quanex does not have any VIEs.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 requires certain financial instruments with characteristics of both liabilities and equity to be classified as liabilities. The provisions of SFAS No. 150 are effective for financial instruments entered into or modified after May 31, 2003, and otherwise are effective in the fourth quarter of the Company's fiscal 2003. The Company's adoption of SFAS No. 150 did not have a material impact on its financial position or results of operations.

2. Acquisitions

Colonial Craft

On February 12, 2002, Quanex completed the purchase of certain assets and assumption of certain liabilities of Ekamar, Inc., formerly known as Colonial Craft, Inc., a Minnesota corporation, through its wholly owned subsidiary, Quanex Windows, Inc., for approximately $17.3 million in cash. Approximately $1.5 million of this purchase price was set aside in an escrow fund for environmental and certain other issues that may arise. No claims were made against this escrow fund, and as such, it has subsequently been released.

The acquired business operates as a wholly owned subsidiary of the Company and has been renamed Colonial Craft, Inc. ("COLONIAL CRAFT"). The acquisition was accounted for as a purchase transaction under SFAS No. 141, and accordingly the tangible assets acquired and liabilities assumed were recorded at their fair value at the date of the acquisition. The results of operations of COLONIAL CRAFT have been included in the consolidated financial statements of Quanex subsequent to the date of acquisition. Pro forma results of operations have not been presented because the effect of the acquisition was not material.

COLONIAL CRAFT is a manufacturer of value-added fenestration related wood products based in Roseville, Minnesota and Luck, Wisconsin (relocating Roseville facility to Mounds View, Minnesota in December 2002). COLONIAL CRAFT manufactures custom wood window accessories with two primary product lines: wood window grilles and hardwood architectural mouldings. COLONIAL CRAFT has become part of the Engineered Products division within the

building products business segment. COLONIAL CRAFT provides direct synergy with one of the Company's two core businesses, sharing a similar customer base with Engineered Products.

Within the terms of the purchase agreement, both selling and purchasing parties acknowledged that environmental reports showed evidence of minimal soil contamination at the Luck, Wisconsin facility, one of three COLONIAL CRAFT facilities. During the fiscal quarter ended July 31, 2002, the Company received notification from the Wisconsin Department of Commerce which stated that the residual soil and groundwater contamination was at levels below state regulatory limits and that they had determined that this site does not pose a significant threat to the environment or human health. During the fourth fiscal quarter of 2002, the Company closed the monitoring wells, as required, and received a notification from the Wisconsin Department of Commerce in November 2002 that the site was now listed as "closed".

The following table summarizes the fair values of the assets acquired and liabilities assumed at February 12, 2002 (in thousands).

Current assets	$	3,806
Property plant and equipment		4,775
Goodwill		7,210
Tradename		2,200
Patents		443
Non-compete agreements		313
Other non-current assets		29
Total assets	$	18,776
Current liabilities	$	1,265
Non-current liabilities		30
Total liabilities		1,295
Investment		17,481
Total liabilities and equity	$	18,776

The patents, which were valued at $443 thousand, are being amortized on a straight-line basis over a weighted average period of approximately 11 years. The non-compete agreements valued at $313 thousand are being amortized on the straight-line basis over 5 years. The tradename and goodwill are not subject to amortization, but are evaluated periodically in accordance with SFAS 142.

Goodwill for COLONIAL CRAFT is deductible for tax purposes. The tax basis of goodwill for COLONIAL CRAFT at the date of acquisition was approximately $12 million.

Temroc

On November 30, 2000, Quanex completed the purchase of all of the capital stock of Temroc Metals, Inc., ("Temroc"), a Minnesota corporation, for approximately $22 million in cash. Temroc, as a surviving corporation, became a wholly owned subsidiary of the Company. Goodwill associated with Temroc is approximately $14 million.

Temroc is a leading aluminum extrusion and fabrication company based in Hamel, Minnesota where it manufactures customized aluminum extrusions and fabricated metal products for recreational vehicles, architectural products, electronics and other markets. Temroc has become part of the Company's vehicular segment and will continue to operate as a manufacturer of aluminum extrusions and fabricated metal products.

3. Executive Life Insurance Benefit

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

During the fiscal year ended October 31, 2002, another of the Company's former executives, on whose life it held life insurance policies, died. As a result, the Company received life insurance proceeds totaling $26.1 million. Estimates of the cash surrender value of these life insurance policies amounting to $15.9 million were previously recognized in "Other assets" on the financial statements. The excess of the proceeds over the previously recorded cash surrender value and the liability to the beneficiaries of the executive amounting to $9.0 million was recognized as a non-taxable benefit on the income statement during the period ended October 31, 2002. The impact on October 31, 2002 earnings per share of this benefit was $0.61 basic and $0.56 diluted.

4. Goodwill and Acquired Intangible Assets

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

The carrying amounts of goodwill as of October 31, 2003 and 2002 are as follows (in thousands):

Vehicular Segment	$ 13,496
Building Products Segment	52,940
Total	$ 66,436

Intangible assets consist of the following (in thousands):

	As of October 31, 2003	
	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:		
Non-compete Agreements	$ 313	$ 119
Patents	443	82
Total	$ 756	$ 201
Unamortized intangible assets:		
Tradename	$ 2,200	

The aggregate amortization expense for intangible assets for the years ended October 31, 2003 and 2002 is $115 thousand and $86 thousand, respectively. Estimated amortization expense for the next five years follows (in thousands):

Fiscal years ending October 31,	Estimated Amortization
2004	$ 115
2005	$ 96
2006	$ 86
2007	$ 46
2008	$ 33

The following proforma table compares the three most recent fiscal years as if SFAS No. 142 had been in effect for the entire period (in thousands):

	For the Year Ended October 31,		
	2003	2002	2001
Reported Net income	$ 42,887	$ 55,482	$ 29,194
Add back: Goodwill amortization (net of taxes)	—	—	1,487
Proforma Net income	$ 42,887	$ 55,482	$ 30,681
Basic earnings per share:			
Reported Net income	$ 2.65	$ 3.74	$ 2.18
Goodwill amortization (net of taxes)	—	—	0.11
Proforma earnings per share	$ 2.65	$ 3.74	$ 2.29
Diluted earnings per share:			
Reported Net income	$ 2.62	$ 3.52	$ 2.07
Goodwill amortization (net of taxes)	—	—	0.10
Proforma diluted earnings per share	$ 2.62	$ 3.52	$ 2.17

5. Earnings per Share

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

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

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

	For the Year Ended October 31, 2001		
	Numerator (Income)	Denominator (Shares)	Per Share Amount
Basic earnings per share computation	$ 29,194	13,399	$ 2.18
Effect of dilutive securities			
Effect of common stock equivalents arising from stock options	—	58	
Effect of common stock held by rabbi trust	—	74	
Effect of conversion of subordinated debentures	2,810	1,895	
Diluted earnings per share computation	$ 32,004	15,426	$ 2.07

6. Inventories

Inventories consist of the following:

	October 31,	
	2003	2002
	(In thousands)	
Raw materials	$ 18,741	$ 24,307
Finished goods and work in process	51,006	58,108
	69,747	82,415
Other	9,575	8,341
Total	$ 79,322	$ 90,756

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

LIFO	$ 54,032	$ 64,269
FIFO	25,290	26,487
Total	$ 79,322	$ 90,756

With respect to inventories valued using the LIFO method, replacement cost exceeded the LIFO value by approximately $13,946,000 and $7,884,000 at October 31, 2003 and 2002, respectively.

7. Property Plant and Equipment

Property, plant and equipment consist of the following:

	October 31,	
	2003	2002
	(In thousands)	
Land and land improvements	$ 22,370	$ 22,339
Buildings	126,229	125,510
Machinery and equipment	627,139	609,888
Construction in progress	18,262	16,118
	794,000	773,855
Less accumulated depreciation and amortization	(458,096)	(420,723)
	$ 335,904	$ 353,132

The Company had commitments for the purchase or construction of capital assets amounting to approximately $6 million at October 31, 2003.

8. Accrued Liabilities

Accrued liabilities consist of the following:

	October 31,	
	2003	2002
	(In thousands)	
Payroll, payroll taxes and employee benefits	$ 25,935	$ 31,127
Accrued contribution to pension funds	2,035	1,518
Interest	175	196
State and local taxes	2,527	3,257
Other	8,537	8,935
	$ 39,209	$ 45,033

9. Income Taxes

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

Income tax expense consists of the following:

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Current:			
Federal	$ 14,254	$ 15,043	$ 8,101
State	1,255	1,410	1,105
	15,509	16,453	9,206
Deferred	7,427	9,679	7,222
Income tax expense	$ 22,936	$ 26,132	$ 16,428

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

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

	October 31,	
	2003	2002
	(In thousands)	
Deferred tax liability:		
Property, plant and equipment	$ 47,408	$ 43,794
Other	10,673	11,767
	58,081	55,561
Deferred tax assets:		
Intangibles	10,429	12,680
Postretirement benefit obligation	3,328	3,363
Other employee benefit obligations	6,920	7,004
Environmental accruals	5,898	6,518
Other	2,977	6,088
	29,552	35,653
Net deferred tax liability	28,529	$ 19,908
Deferred income tax non-current liability	$ 34,895	$ 29,210
Deferred tax current assets	(6,366)	(9,302)
Net deferred tax liability	$ 28,529	$ 19,908

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

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Income tax expense at statutory tax rate	$ 23,038	$ 28,565	$ 15,968
Increase (decrease) in taxes resulting from:			
State income taxes, net of federal effect	1,880	2,339	772
Life insurance benefit	(753)	(3,157)	—
Goodwill	—	—	664
Other items, net	(1,229)	(1,615)	(976)
	$ 22,936	$ 26,132	$ 16,428

The Company reached a settlement with the Internal Revenue Service with respect to the audit of certain portions of fiscal years 1997, 1998 and 1999. The Company currently has a case in Tax Court regarding the disallowance of a capital loss realized in 1997.

During 2003, the Company made tax payments of $503,000 related to the 1999 audit. Adequate provision had been made in prior years and the Company believes the outcome of these tax matters will not have a material impact on its financial position or results of operations.

10. Long-Term Debt and Financing Arrangements

Long-term debt consists of the following:

	October 31,	
	2003	2002
	(In thousands)	
"Bank Agreement" Revolver	$ 10,000	$ 65,000
Convertible subordinated debentures redeemed June 12, 2002	—	—
Industrial Revenue and Economic Development Bonds, unsecured, principle	1,665	1,665

due in the years 2005 and 2010, bearing interest ranging from 6.50% to 8.375%		
State of Alabama Industrial Development Bonds	3,450	3,800
Scott County, Iowa Industrial Waste Recycling Revenue Bonds	2,200	2,400
Temroc Industrial Development Revenue Bonds	2,228	2,425
Other	227	275
	$ 19,770	$ 75,565
Less maturities due within one year included in current liabilities	3,877	434
	$ 15,893	$ 75,131

Current Bank Agreement

In November 2002, the Company entered into a secured $200 million Revolving Credit Agreement ("Bank Agreement"). The Bank Agreement is secured by all Company assets, excluding land and buildings. The current Bank Agreement expires November 2005 and provides for up to $25 million for standby letters of credit, limited to the undrawn amount available under the current Bank Agreement. All borrowings under the current bank agreement bear interest, at the option of the Company, at either (a) the prime rate or federal funds rate plus one percent, whichever is higher, or (b) a Eurodollar based rate. The weighted average interest rate on borrowings under this agreement was 2.07% for 2003. The current Bank Agreement requires facility fees, which are not significant, maintenance of certain financial ratios and maintenance of a minimum consolidated tangible net worth. As of October 31, 2003, the company was in compliance with all current Bank Agreement covenants.

On December 19, 2003, subsequent to their fiscal 2003 year end, Quanex executed an agreement with their credit facility banks to increase the Bank Agreement revolver to $310 million to provide funds necessary for the North Star and TruSeal acquisitions, as detailed in Note 19.

Previous Bank Agreement "Revolver"

In July 1996, the Company entered into an unsecured $250 million Revolving Credit and Term Loan Agreement ("Bank Agreement"). At October 31 2002 and 2001, this Bank Agreement consisted of a revolving line of credit ("Revolver") under which the Company had $65 and $140 million, respectively, in borrowings. The weighted average interest rates on borrowings under the Revolver were 2.64% and 6.03% in 2002 and 2001, respectively. This Bank Agreement was replaced with a new Bank Agreement which is described above. The intent and ability to refinance the outstanding balance on this bank agreement on a long-term basis was evidenced by the signing of the new bank agreement in November 2002. Therefore, the outstanding balance under the previous bank agreement revolver was classified as non-current as of October 31, 2002.

Convertible Subordinated Debentures

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

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

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

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

Other Debt Instruments

The State of Alabama Industrial Development Bonds were assumed as part of the Nichols Aluminum Alabama acquisition. These bonds mature August 1, 2004 with interest payable monthly. The bonds bear interest at the weekly interest rate as determined by the remarketing agent under then prevailing market conditions to be the minimum interest rate, which, if borne by the bonds on the effective date of such rate, would enable the remarketing agent to sell the bonds on such business day at a price (without regard to accrued interest) equal to the principal amount of the bonds. The interest rate, however, may not exceed 13% per annum. Interest rates during the year ended October 31, 2003 ranged from 0.90% to 2.05%. These bonds are secured by a Letter of Credit.

On June 1, 1999, the Company borrowed $3 million through Scott County, Iowa Variable Rate Demand Industrial Waste Recycling Revenue Bonds Series 1999. The bonds require 15 annual principal payments of $200 thousand beginning on July 1, 2000. The variable interest rate is established by the remarketing agent based on the lowest weekly rate of interest that would permit the sale of the bonds at par, on the basis of prevailing financial market conditions. Interest is payable on the first business day of each calendar month. Interest rates on these bonds during fiscal 2003 have ranged from 1.00% to 2.10%. These bonds are secured by a Letter of Credit.

The Temroc Industrial Development Revenue Bonds were obtained as part of the acquisition of Temroc. These bonds are due in annual installments through October 2012. Interest is payable semi-annually at fixed rates from 4.5% to 5.6% depending on maturity (average rate of 5.1% over the term of the bonds). These bonds are secured by a mortgage on Temroc's land and building.

Aggregate maturities of long-term debt at October 31, 2003, are as follows (in thousands):

2004	$ 3,877
2005	429
2006	10,479
2007	451
2008	460
Thereafter	4,074
	$ 19,770

11. Pension Plans and Other Postretirement Benefits

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

Defined Benefit Plans:

The single employer defined benefit pension plans pay benefits to employees at retirement using formulas based upon years of service and either compensation rates near retirement or a flat dollar multiplier, as applicable. The Company's funding policy is generally to make the minimum annual contributions required by applicable regulations. In fiscal 2002, the Company made the maximum income tax deductible contribution amount allowed. The Company has until July 15, 2004 to make its 2003 contribution. The plans invest primarily in marketable equity and debt securities.

The Company also provides certain healthcare and life insurance benefits for eligible retired employees employed prior to January 1, 1993. Certain employees may become eligible for those benefits if they reach normal retirement age while working for the Company. The Company continues to fund benefit costs on a pay-as-you-go basis. For fiscal year 2003, the Company made benefit payments totaling $445,000, compared to $458,000, and $411,000 in fiscal 2002 and 2001, respectively.

A reconciliation of the beginning benefit obligation to the ending benefit obligation follows:

	Pension Benefits		Postretirement Benefits	
	October 31,			
	2003	2002	2003	2002
	(In thousands)			
Benefit obligation at beginning of year	$ 43,583	$ 37,151	$ 8,434	$ 7,321
Service cost	2,915	2,170	100	101
Interest cost	2,922	2,617	417	560
Amendments	487	19	—	(25)
Actuarial loss (gain)	4,112	2,734	(1,613)	935
Benefits paid	(1,021)	(743)	(445)	(458)
Administrative expenses	(482)	(365)	—	—
Benefit obligation at end of year	$ 52,516	$ 43,583	$ 6,893	$ 8,434

A reconciliation of the beginning fair value of plan assets to the ending fair value of plan assets follows:

	Pension Benefits October 31,	
	2003	2002
	(In thousands)	
Fair value of plan assets at beginning of year	$ 28,427	$ 22,760
Actual return (loss) on plan assets	4,429	(1,407)
Employer contributions	1,518	8,182
Benefits paid	(1,021)	(743)

Administrative expenses	(482)	(365)
Fair value of plan assets at end of year	$ 32,871	$ 28,427

A reconciliation of the funded status of the plans with the amounts recognized in the accompanying balance sheets is set forth below:

	Pension Benefits		Postretirement Benefits	
	October 31,			
	2003	2002	2003	2002
	(In thousands)			
Funded status	$ (19,645)	$ (15,156)	$ (6,893)	$ (8,434)
Unrecognized transition asset	(158)	(268)	—	—
Unrecognized prior service cost	1,599	1,305	(537)	(595)
Unrecognized net loss (gain)	15,405	13,953	(385)	1,131
Other	5	5	(30)	(30)
Accrued benefit cost	$ (2,794)	$ (161)	$ (7,845)	$ (7,928)
Amounts recognized in the Balance Sheet:				
Deferred benefit credit	$ (8,323)	$ (4,960)	$ (7,845)	$ (7,928)
Accrued contribution to pension	(2,035)	(1,518)	—	—
Intangible asset	1,599	1,305	—	—
Accumulated other comprehensive income	5,965	5,012	—	—
Accrued benefit cost	$ (2,794)	$ (161)	$ (7,845)	$ (7,928)

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

	Pension Benefits		Postretirement Benefits	
	October 31,			
	2003	2002	2003	2002
	(In thousands)			
Accumulated benefit obligation	$ 43,234	$ 34,910	$ 6,893	$ 8,434
Fair value of plan assets	32,871	28,427	—	—

Below are the assumptions used.

	Pension Benefits			Postretirement Benefits		
	October 31,					
	2003	2002	2001	2003	2002	2001
	(In thousands)					
Discount rate	6.25%	6.75%	7.25%	6.25%	6.75%	7.25%
Expected return on plan assets	8.50%	8.50%	10.00%	—	—	—
Rate of compensation increase	4.00%	4.00%	4.00%	—	—	—

The assumed health care cost trend rate was 9.00% in 2003, decreasing uniformly to 4.50% in the year 2009 and remaining level thereafter. If the health care cost trend rate assumptions were increased by 1%, the accumulated postretirement benefit obligation as of October 31, 2003 would be increased by 1.95%. The effect of this change on the sum of the service cost and interest cost would be an increase of 1.37%. If the health care cost trend rate assumptions were decreased by 1%, the accumulated

postretirement benefit obligation as of October 31, 2003 would be decreased by 1.76%. The effect of this change on the sum of the service cost and interest cost would be a decrease of 1.21%.

Net pension costs for the single employer defined benefit pension plans were as follows:

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Service Cost	$ 2,915	$ 2,170	$ 1,976
Interest cost	2,922	2,617	2,450
Expected return on plan assets	(2,444)	(2,044)	(2,421)
Amortization of unrecognized transition asset	(111)	(111)	(111)
Amortization of unrecognized prior service cost	193	163	109
Amortization of unrecognized net loss	677	263	—
Other	—	(2)	—
Net periodic pension cost	$ 4,152	$ 3,056	$ 2,003

Net periodic costs for the postretirement benefit plans other than pensions were as follows:

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Net periodic postretirement benefit cost:			
Service cost	$ 100	$ 102	$ 100
Interest cost	417	560	521
Net amortization and deferral	(155)	(54)	(65)
Net periodic postretirement benefit cost	$ 362	$ 608	$ 556

Defined Contribution Plans:

The Company has various defined contribution plans in effect for certain eligible employees. The Company makes contributions to the plans subject to certain limitations outlined in the plans. Contributions to these plans were approximately $5,451,000, $5,456,000, and $4,696,000 during fiscal 2003, 2002, and 2001, respectively.

Other:

Quanex has a Supplemental Benefit Plan covering certain key officers of the Company. Earned vested benefits under the Supplemental Benefit Plan were approximately $745,000, $2,234,000 and $5,456,000 at October 31, 2003, 2002 and 2001, respectively. These benefits are funded with life insurance policies purchased by the Company.

12. Industry Segment Information

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

performance". Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments.

Beginning in 2002, Quanex began reporting under these two market focused segments. The vehicular products segment is comprised of MACSTEEL, Piper Impact and Temroc. The building products segment is comprised of Engineered Products and Nichols Aluminum. Corporate and other will include corporate office charges, intersegment eliminations and LIFO inventory adjustments.

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

For the years ended October 31, 2003, 2002 and 2001, no one customer represented 10% or more of the consolidated net sales of the Company.

	For the Years Ended October 31,		
	2003	2002	2001
	($ in thousands)		
Net Sales			
Vehicular Products(3)	$ 468,506	$ 459,531	$ 439,307
Building Products(4)	562,709	534,856	485,046
Corporate and Other(1)	—	—	—
Consolidated	$ 1,031,215	$ 994,387	$ 924,353
Operating Income (Loss):			
Vehicular Products(3)	$ 48,208	$ 57,606	$ 47,466
Building Products(4)	35,648	37,985	23,662
Corporate & Other(1)	(20,061)	(12,291)	(13,812)
Consolidated	$ 63,795	$ 83,300	$ 57,316
Depreciation and Amortization:			
Vehicular Products(3)	$ 29,573	$ 27,849	$ 25,905
Building Products(4)	16,152	15,492	17,061
Corporate & Other(1)	690	646	944
Consolidated	$ 46,415	$ 43,987	$ 43,910
Capital Expenditures:(2)			
Vehicular Products(3)	$ 14,497	$ 22,931	$ 47,234
Building Products(4)	14,253	11,464	8,241
Corporate & Other(1)	138	118	165
Consolidated	$ 28,888	$ 34,513	$ 55,640
Identifiable Assets:			
Vehicular Products(3)	$ 350,767	$ 363,559	$ 362,442
Building Products(4)	278,629	283,475	269,387
Corporate & Other(1)	36,467	42,106	65,802
Consolidated	$ 665,863	$ 689,140	$ 697,631
Goodwill, Net			
Vehicular Products	$ 13,496	$ 13,496	$ 13,496
Building Products	52,940	52,940	45,730
	$ 66,436	$ 66,436	$ 59,226

(1) Included in "Corporate and Other" are intersegment eliminations, corporate expenses and LIFO inventory adjustments.

(2) Includes capitalized interest.

(3) Fiscal 2001 results include Temroc operations since the acquisition date of November 30, 2000. See Note 2 to the financial statements.

(4) Fiscal 2002 results include COLONIAL CRAFT operations since the acquisition date of February 12, 2002. See Note 2 to the financial statements.

Net Sales by Product Information

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Net Sales			
Engineered Steel Bars	$ 393,505	$ 365,393	$ 330,692
Aluminum Mill Sheet Products	406,287	383,864	361,660
Window and Door Components	156,422	150,992	123,386
Extruded and Fabricated Products	75,001	94,138	108,615

Total	$ 1,031,215	$ 994,387	$ 924,353

Geographic Information

	Years Ended October 31,		
	2003	2002	2001
	(In thousands)		
Net Sales			
United States	$ 956,669	$ 930,734	$ 870,163
Mexico	22,151	19,242	16,148
Canada	37,611	32,797	26,176
Asian countries	9,917	7,882	7,128
European countries	4,168	3,533	4,315
Other foreign countries	699	199	423
Total	$ 1,031,215	$ 994,387	$ 924,353

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

13. Preferred Stock Purchase Rights

The Company declared a dividend in 1986 of one Preferred Stock Purchase Right (a "Right") on each outstanding share of its common stock. This action was intended to assure that all shareholders would receive fair treatment in the event of a proposed takeover of the Company. On April 26, 1989, the Company amended the Rights to provide for additional protection to shareholders and to provide the Board of Directors of the Company with needed flexibility in responding to abusive takeover tactics. On April 15, 1999, the Second Amended and Restated Rights Agreement went into effect. Each Right, when exercisable, entitles the holder to purchase 1/100th of a share of the Company's Series A Junior Participating Preferred Stock at an exercise price of $90. Each 1/100th of a share of Series A Junior Participating Preferred Stock will be entitled to a dividend equal to the greater of $.01 or the dividend declared on each share of common stock, and will be entitled to 1/100th of a vote, voting together with the shares of common stock. The Rights will be exercisable only if, without the Company's prior consent, a person or group of persons acquires or announces the intention to acquire 20% or more of the Company's common stock. If the Company is acquired through a merger or other business combination transaction, each Right will entitle the holder to purchase $120 worth of the

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

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

14. Stock Repurchase Program and Treasury Stock

In December 1999, Quanex announced that its Board of Directors approved a program to repurchase up to 2 million shares of the Company's common stock in the open market or in privately negotiated transactions.

During the fiscal year ended October 31, 2001, the Company repurchased 119,000 shares at a cost of $2.2 million. The cost of treasury shares of $12.7 million at October 31, 2001 was reflected as a reduction of stockholders' equity in the balance sheet.

The stock purchase program was suspended and no treasury shares were purchased during fiscal 2002. A majority of the 633,935 shares held in treasury at October 31, 2001 were reissued through stock option exercises or other compensation plans during fiscal 2002, leaving no shares in treasury as of October 31, 2002.

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

15. Restricted Stock and Stock Option Plans

Key Employee and Non-Employee Director Plans:

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

Restricted Stock Plans

Under the Company's restricted stock plans, common stock may be awarded to key employees, officers and non-employee directors. The recipient is entitled to all of the rights of a shareholder, except that during the forfeiture period the shares are nontransferable. The awards vest over a specified time period. Upon issuance of stock under the plan, unearned compensation equal to the market value at the date of grant is charged to stockholders' equity and subsequently amortized to expense over the restricted period. There were 3,000, 0 and 44,000 restricted shares granted in 2003, 2002 and 2001, respectively. The amount charged to compensation expense in 2003, 2002 and 2001 was $294,000, $479,000 and $368,000, respectively, relating to amortization of restricted stock granted in 2003 and prior years. In December 2003, subsequent to the fiscal year ended October 31, 2003, the Company granted 23,800 restricted shares to certain officers and directors.

Stock Option Plans

Under the Company's option plans, options are granted at prices determined by the Board of Directors which may not be less than the fair market value of the shares at the time the options are granted. Unless otherwise provided by the Board at the time of grant, options become exercisable in one-third increments maturing cumulatively on each of the first through third anniversaries of the date of grant and must be exercised no later than ten years from the date of grant. Effective December 5, 2002, the 1996 Employee Plan (the "1996 Plan") was amended to add non-employee Directors as eligible participants under that plan. This amendment also increased the number of shares available for options and restricted stock awards under the 1996 Plan by 1,200,000 shares. There were 1,348,633, 391,597 and 388,145 shares available for granting of options at October 31, 2003, 2002, and 2001, respectively. The exercise price for the outstanding options as of October 31, 2003 range from $18.19 to $40.05 per share.

Stock option transactions for the three years ended October 31, 2003, were as follows:

	Shares Exercisable	Shares Under Option	Average Price Per Share
Balance at October 31, 2000	1,139,546	1,622,103	$ 22
Granted		382,000	24
Exercised		(70,048)	20
Cancelled		(23,751)	21
Balance at October 31, 2001	1,291,129	1,910,304	$ 23
Granted		15,000	36
Exercised		(1,085,250)	23
Cancelled/Lapsed		(18,452)	22
Balance at October 31, 2002	489,366	821,602	$ 23
Granted		285,500	32
Exercised		(180,936)	22
Cancelled/Lapsed		(45,536)	27
Balance at October 31, 2003	504,535	880,630	$ 25

In November and December 2003, subsequent to the fiscal year ended October 31, 2003, the Company granted 173,100 options to certain officers and employees at an average exercise price of $39.60 per share.

Non-Employee Director Plans:

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

1987 Non-Employee Directors Plan

The Company's 1987 Non-employee Directors stock option plan provides for the granting of stock options to non-employee Directors to purchase up to an aggregate amount of 100,000 shares of common stock. The plan provides that each non-employee Director and each future non-employee Director, as of the first anniversary of the date of his/her election as a Director of the Company, will be granted an option to purchase 10,000 shares of common stock at a price per share of common stock

equal to the fair market value of the common stock as of the date of the grant. During 1998, the Board of Directors passed a resolution, which reduced the number of options to be granted from 10,000 to 6,000.

Options become exercisable in one-third increments maturing cumulatively on each of the first through third anniversaries of the date of the grant and must be exercised no later than 10 years from the date of grant. No options may be granted under the plan after June 22, 1997. There were no shares available for granting of options at October 31, 2003, 2002, or 2001. The exercise price of the all of the shares outstanding as of October 31, 2003 was $19.88. Stock option transactions for the three years ended October 31, 2003, were as follows:

	Shares Exercisable	Shares Under Option	Average Price Per Share
Balance at October 31, 2000	20,000	20,000	$ 20
Granted		—	—
Exercised		—	—
Cancelled		—	—
Balance at October 31, 2001	20,000	20,000	$ 20
Granted		—	—
Exercised		(15,000)	20
Cancelled		—	—
Balance at October 31, 2002	5,000	5,000	$ 20
Granted		—	—
Exercised		—	—
Cancelled		—	—
Balance at October 31, 2003	5,000	5,000	$ 20

1989 Non-Employee Directors Plan

The Company's 1989 Non-employee Directors stock option plan provides for the granting of stock options to non-employee Directors to purchase up to an aggregate of 210,000 shares of common stock. Each non-employee Director as of December 6, 1989 was granted an option to purchase 3,000 shares of common stock at a price per share of common stock equal to the fair market value of the common stock as of the date of grant. Also, each non-employee Director who is a director of the Company on any subsequent October 31, while the plan is in effect and shares are available for the granting of options hereunder, shall be granted on such October 31, an option to purchase 3,000 shares of common stock at a price equal to the fair market value of the common stock as of such October 31. During 1998, the Board of Directors passed a resolution, which decreased the number of options to be granted annually as prescribed above from 3,000 to 2,000. Options become exercisable at any time commencing six months after the grant and must be exercised no later than 10 years from the date of grant. No option may be granted under the plan after December 5, 1999. There were no shares available for granting of options at October 31, 2003, 2002 or 2001. The exercise price of the options outstanding as of October 31, 2003 ranged from $16.88 to $28.50.

Stock option transactions for the three years ended October 31, 2003, were as follows:

	Shares Exercisable	Shares Under Option	Average Price Per Share
Balance at October 31, 2000	135,000	135,000	$ 23
Granted		—	—
Exercised		(14,000)	20
Cancelled		(6,000)	22
Balance at October 31, 2001	115,000	115,000	$ 24
Granted		—	—
Exercised		(51,000)	23
Cancelled		(3,000)	19
Balance at October 31, 2002	61,000	61,000	$ 25
Granted		—	—
Exercised		(11,000)	22
Cancelled		—	—
Balance at October 31, 2003	50,000	50,000	$ 25

1997 Non-Employee Directors Plan

The Company's 1997 Non-Employee Directors stock option plan provided for the granting of stock options to non-employee Directors to purchase up to an aggregate of 400,000 shares of common stock. On December 5, 2002 the Company elected to terminate future grants of options under this plan. There were two types of grants under this plan which are described as follows:

Automatic Annual Grants

While this plan was in effect and shares were still available for the granting of options hereunder, each non-employee Director who was a director of the Company on October 31 and who had not received options under the 1989 Non-Employee Director plan would be granted on such October 31, an option to purchase such number of shares of common stock as is determined by the Board of Directors at a price equal to the fair market value of the common stock as of such October 31. These options are exercisable in full immediately upon the date of grant.

New Director Grants

While this plan was in effect and shares were still available for the granting of options hereunder, there would be granted to each non-employee Director who was not granted an option under the 1987 Non-Employee Director Stock Option Plan as of the date upon which such director shall have continuously served as a director of the Company for a period of one year an option to purchase such number of Quanex Corporation shares of stock as is determined by the Board of Directors. These Plan options become exercisable in one-third increments maturing cumulatively on each of the first through third anniversaries of the date of the grant and must be exercised no later than 10 years from the date of grant.

There were 0, 332,000 and 350,000 shares available for granting of options at October 31, 2003, 2002 and 2001, respectively. The exercise price of the options outstanding as of October 31, 2003 ranged from $18.25 to $35.85. Stock option transactions for the three years ended October 31, 2003, were as follows:

	Shares Exercisable	Shares Under Option	Average Price Per Share
Balance at October 31, 2000	25,333	36,000	$ 21
Granted		14,000	26
Exercised		—	—
Cancelled		—	—
Balance at October 31, 2001	44,666	50,000	$ 22
Granted		18,000	36
Exercised		(15,000)	21
Cancelled		—	—
Balance at October 31, 2002	47,000	53,000	$ 27
Granted		—	—
Exercised		(6,000)	18
Cancelled		—	—
Balance at October 31, 2003	43,000	47,000	$ 28

16. Financial Instruments and Risk Management

Effective November 1, 2000, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS No. 138, which requires the Company to measure all derivatives at fair value and to recognize them in the balance sheet as an asset or liability, depending on the Company's rights or obligations under the applicable derivative contract. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

In April 2003, the FASB issued SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as "derivatives") and for hedging activities under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities". The provisions of this statement are effective for contracts entered into or modified after June 30, 2003, with certain exceptions. The Company does not anticipate any material impact on the Company's financial position, results of operations, or cash flows as a result of adoption.

Metal Exchange Forward Contracts

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

Through the use of firm price raw material purchase commitments and LME contracts, the Company intends to protect gross margins from the effects of changing prices of aluminum. To the extent that the raw material costs factored into the firm price sales commitments are matched with firm price raw material purchase commitments, changes in aluminum prices should have no effect on the Company. Where firm price sales commitments are matched with LME contracts, the Company is subject to the ineffectiveness of LME contracts to perfectly hedge raw material prices.

The Company grouped LME contracts into two types: customer specific and non-customer specific. The customer specific contracts have been designated as cash flow hedges of forecasted aluminum raw material purchases in accordance with SFAS No. 133. The non-customer specific LME contracts that were used to manage or balance the raw material needs were designated as hedges and, therefore, did not receive hedge accounting under SFAS No. 133. Both types of contracts were measured at fair market value on the balance sheet.

The Company adopted SFAS No. 133 effective November 1, 2000 recording a derivative liability of $372 thousand representing the fair value of these contracts as of that date. A corresponding amount, net of taxes of $145 thousand, was recorded in other comprehensive income.

At October 31, 2001, open LME contracts covered notional volumes of 45.4 million pounds and had a fair value net loss of approximately $1.8 million, which was recorded as part of other current and non-current assets and liabilities in the financial statements. During the years ended October 31, 2003 and 2002, Nichols Aluminum primarily used firm price raw material purchase commitments instead of LME forward contracts to lock in raw material prices. At October 31, 2002, the Company had no open LME forward contracts and therefore no asset or liability associated with metal exchange derivatives. At October 31, 2003, two open LME contracts covered notional volumes of 1.3 million pounds and had a fair value net loss of approximately $46 thousand, which was recorded as part of other current assets and other current liabilities in the financial statements.

The effective portion of the gains and losses related to the customer specific forward LME contracts designated as hedges are reported in other comprehensive income. These gains and losses are reclassified into earnings in the periods in which the related inventory is sold. Gains and losses on these customer specific hedge contracts, including amounts related to hedge ineffectiveness, are reflected in "Cost of sales" in the income statement. For the years ended October 31, 2003, 2002 and 2001, net gains of $14 thousand, $136 thousand and a net loss of $283 thousand, respectively, were recognized in "Cost of sales" representing the amount of the hedges' ineffectiveness. No components of these gains and losses were excluded from the assessment of hedge effectiveness. Additionally, no hedge contracts were discontinued due to the determination that the original forecasted transaction would not occur. Accordingly, there was no income statement impact related to that action.

The entire amount of gains and losses of the non-customer specific forward LME contracts not designated as hedges were reflected in "Cost of sales" in the income statement in the period in which they occurred. These gains and losses included the changes in fair market value during the period for all open and closed contracts.

Interest Rate Swap Agreements

In fiscal 1996, the Company entered into interest rate swap agreements, which effectively converted $100 million of its variable rate debt under the Bank Agreement Revolver to fixed rate. The Company's risk management policy related to these swap agreements is to hedge the exposure to interest rate movements on a portion of its long-term debt. Under the swap agreements, payments are made based on a fixed rate ($50 million at 7.025% and $50 million at 6.755%) and received on a LIBOR based variable rate (1.82% at October 31, 2002). Differentials to be paid or received under the agreements are recognized as interest expense. The agreements matured in 2003. The Company has designated the interest rate swap agreements as cash flow hedges of future interest payments on its variable rate debt under the Bank Agreement Revolver.

Accounting before adoption of SFAS No. 133: Prior to the adoption of SFAS No. 133 on November 1, 2000, hedging gains and losses were included in "Interest Expense" in the income statement based on the quarterly swap settlement.

Accounting after adoption of SFAS No. 133: On November 1, 2000, the Company recorded a derivative liability of $918 thousand, representing the fair value of the swaps as of that date. A corresponding amount, net of income taxes of $358 thousand, was recorded to other comprehensive income.

The fair value of the swaps as of October 31, 2003, 2002 and 2001 was $0, a loss of $4.0 million and a loss of $7.3 million, respectively, which is recorded in other current liabilities. Gains and losses related to the swap agreements will be reclassified into earnings in the periods in which the related hedged interest payments are made. Gains and losses on these agreements, including amounts recorded related to hedge ineffectiveness, are reflected in "Interest expense" in the income statement. Net losses of $157 thousand, $386 thousand and $730 thousand, were recorded as interest expense in the years ended October 31, 2003, 2002 and 2001, respectively, representing the amount of the hedge's ineffectiveness. No components of the swap instruments' losses were excluded from the assessment of hedge effectiveness.

Discontinuance of cash flow hedge: Based on future cash flow projections that were prepared during the second fiscal quarter period ended April 30, 2002, it was determined that it was probable that the Company would pay down its variable rate debt under the Bank Agreement Revolver to approximately $65 million by the end of this fiscal year. Based on these projections, a portion of the future projected cash flow being hedged (interest payments) would not occur. Therefore, during the period ended April 30, 2002, the Company discontinued hedge accounting under SFAS 133 for $35 million of the interest swap agreement and reclassified the related portion of other comprehensive income, a loss of $1.3 million to interest expense. Additionally, during the fourth fiscal quarter ended October 31, 2002, the timing of the finalization of the new bank agreement was determined.

With the execution of the Bank Agreement in November 2002, the interest rate swaps no longer qualified as a hedge. As a result, the Company discontinued hedge accounting under SFAS No. 133 on the swaps after the effective date of the Bank Agreement and reclassified the related portion of other

comprehensive income ($2.1 million) to interest expense in the fiscal quarter and year ended October 31, 2002.

The interest rate swap agreements were effective until July 29, 2003 and the final interest settlement payment was made at that time. As of October 31, 2003, there were no open swap agreement contracts and therefore no asset or liability reflected on the balance sheet. A net loss of $2 thousand was recorded in interest expense in the year ended October 31, 2003, representing the change in the fair market value of the swap agreements since October 31, 2002.

Other Financial Assets and Liabilities

The fair values of the Company's financial assets approximate the carrying values reported on the consolidated balance sheet. The fair value and carrying value of long-term debt was $19.8 million and $75.6 million, as of October 31, 2003 and 2002, respectively. The fair value of long-term debt was based on the quoted market price, recent transactions, or based on rates available to the Company for instruments with similar terms and maturities.

17. Leases

Quanex has operating leases for certain real estate and equipment. Rental expense for the years ended October 31, 2003, 2002 and 2001 was $2.2 million, $2.2 million and $2.1 million, respectively.

Future minimum payments as of October 31, 2003, by year and in the aggregate under operating leases having non-cancelable lease terms in excess of one year were as follows (in thousands):

	Operating Leases
2004	$ 2,063
2005	1,522
2006	1,176
2007	1,012
2008	648
Thereafter	462
Total	$ 6,883

18. Contingencies

Quanex is subject to loss contingencies arising from federal, state, and local environmental laws. Environmental expenditures are expensed or capitalized depending on their future economic benefit. The Company accrues its best estimates of its remediation obligations and adjusts such accruals as further information and circumstances develop. Those estimates may change substantially depending on information about the nature and extent of contamination, appropriate remediation technologies, and regulatory approvals. Costs of future expenditures for environmental remediation are not discounted to their present value. 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 companies 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. It is management's opinion that the Company has established appropriate reserves for environmental remediation obligations at several of its plant sites and disposal

facilities. Those amounts are not expected to have a material adverse effect on the Company's financial condition. Total remediation reserves, at October 31, 2003, were approximately $16.8 million. These reserves include, without limitation, the Company's best estimate of liabilities related to costs for further investigations, environmental remediation, and corrective actions related to the acquisition of Piper Impact, the acquisition of Nichols Aluminum Alabama and the Company's former Tubing Operations. Actual cleanup costs at the Company's current plant sites, former plants, and disposal facilities could be more or less than the amounts accrued for remediation obligations. Because of uncertainties as to the extent of environmental impact and concurrence of governmental authorities, it is not possible at this point to reasonably estimate the amount of any obligation for remediation in excess of current accruals that would be material to Quanex's financial statements because of uncertainties as to the extent of environmental impact and concurrence of governmental authorities.

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

19. SUBSEQUENT EVENTS

On September 30, 2003 the Company announced that it signed a definitive purchase agreement with North Star Steel, a subsidiary of Cargill, Incorporated, to purchase the net assets of North Star's Monroe, Michigan based manufacturing facility in a cash transaction. The Company expects to close the transaction during its fiscal quarter ending January 31, 2004. North Star Steel—Monroe, located in Monroe, Michigan, is a scrap-based mini-mill producer of special bar quality and engineered steel bars primarily serving the light vehicle and heavy-duty truck markets. The facility, with revenues of approximately $175 million, can produce over 500,000 tons of bars in diameters from 0.5625" to 3.25". The facility employs approximately 380 employees. The operation will become part of Quanex's vehicular products segment and will be renamed MACSTEEL Monroe.

On November 21, 2003 the Company announced that it had signed a definitive purchase agreement to purchase the stock of TruSeal Technologies, Inc., in a cash transaction. The Company expects to close the transaction during its fiscal quarter ending January 31, 2004. TruSeal, headquartered in Beachwood, Ohio, manufactures and markets a full line of patented, flexible insulating glass spacer systems and sealants for wood, vinyl and aluminum windows. The product separates and seals glass within the window frame and acts as a thermal barrier to conserve energy. TruSeal's revenue for calendar year 2003 is expected to be approximately $80 million and they employ about 300 employees. The operation will become part of Quanex's building products segment.

These acquisitions will be financed through borrowings under the Company's existing Bank Agreement as amended on December 19, 2003. (See Note 10.)

QUANEX CORPORATION

SUPPLEMENTARY FINANCIAL DATA

Quarterly Results of Operations (Unaudited)

The following sets forth the selected quarterly information for the years ended October 31, 2003 and 2002.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands except per share amounts)			
2003:				
Net sales	$ 229,509	$ 254,610	$ 260,277	$ 286,819
Gross profit	23,409	29,234	31,120	34,113
Net income	6,783	9,365	13,623	13,116
Earnings per share:				
Basic earnings per share	$ .41	$ .58	$ .85	$ .82
Diluted earnings per share	.41	.58	.84	.80
2002:				
Net sales	$ 204,243	$ 249,500	$ 266,891	$ 273,753
Gross profit	22,305	34,123	39,493	43,289
Net income	5,460	10,632	24,337	15,053
Earnings per share:				
Basic earnings per share	$ 0.41	$ 0.77	$ 1.56	$ 0.92
Diluted earnings per share	0.39	0.70	1.42	0.97

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at Beginning of Year	Charged to Costs & Expenses	Write-offs	Other	Balance at End of Year
	(In thousands)				
Allowance for doubtful accounts:					
Year ended October 31, 2003	$ 6,877	$ 722	$ (384)	$ 7	$ 7,222
Year ended October 31, 2002	$ 8,953	$ 1,113	$ (3,227)	$ 38	$ 6,877
Year ended October 31, 2001	$ 11,240	$ 868	$ (3,213)	$ 58	$ 8,953

Quarterly Financial Results
(from continuing operations)

	2003	2002	2001
Net Sales ($ millions)			
January	229.5	204.2	199.9
April	254.6	249.5	220.3
July	260.3	266.9	248.1
October	286.8	273.8	256.0
Total	1,031.2	994.4	924.3
Gross Profit ($ millions)			
January	23.4	22.3	20.8
April	29.2	34.1	23.8
July	31.1	39.5	32.8
October	34.1	43.3	37.9
Total	117.8	139.2	115.3
Income from Continuing Operations ($ millions)			
January	6.8	5.5	4.0
April	9.4	10.6	4.3
July(1)(2)	13.6	24.3	9.6
October	13.1	15.0	11.2

Total	42.9	55.4	29.1
Income from Continuing Operations Per Basic Common Share ($)			
January	.41	.41	.30
April	.58	.77	.32
July(1)(2)	.85	1.56	.72
October	.82	.92	.84
Fiscal Year	2.65	3.74	2.18
Quarterly Common Stock Dividends ($)			
January	.17	.16	.16
April	.17	.16	.16
July	.17	.16	.16
October	.17	.16	.16
Total	.68	.64	.64
Common Stock Sales Price (High & Low—$)			
January	37.55	29.64	21.00
	29.12	25.71	16.38
April	33.49	38.35	21.15
	27.93	28.63	17.35
July	33.49	44.19	27.55
	28.59	31.01	20.70
October	40.60	40.55	27.48
	29.94	33.18	20.75

(1) Fiscal 2002 third quarter income from continuing operations includes a retired executive life insurance benefit of $9.0 million.

(2) Fiscal 2003 third quarter income from continuing operations includes a retired executive life insurance benefit of $2.2 million.

Item 9. ***Change in and Disagreements with Accountants on Accounting and Financial Disclosure***

None

Item 9A. ***Controls and Procedures***

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

PART III

Item 10. ***Directors and Executive Officers of the Registrant***

The Company has a Code of Ethics (the "Code") that applies to all employees, executive officers including the chief executive officer, principal financial officer and principal accounting officer and directors of the Company that includes provisions covering conflicts of interest, ethical conduct, compliance with applicable government laws, rules and regulations, and accountability for adherence to the Code.

The Company's Board of Directors has adopted Corporate Governance Guidelines and charters for the Audit, Compensation and Management Development, and Nominating and Corporate Governance Committees of the Board of Directors.

You can obtain a printed copy of any of the materials referenced above at the following address:

Quanex Corporation
1900 West Loop South, Suite 1500
Houston, TX 77027
713-961-4600

The Company's Board of Directors has determined that at least one person serving on its Audit Committee is an "audit committee financial expert" as defined under Item 401(h) of Regulation S-K. Mr. Barger, Mr. Ross and Mr. Wellek, all members of the Audit Committee, are audit committee financial experts and are independent as set forth in Item 7(d)(3)(iv) of schedule 14A under the Exchange Act.

Pursuant to General Instruction G(3) to Form 10-K, additional information on directors and executive officers of the Registrant is incorporated herein by reference from the Registrant's Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the close of the fiscal year ended

October 31, 2003.

Item 11. ***Executive Compensation***

Pursuant to General Instruction G(3) to Form 10-K, information on executive compensation is incorporated herein by reference from the Registrant's Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the close of the fiscal year ended October 31, 2003.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Pursuant to General Instruction G(3) to Form 10-K, information on security ownership of certain beneficial owners and management is incorporated herein by reference from the Registrant's Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the close of the fiscal year ended October 31, 2003.

Item 13. ***Certain Relationships and Related Transactions***

Pursuant to General Instruction G(3) to Form 10-K, information on certain relationships and related transactions is incorporated herein by reference from the Registrant's Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after the close of the fiscal year ended October 31, 2003.

Item 14. ***Principal Accountant Fees and Services***

Pursuant to SEC Release No. 33-8183 (as corrected by Release No. 33-8183A), the disclosure requirements of this Item are not effective until the Annual Report on Form 10-K for the first fiscal year ending after December 15, 2003.

PART IV

Item 15. ***Exhibits, Financial Statement Schedules and Reports on Form 8-K***

Exhibit Number	Description of Exhibits
2.1	Asset Purchase Agreement dated July 31, 1996, among the Company, Piper Impact, Inc., a Delaware corporation, Piper Impact, Inc., a Tennessee corporation, B. F. Sammons and M. W. Robbins, filed as Exhibit 2.1 of the Company's Report on Form 8-K (Reg. No. 001-05725), dated August 9, 1996, and incorporated herein by reference.
2.2	Stock Purchase Agreement dated April 18, 1997, by and among Niagara Corporation, Niagara Cold Drawn Corp., and Quanex Corporation filed as Exhibit 2.1 to the Company's Current Report on Form 8-K (Reg. No. 001-05725), dated May 5, 1997, and incorporated herein by reference.
2.3	Purchase Agreement dated December 3, 1997, among Quanex Corporation, Vision Metals Holdings, Inc., and Vision Metals, Inc., filed as Exhibit 2.1 to the Company's Current Report on Form 8-K (Reg. No. 001-05725), dated December 3, 1997, and incorporated herein by reference.

2.4 Acquisition Agreement and Plan of Merger, dated October 23, 2000, between Quanex Corporation ("Company"), Quanex Five, Inc., a Delaware corporation and wholly owned subsidiary of the Company, and Temroc Metals, Inc., a Minnesota corporation, filed as Exhibit 2.1 to the Company's Report on Form 8-K (Reg. No. 001-05725), dated November 30, 2000, and incorporated herein by reference.

2.5 First Amendment to Agreement and Plan of Merger dated November 15, 2000 between Quanex Corporation ("Company"), Quanex Five, Inc., a Delaware corporation and wholly owned subsidiary of the Company, and Temroc Metals, Inc., a Minnesota corporation, filed as Exhibit 3.1 to the Company's Report on Form 8-K (Reg. No. 001-05725), dated November 30, 2000 and incorporated herein by reference.

*2.6 Stock Purchase Agreement dated November 21, 2003, by and among Kirtland Capital Partners II L.P., Kirtland Capital Company II LLC, TruSeal Investments Ltd., the other stockholders of TruSeal Technologies, Inc., and Quanex Corporation. Pursuant to Item 601(b)(2) of Regulation S-K, certain schedules to this Stock Purchase Agreement have not been filed with this exhibit. The schedules contain various items relating to the assets of the corporation being acquired and the representations and warranties made by the parties to the agreement. The registrant agrees to furnish supplementally any omitted schedule to the SEC upon request.

*2.7 Amended and Restated Asset Purchase and Sale Agreement dated December 23, 2003, by and between North Star Steel Company, MACSTEEL Monroe, Inc. (formerly Quanex Two, Inc.), and Quanex Corporation. Pursuant to Item 601(b)(2) of Regulation S-K, certain schedules to this Amended and Restated Asset Purchase and Sale Agreement have not been filed with this exhibit. The schedules contain various items relating to the assets of the business being acquired and the representations and warranties made by the parties to the agreement. The registrant agrees to furnish supplementally any omitted schedule to the SEC upon request.

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 fiscal year ended October 31, 1999 and incorporated herein by reference.

3.3 Amendment to Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Registrant dated as of April 15, 1999, filed as Exhibit 3.3 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1999 and incorporated herein by reference.

3.4 Certificate of Correction of Amendment to Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock dated as of April 16, 1999, filed as Exhibit 3.4 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 1999 and incorporated herein by reference.

3.5 Amended and Restated Bylaws of the Registrant, as amended through August 26, 1999 filed as Exhibit 3 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the fiscal quarter ended July 31, 1999, and incorporated herein by reference.

4.1 Form of Registrant's Common Stock certificate, filed as Exhibit 4.1 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended April 30, 1987, and incorporated herein by reference.

4.2 Second Amended and Restated Rights Agreement dated as of April 15, 1999, between the Registrant and American Stock Transfer & Trust Co. as Rights Agent, filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K (Reg. No. 001-05725) dated April 15, 1999, and incorporated herein by reference.

4.3 Revolving Credit Agreement dated as of November 26, 2002, by and among Quanex Corporation, the financial institutions from time to time signatory thereto and Comerica Bank, as agent for the banks filed as Exhibit 4.4 to the Registrant's Annual Report on Form 10-K dated October 31, 2003, and incorporated herein by reference. Certain schedules and exhibits to this Revolving Credit Agreement have not been filed with this exhibit. The Company agrees to furnish supplementally any omitted schedule or exhibit to the SEC upon request.

4.4 First Amendment to Security Agreement, dated February 17, 2003, effective November 26, 2002, filed as Exhibit 4.5 to the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) dated January 31, 2003 and incorporated herein by reference.

*4.5 Consent and First Amendment to Revolving Credit Agreement dated December 19, 2003, by and among Quanex Corporation, the financial institutions from time to time signatory thereto and Comerica Bank, as agent for the Banks. Certain schedules and exhibits to this Consent and First Amendment to Revolving Credit Agreement have not been filed with this exhibit. The Company agrees to furnish supplementally any omitted schedule or exhibit to the SEC upon request.

†10.1 Quanex Corporation 1988 Stock Option Plan, as amended, and form of Stock Option year Agreement filed as Exhibit 10.4 to the Registrant's annual Report on Form 10-K for the year ended October 31, 1988, together with the amendment filed as Exhibit 10.17 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended January 31, 1995, and incorporated herein by reference.

†10.2 Amendment to the Quanex Corporation 1988 Stock Option Plan, dated as of December 1997, filed as Exhibit 10.2 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.

†10.3 Amendment to the Quanex Corporation 1988 Stock Option Plan, dated as of December 9, 1999, filed as Exhibit 10.3 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.

†10.4 Quanex Corporation Deferred Compensation Plan, as amended and restated, dated September 29, 1999, filed as Exhibit 10.4 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.

†10.5 First Amendment to Quanex Corporation Deferred Compensation Plan, dated December 7, 1999, filed as Exhibit 10.5 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.

†10.6 Quanex Corporation Executive Incentive Compensation Plan, as amended and restated, dated October 12, 1995, filed as Exhibit 10.8 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.

†10.7 Quanex Corporation Supplemental Benefit Plan, as amended and restated effective June 1, 1999, filed as Exhibit 10.9 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

†10.8 Form of Change in Control Agreement, between the Registrant and each executive officer of the Registrant, filed as Exhibit 10.10 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.

†10.9 Quanex Corporation 1987 Non-Employee Director Stock Option Plan, as amended, and the related form of Stock Option Agreement, filed as Exhibit 10.14 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1988, together with the amendment filed as Exhibit 10.14 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended January 31, 1995, and incorporated herein by reference.

†10.10 Amendment to the Quanex Corporation 1987 Non-Employee Director Stock Option Plan, dated December 1997, filed as Exhibit 10.13 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.

†10.11 Amendment to the Quanex Corporation 1987 Non-Employee Director Stock Option Plan, dated December 9, 1999, filed as Exhibit 10.14 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.

†10.12 Quanex Corporation 1989 Non-Employee Director Stock Option Plan, as amended, filed as Exhibit 4.4 of the Registrant's Form S-8, Registration No. 33-35128, together with the amendment filed as Exhibit 10.15 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the quarter ended January 31, 1995, and incorporated herein by reference.

†10.13 Amendment to the Quanex Corporation 1989 Non-Employee Director Stock Option Plan, dated December 1997, filed as Exhibit 10.16 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.

†10.14 Amendment to the Quanex Corporation 1989 Non-Employee Director Stock Option Plan, dated December 9, 1999, filed as Exhibit 10.17 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.

†10.15 Quanex Corporation Employee Stock Option and Restricted Stock Plan, as amended, filed as Exhibit 10.14 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1994, and incorporated herein by reference.

†10.16 Amendment to the Quanex Corporation Employee Stock Option and Restricted Stock Plan, dated December 1997, filed as Exhibit 10.19 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.

†10.17 Amendment to the Quanex Corporation Employee Stock Option and Restricted Stock Plan, dated December 9, 1999, filed as Exhibit 10.20 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.

†10.18 Amendment to the Quanex Corporation Employee Stock Option and Restricted Stock Plan, effective July 1, 2000 filed as Exhibit 10.18 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 2000 and incorporated herein by reference.

†10.19 Retirement Agreement dated as of September 1, 1992, between the Registrant and Carl E. Pfeiffer, filed as Exhibit 10.20 to the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1992, and incorporated herein by reference.

†10.20 Stock Option Agreement dated as of October 1, 1992, between the Registrant and Carl E. Pfeiffer, filed as Exhibit 10.21 to the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1992, and incorporated herein by reference.

†10.21 Deferred Compensation Agreement dated as of July 31, 1992, between the Registrant and Carl E. Pfeiffer, filed as Exhibit 10.22 to the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1992, and incorporated herein by reference.

†10.22 Quanex Corporation Non-Employee Director Retirement Plan, filed as Exhibit 10.18 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1994, and incorporated herein by reference.

†10.23 Amendment to Quanex Corporation Non-Employee Director Retirement Plan dated May 25, 1995, filed as Exhibit 10.3 of the Registrant's

Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the fiscal quarter ended January 31, 2000 and incorporated herein by reference.

†10.24 Agreement to Freeze the Quanex Corporation Non-Employee Director Retirement Plan, effective December 5, 2002, filed as Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the fiscal quarter ended April 30, 2003 and incorporated herein by reference

†10.25 Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan, filed as Exhibit 10.19 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1996, and incorporated herein by reference.

†10.26 Amendment to Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan, dated December 1997, filed as Exhibit 10.26 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.

†10.27 Amendment to Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan, dated December 9, 1999, filed as Exhibit 10.27 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.

†10.28 Amendment to Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan, effective February 23, 2000, filed as Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the fiscal quarter ended January 31, 2000 and incorporated herein by reference.

†10.29 Amendment to Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan, effective July 1, 2000 filed as Exhibit 10.28 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the fiscal year ended October 31, 2000 and incorporated herein by reference.

†10.30 Amendment to the Quanex Corporation 1996 Employee Stock Option and Restricted Stock Plan, effective December 5, 2002, filed as Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the fiscal quarter ended April 30, 2003 and incorporated herein by reference.

†10.31 Quanex Corporation Deferred Compensation Trust filed as Exhibit 4.8 of the Registrant's Registration Statement on Form S-3, Registration No. 333-36635, and incorporated herein by reference.

†10.32 Amendment to Quanex Corporation Deferred Compensation Trust, dated December 9, 1999, filed as Exhibit 10.29 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.

†10.33 Amendment and restatement of the Quanex Corporation Deferred Compensation Plan, effective November 1, 2001 filed as Exhibit 10.5 of the Registrant's Quarterly Report on Form 10-Q dated March 7, 2002, and incorporated herein by reference.

†10.34 Quanex Corporation 1997 Non-Employee Director Stock Option Plan filed as Exhibit 10.21 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1997 and incorporated herein by reference.

†10.35 Amendment to Quanex Corporation 1997 Non-Employee Director Stock Option Plan, dated December 9, 1999, filed as Exhibit 10.31 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.

†10.36 Agreement to Terminate the Quanex Corporation 1997 Non-Employee Director Stock Option Plan, effective December 5, 2002, filed as Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725) for the fiscal quarter ended April 30, 2003 and incorporated herein by reference.

†10.37 Quanex Corporation 1997 Key Employee Stock Plan (formerly known as the Quanex Corporation 1997 Key Employee Stock Option Plan) as amended and restated, dated October 20, 1999, filed as Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725), dated June 11, 2001.

†10.38 Amendment to Quanex Corporation 1997 Key Employee Stock Plan (formerly known as the Quanex Corporation 1997 Key Employee Stock Option Plan) dated December 9, 1999, filed as Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725), dated June 11, 2001 and incorporated herein by reference.

†10.39 Amendment to Quanex Corporation 1997 Key Employee Stock Plan (formerly known as the Quanex Corporation 1997 Key Employee Stock Option Plan) effective July 1, 2000, filed as Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-05725), dated June 11, 2001 and incorporated herein by reference.

†10.40 Amendment to the Quanex Corporation 1997 Key Employee Stock Option Plan effective October 25, 2001, filed as Exhibit 10.36 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 2001 and incorporated herein by reference.

†10.41 Quanex Corporation Long-Term Incentive Plan effective November 1, 2001, filed as Exhibit 10.37 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 2001 and incorporated herein by reference.

†10.42	Letter Agreement between Quanex Corporation and Raymond A. Jean, dated February 14, 2001, filed as Exhibit 10.6 of the Registrant's Quarterly Report on Form 10-Q, dated March 7, 2002 and incorporated herein by reference.
10.43	Lease Agreement between The Industrial Development Board of the City of Decatur and Fruehauf Trailer Company dated May 1, 1963, filed as Exhibit 10.22 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1998 and incorporated herein by reference.
10.44	Lease Agreement between The Industrial Development Board of the City of Decatur and Fruehauf Corporation dated May 1, 1964, filed as Exhibit 10.23 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1998 and incorporated herein by reference.
10.45	Lease Agreement between The Industrial Development Board of the City of Decatur and Fruehauf Corporation dated October 1, 1965, filed as Exhibit 10.24 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1998 and incorporated herein by reference.
10.46	Lease Agreement between The Industrial Development Board of the City of Decatur (Alabama) and Fruehauf Corporation dated December 1, 1978, filed as Exhibit 10.25 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1998 and incorporated herein by reference.
10.47	Assignment and Assumption Agreement between Fruehauf Trailer Corporation and Decatur Aluminum Corp. (subsequently renamed Nichols Aluminum-Alabama, Inc.) dated October 9, 1998, filed as Exhibit 10.26 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1998 and incorporated herein by reference.

10.48	Agreement between The Industrial Development Board of the City of Decatur and Decatur Aluminum Corp. (subsequently renameD Nichols Aluminum-Alabama, Inc.) dated September 23, 1998, filed as Exhibit 10.27 of the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 1998 and incorporated herein by reference.
10.49	Lease Agreement between Cabot Industrial Properties, L.P. and Quanex Corporation dated August 30, 2002, filed as Exhibit 10.52 to the Registrant's Annual Report on Form 10-K (Reg. No. 001-05725) for the year ended October 31, 2003 and incorporated herein by reference.
*21	Subsidiaries of the Registrant.
*23	Consent of Deloitte & Touche LLP.
*31.1	Certification by chief executive officer pursuant to Rule 13a-14(a)/15d-14(a).
*31.2	Certification by chief financial officer pursuant to Rule 13a-14(a)/15d-14(a).
*32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

† Management Compensation or Incentive Plan

* Filed herewith

As permitted by Item 601(b)(4)(iii)(A) of Regulation S-K, the Registrant has not filed with this Annual Report on Form 10-K 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.

(b) *Reports on Form 8-K*

On September 30,2003, the Company filed a Current Report on Form 8-K which included a press release announcing definitive agreement to purchase Cargill's North Star Steel—Monroe Facility.

On November 24, 2003, the Company filed a Current Report on Form 8-K which included a press release announcing definitive agreement to purchase the stock of TruSeal Technologies, Inc.

On December 4, 2002, the Company filed a Current Report on Form 8-K which included a press release reporting its earnings results for the fourth quarter and fiscal year ended October 31, 2003. The press release was incorporated by reference as Exhibit 99.1 to that filing.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

By: /s/ RAYMOND A. JEAN December 22, 2003

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ RAYMOND A. JEAN Raymond A. Jean	Chairman of the Board, President and Chief Executive Officer	December 22, 2003
/s/ DONALD G. BARGER, JR. Donald G. Barger, Jr.	Director	December 22, 2003
/s/ VINCENT R. SCORSONE Vincent R. Scorsone	Director	December 22, 2003
/s/ MICHAEL J. SEBASTIAN Michael J. Sebastian	Director	December 22, 2003
/s/ RUSSELL M. FLAUM Russell M. Flaum	Director	December 22, 2003
/s/ SUSAN F. DAVIS Susan F. Davis	Director	December 22, 2003
/s/ JOSEPH J. ROSS Joseph J. Ross	Director	December 22, 2003
/s/ RICHARD L. WELLEK Richard L. Wellek	Director	December 22, 2003
/s/ TERRY M. MURPHY Terry M. Murphy	Vice President—Finance Chief Financial Officer (Principal Financial Officer)	December 22, 2003
/s/ RICARDO ARREDONDO Ricardo Arredondo	Vice President and Controller (Principal Accounting Officer)	December 22, 2003

QuickLinks

Exhibit 2.6

STOCK PURCHASE AGREEMENT

by and among

KIRTLAND CAPITAL PARTNERS II L.P.,

KIRTLAND CAPITAL COMPANY II LLC,

TRUSEAL INVESTMENTS LTD.,

THE OTHER STOCKHOLDERS OF TRUSEAL TECHNOLOGIES, INC.
LISTED ON EXHIBIT A HERETO

and

QUANEX CORPORATION

Dated as of November 21, 2003

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SCHEDULES AND EXHIBITS

Schedules

Exhibits

STOCK PURCHASE AGREEMENT

THIS STOCK PURCHASE AGREEMENT (this "***Agreement***"), is dated as of November 21, 2003, by and among Kirtland Capital Partners II L.P., a Delaware limited partnership ("***KCP II***"), Kirtland Capital Company II LLC, a Delaware limited liability company ("***KCC II***") and TruSeal Investments Ltd., an Ohio limited liability company (together with KCP II and KCC II, collectively referred to herein as "***Kirtland***"), the other stockholders of TruSeal Technologies, Inc., a Delaware corporation (the "***Company***"), listed on **Exhibit A** attached hereto (collectively with Kirtland, the "***Stockholders***") and Quanex Corporation, a Delaware corporation ("***Buyer***").

RECITALS

A. The Stockholders are the record owners of an aggregate of 79,797.502 issued and outstanding shares (the "***Shares***") of Class A voting common stock, par value $0.01 per share (the "***Class A Common Stock***"), of the Company.

B. Those individuals listed on **Exhibit B** attached hereto (the "***Optionholders***") are the record owners of options to purchase an aggregate of 7,439.30 shares of Class A Common Stock issued pursuant to the Company's 1997 Stock Option Plan (collectively, the "***Options***").

C. The Warrantholders are the record owners of warrants to purchase an aggregate of 10,350.00 shares of Class B non-voting common stock, par value $0.01 per share (the "***Class B Common Stock***"), of the Company pursuant to that certain Warrantholders Agreement, dated as of June 23, 1997, by and among the Company, Kirtland and the Warrantholders and the warrant certificates issued in connection therewith (the "***Warrants***").

D. The Stockholders desire to sell to Buyer, and Buyer desires to purchase from the Stockholders, all of the Shares upon the terms set forth in this Agreement.

E. The Optionholders and the Warrantholders desire to surrender and terminate the Options and Warrants, respectively, for the consideration set forth in this Agreement.

F. Concurrently with the execution and delivery of this Agreement, the Warrantholders are executing and delivering an agreement pursuant to which they will surrender their Warrants in exchange for the purchase price described in this Agreement.

NOW, THEREFORE, in consideration of the foregoing and the respective representations, warranties, covenants and agreements set forth herein and subject to the terms and conditions set forth herein, the Stockholders and Buyer hereby agree as follows:

ARTICLE I
DEFINITIONS

For purposes of this Agreement:

"***Actions***" means any suit, claim, action, legal proceeding or administrative proceeding before any Governmental Authority; any arbitration or mediation proceeding; or any investigation by any Governmental Authority.

"***Affiliate***" means with respect to any Person, any other Person that directly or indirectly controls, is controlled by or is under common control with such Person. For these purposes, "control" means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise.

"***Agreement***" has the meaning set forth in the preamble.

"***Arbitration Firm***" has the meaning set forth in **Section 2.3(b)**.

"***Audited Financial Statements***" has the meaning set forth in **Section 4.5(a)**.

"***Balance Sheet Date***" has the meaning set forth in **Section 4.5(a)**.

"***Business Day***" means any day other than a Saturday, Sunday or a day on which banks in New York, New York are authorized or obligated by Law or executive order to close.

"***Buyer***" has the meaning set forth in the preamble.

"***Buyer Indemnitees***" has the meaning set forth in **Section 10.2**.

"***Claim Response***" has the meaning set forth in **Section 10.7(a)**.

"***Claims Notice***" has the meaning set forth in **Section 10.7(a)**.

"***Class A Common Stock***" has the meaning set forth in the recitals.

"***Class B Common Stock***" has the meaning set forth in the recitals.

"***Closing***" has the meaning set forth in **Section 3.1**.

"***Closing Date***" has the meaning set forth in **Section 3.1**.

"***Code***" means the Internal Revenue Code of 1986, as amended, and the rules and regulations promulgated thereunder.

"***Common Stock***" means collectively, Class A Common Stock and Class B Common Stock.

"***Company***" has the meaning set forth in the preamble.

"***Company Benefit Plans***" has the meaning set forth in **Section 4.12(a)**.

"***Company Debt***" means all obligations of the Company to pay any amounts under the Credit Agreement and the Securities Purchase Agreement and the related notes issued thereunder.

"***Company Financial Statements***" has the meaning set forth in **Section 4.5(a)**.

"***Company Stockholders Agreement***" has the meaning set forth in **Section 3.2(l)**.

"***Confidentiality Agreement***" has the meaning set forth in **Section 7.3(b)**.

"***Consent***" means any consent, approval, authorization, qualification, waiver, order, registration or notification required to be obtained from, filed with or delivered to a Governmental Authority or any other Person.

"***Covenant Termination Date***" has the meaning set forth in **Section 10.1(b)**.

"***Credit Agreement***" means the Credit Agreement, dated June 23, 1997, by and among the Company, the Guarantors party thereto, the Banks party thereto, PNC Bank, National Association, as Agent and National City Bank, as Co-Agent.

"***Damages***" has the meaning set forth in **Section 10.2**.

"***Dispute***" has the meaning set forth in **Section 10.8**.

"***Dispute Period***" has the meaning set forth in **Section 10.7(b)(i)**.

"***Dispute Notice***" has the meaning set forth in **Section 10.7(b)(i)**.

"***DOJ***" means the United States Department of Justice.

"***Environment***" means soil, surface waters, groundwater, land, streams, sediments, surface or subsurface strata and ambient air.

"***Environmental Condition***" shall mean any condition of the Environment with respect to the Real Property, or with respect to any other real property at which any Hazardous Material generated by the Company or the Subsidiary prior to the Closing Date has been treated, stored or disposed of, which violates any Environmental Law, or even though not violative of any Environmental Law, nevertheless results in any Release giving rise to a third-party claim.

"***Environmental Law***" means any Law relating to or concerning (a) the protection of the Environment, (b) the control of any pollutant, (c) solid, gaseous or liquid waste generation, handling, treatment, storage, disposal or transportation or (d) the regulation of or exposure to Hazardous Materials.

"***Environmental Liabilities***" means any and all Damages (including any remedial, removal, response, abatement, cleanup, investigation or monitoring costs and associated legal costs) incurred or imposed (a) pursuant to any agreement, order, notice of responsibility, directive (including directives embodied in Environmental Laws), injunction, judgment or similar document (including settlements) arising out of, in connection with, or under Environmental Laws or (b) pursuant to any claim by a Governmental Authority or any other Person for personal injury, property damage, damage to natural resources, remediation, or payment or reimbursement of response costs incurred or expended by the Governmental Authority or other Person, pursuant to common law, statute or contract and related to the use or Release of Hazardous Materials.

"***ERISA***" means the Employee Retirement Income Security Act of 1974, as amended, and the rules and regulations promulgated thereunder.

"***Escrow Agent***" means Comerica Bank.

"***Escrow Agreement***" means the agreement by and among the Stockholder Representative, the Escrow Agent and Buyer, in the form attached hereto as **Exhibit C**.

"***Escrow Amount***" means $12,000,000.

"***Escrow Claim***" has the meaning set forth in **Section 10.7(b)(i)**.

"***Escrow Claim Notice***" has the meaning set forth in **Section 10.7(b)(i)**.

"***Final Working Capital***" has the meaning set forth in **Section 2.3(a)**.

"***Fully Diluted Shares***" means the aggregate number of shares of Common Stock outstanding at the Closing assuming the exercise of all Options and Warrants.

"***GAAP***" means United States generally accepted accounting principles applied on a consistent basis.

"***General Enforceability Exceptions***" has the meaning set forth in **Section 4.8**.

"***Governmental Authority***" means any government or political subdivision, whether federal, state, local or foreign, or any agency or instrumentality of any such government or political subdivision, or any federal, state, local or foreign court or arbitrator.

"***Hazardous Material***" means (a) any pollutant, toxic substance, hazardous waste, hazardous material, hazardous substance or contaminant, as listed, defined in, or the subject of any Environmental Law, (b) any petroleum, petroleum product or petroleum-containing material, (c) any radioactive material, urea formaldehyde, asbestos, asbestos-containing material or polychlorinated biphenyls or (d) any other chemical, substance or waste that is regulated by any Governmental Authority under any Environmental Law.

"***HSR Act***" means the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations promulgated thereunder.

"***HSR Filing***" has the meaning set forth in **Section 7.4**.

"***Income Taxes***" means any United States federal, state, local or foreign Tax that is based on or measured by reference to net income.

"***Indemnifying Party***" means any Person required to provide indemnification or reimbursement, as applicable, under this Agreement.

"***Indemnitee***" means any Person entitled to indemnification or reimbursement, as applicable, under this Agreement.

"***Intellectual Property***" means all intellectual property of every kind and nature, including: (i) patents and patent applications, patent disclosures and inventions (whether or not patentable and whether or not reduced to practice) and any reissue, continuation, continuation in part, division, revision, extension or reexamination thereof; (ii) trademarks, service marks, trade names, brand names, service names, trade dress, slogans, logos and internet domain names and their associated goodwill and registrations and applications for registration of the foregoing; (iii) trade secrets, proprietary or confidential information, formulae, compositions, processes, designs, technology, know-how and technical information, whether or not patented or patentable and (iv) copyrights, copyright registrations (including applications therefor), copyrightable works (including plans, specifications, drawings and blueprints) and website content and software.

"***Interim Financial Statements***" has the meaning set forth in **Section 4.5(a)**.

"***IRS***" means the Internal Revenue Service.

"***Kirtland***" has the meaning set forth in the preamble.

"***KCC II***" has the meaning set forth in the preamble.

"***KCP II***" has the meaning set forth in the preamble.

"***Law***" means any law, statute, code, ordinance, regulation, rule, principle of common law, or Order of any Governmental Authority.

"***Liens***" means any mortgage, lien, option, pledge, charge, claim, community or other marital property interest, security interest, judgment, attachment, restriction on transfer, right of way, easement, encroachment, servitude, right of first refusal or other similar encumbrance, excluding restrictions on transfer arising under applicable federal or state securities Laws.

"***Material Adverse Effect***" means, with respect to the Company or Buyer, as applicable, any change, occurrence or development that has a material adverse effect on the business, properties, assets, liabilities, results of operations or financial condition of such party and its subsidiaries taken as a whole, but excluding any effect (a) resulting from general economic conditions, (b) affecting companies in the industry in which it conducts its business generally, (c) resulting from the announcement or performance of this Agreement or the transactions contemplated hereby or (d) resulting from any actions required under this Agreement to obtain any Consent from any Person or Governmental Authority.

"***Material Contracts***" has the meaning set forth in **Section 4.13(a)**.

"***Material Equipment***" has the meaning set forth in **Section 4.9**.

"***NOL Tax Benefits***" means the amount of the net operating loss and any net operating loss carryforward generated in a Pre-Closing Period that are reported in the federal income Tax Return of the Company for purposes of determining the Company's regular tax liability (as defined in Section 26 of the Code) for the period ended as of the Closing Date, as reduced by any NOL Tax Benefit Adjustment, multiplied by 31%.

"***NOL Tax Benefits Adjustment***" means the amount of any increase in an item of income or disallowance (or deferral) of any item of deduction in computing United States federal taxable income of the Company for a Pre-Closing Period in which a net operating loss was generated as required by settlement made in compliance with the provisions of **Section 10.7** or Order that cannot be challenged or appealed or is otherwise final, less any disallowance (or deferral) of a deduction of any of the items listed on **Schedule 7.10** to the extent that the amount of such disallowance (or deferral) may be deducted in computing taxable income in any of Buyer's taxable years ending on or before October 31, 2006.

"***Noncompete Provision***" has the meaning set forth in **Section 7.17**.

"***Notice***" has the meaning set forth in **Section 10.7(b)(i)**.

"***Option Consideration***" has the meaning set forth in **Section 2.2(b)(ii)**.

"***Optionholders***" has the meaning set forth in the recitals.

"***Options***" has the meaning set forth in the recitals.

"***Order***" means any order, judgment, ruling, injunction, assessment, award, decree or writ of any Governmental Authority.

"***Payoff Letters***" means the letters provided by the lenders or other holders of Company Debt to the Company in connection with the repayment of the Company Debt as contemplated hereby.

"***Permits***" means any license, permit, authorization, certificate of authority, qualification, variance, consent, franchise, approval, registration, identification number or similar document or authority that has been issued or granted by any Governmental Authority and any applications for any of the foregoing.

"***Permitted Liens***" means (a) Liens arising under the Credit Agreement, (b) Liens for Taxes, assessments and other charges of Governmental Authorities not yet due and payable, (c) mechanics', workmens', repairmen's, warehousemen's, carriers' or other like Liens arising or incurred in the ordinary course of business or by operation of Law if the underlying obligations are not due and payable and (d) with respect to the Real Property (i) any conditions that may be shown by (A) the survey of the Company's Beachwood, Ohio property conducted by Thomas J. Neff, Jr., dated October 14, 2003 or (B) the survey of the Company's Barbourville, Kentucky property conducted by A&L Surveying and Engineering, LLC, dated October 30, 2003, (ii) those easements, encroachments, restrictions, rights of way and other non-monetary title defects and Liens listed on **Schedule 1.1(a)** and (iii) zoning, building and other similar restrictions; *provided, however,* that none of the foregoing described in clauses (c) or (d) will individually or in the aggregate impair the continued use and operation of the property to which they relate in the businesses of the Company or Subsidiary as presently conducted.

"***Person***" means any individual, sole proprietorship, partnership, corporation, limited liability company, joint venture, unincorporated society or association, trust or other legal entity or Governmental Authority.

"***Post-Closing Straddle Period***" has the meaning set forth in **Section 7.9(b)**.

"***Pre-Closing Period***" has the meaning set forth in **Section 4.6(h)**.

"***Pre-Closing Straddle Period***" has the meaning set forth in **Section 7.9(b)**.

"***Product Claims Agreement***" has the meaning set forth in **Section 7.14**.

"***Purchase Price***" has the meaning set forth in **Section 2.2(a)**.

"***Real Property***" means all of the Company's and Subsidiary's real property and interest in real property, leaseholds and subleaseholds, purchase options, easements, licenses, rights to access, rights of way, all buildings and other improvements thereon and other real property interests currently used in the business or operations of the Company or Subsidiary.

"***Release***" means any releasing, spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, disposing or dumping of a Hazardous Material into the Environment.

"***Remedial Action***" means any removal, remediation, response, cleanup, containment or other corrective action which is intended or designed to abate, eliminate or mitigate a Release of Hazardous Materials.

"***Response Period***" has the meaning set forth in **Section 10.7(a)**.

"***Responsible Party***" has the meaning set forth in **Section 10.7(d)**.

"***Securities Act***" means the Securities Act of 1933, as amended.

"***Securities Purchase Agreement***" means the Securities Purchase Agreement, dated June 23, 1997, by and among the Company and the Warrantholders.

"***Selling Expenses***" means (a) all of the fees and expenses of Jones Day, PricewaterhouseCoopers and the Persons listed on **Schedule 4.15** incurred in connection with the consummation of the transactions described in this Agreement, such amounts to be set forth in the invoices delivered to Buyer at the Closing, (b) the Stock Transfer Taxes and Costs, (c) all bonuses paid or payable to employees of the Company or Subsidiary in connection with the transactions described in this Agreement and (d) the costs (including premiums) of obtaining the insurance policy described in **Section 3.2(q)**.

"***Share Amount***" means an amount equal to the quotient of (a) the sum of (i) the Purchase Price, (ii) the aggregate exercise prices for all of the Options and (iii) the aggregate exercise prices for all of the Warrants and (b) the Fully Diluted Shares.

"***Shares***" has the meaning set forth in the recitals.

"***Statement***" has the meaning set forth in **Section 7.10(b)**.

"***Stockholder Indemnitees***" has the meaning set forth in **Section 10.3**.

"***Stockholders***" has the meaning set forth in the preamble.

"***Stockholder Representative***" means KCP Services, LLC, a Delaware limited liability company.

"***Stock Transfer Taxes and Costs***" has the meaning set forth in **Section 7.15**.

"***Straddle Period***" has the meaning set forth in **Section 7.9**.

"***Subsidiary***" means TruSeal Technologies Ltd., a New Brunswick corporation and wholly-owned subsidiary of the Company.

"***Subsidiary Shares***" has the meaning set forth in **Section 4.3**.

"***Target Working Capital Range***" means between $7,278,000 and $8,578,000.

"***Tax***" means any net income, alternative or add-on minimum tax, gross income, gross receipts, sales, use, ad valorem, value added, transfer, franchise, profits, license, withholding, payroll, employment, excise, severance, stamp, occupation, premium, property, environmental or windfall profit tax, custom, duty or other tax, governmental fee or other like assessment or charge of any kind whatsoever, together with any interest, penalties, additions to tax or additional amounts imposed by any Taxing Authority.

"***Tax Accrual***" means the amount of any current liability accruals for Taxes reflected on the Audited Financial Statements (excluding reserves for deferred Taxes) solely with respect to the Company and Subsidiary, as adjusted for operations and transactions through the Closing Date in the ordinary course of business of the Company and Subsidiary consistent with past custom and practice.

"***Tax Basket Items***" has the meaning set forth in **Section 7.10(c)**.

"***Tax Matter***" has the meaning set forth in **Section 7.11**.

"***Tax Refund***" means any Tax refund or amounts credited against Taxes, without duplication for Tax refunds or credits included in the amount of the NOL Tax Benefit, to which Buyer, the Company, Subsidiary or any of their Affiliates become entitled with respect to Taxes paid by the Company or Subsidiary for any Pre-Closing Period or Pre-Closing Straddle Period. Tax refunds or amounts credited against Taxes for a Pre-Closing Straddle Period referred to in the previous sentence shall be determined using the principles contained in **Section 7.9(b)**.

"***Tax Returns***" means all Tax returns, statements, reports and forms.

"***Taxing Authority***" means any Governmental Authority responsible for the administration or imposition of any Tax.

"***Warrantholders***" means collectively, Massachusetts Mutual Life Insurance Company, MassMutual Corporate Investors, MassMutual Participation Investors, MassMutual Corporate Value Partners Limited and National City Venture Corporation.

"***Warrants***" has the meaning set forth in the recitals.

"***Working Capital Statement***" has the meaning set forth in **Section 2.3(a)**.

ARTICLE II
SALE AND PURCHASE

2.1 Sale and Purchase of Shares. At the Closing (a) the Stockholders shall sell, assign and transfer to Buyer all of the Shares, (b) the Stockholders shall deliver to Buyer the stock certificates representing all of the Shares, with duly executed stock powers attached in proper form for transfer, free and clear of all Liens, (c) the Stockholders who are Optionholders shall surrender their Options for cancellation, (d) the Stockholders will cause the Warrantholders to surrender the Warrants for cancellation and (e) Buyer shall purchase and acquire the Shares and shall pay and deliver the Purchase Price (as defined in **Section 2.2**) to the Stockholder Representative on behalf of the Stockholders, Optionholders and the Warrantholders and take the other actions described in this **Article II**.

2.2 Purchase Price.

(a) Subject to the adjustment set forth in **Section 2.3**, in full consideration for the transfer of the Shares and the surrender of the Options and Warrants, Buyer shall pay or cause to be paid to the Stockholder Representative, on behalf of the Stockholders, Optionholders and Warrantholders, at the Closing an aggregate amount in cash equal to the excess of $113,000,000 over the sum of (i) the aggregate amount of Company Debt outstanding immediately prior to the Closing; (ii) the Selling Expenses and (iii) the Escrow Amount (the "***Purchase Price***"). The Purchase Price shall be payable at Closing, as further described below.

(b) *Shares, Options and Warrants.* At the Closing, Buyer shall, except as otherwise provided in **Section 2.2(b)(ii)**, pay the Purchase Price to the Stockholder Representative, who shall distribute the Purchase Price to the Stockholders, Optionholders and Warrantholders as follows:

(i) Each Stockholder shall be entitled to receive an amount in cash equal to the product of (A) the Share Amount and (B) the number of Shares owned by such holder, payable in

cash by bank wire transfer of immediately available funds to an account or accounts designated by the Stockholder Representative.

(ii) Each Optionholder shall be entitled to receive for all shares of Class A Common Stock underlying such Options an amount (subject to applicable withholding tax and applicable withholdings under customary policies of the Company) equal to the product of (A) the Share Amount and (B) the number of Options held by such Optionholder at Closing, *minus* the sum of all the exercise prices for all such Options held by such Optionholder (the aggregate amount payable to all Optionholders, in their capacities as such, being hereinafter referred to as the "***Option Consideration***").

(iii) Each Warrantholder shall be entitled to receive for all shares of Class B Common Stock underlying such Warrants an amount equal to the product of (A) the Share Amount and (B) the number of shares of Class B Common Stock for which the Warrants are exercisable, minus the sum of all the exercise prices for all such Warrants held by such Warrantholder.

The Purchase Price shall be paid to the Stockholder Representative by bank transfer of immediately available funds to an account designated by the Stockholder Representative. The Stockholder Representative shall pay the portion of the Purchase Price that is Option Consideration to the Company in cash by bank wire transfer of immediately available funds to an account or accounts designated by the Company at Closing, who shall, in turn, pay the Option Consideration in the amounts and to the Optionholders as the Stockholder Representative shall designate to the Company as promptly as practicable thereafter. From and after the time of the Closing, Buyer shall cause the Company to cooperate with the Stockholder Representative to administer the payment of the Option Consideration to the applicable Optionholders (including permitting the Stockholder Representative to run the Option Consideration payments through the Company's payroll system). The Stockholder representative shall be responsible for administering the payment of the Option Consideration and determining all amounts (including amounts paid from the Purchase Price, the Escrow Account and any adjustment payable under Section 2.3(e)) to be withheld from and to be paid to the Stockholders, Optionholders and Warrantholders.

(c) *Other Settlements.* At the Closing, Buyer shall (i) on behalf of the Company, cause the Company Debt outstanding immediately prior to the Closing to be repaid in full to the Person or Persons entitled thereto pursuant to the Payoff Letters; (ii) pay the Selling Expenses (net of applicable withholding Taxes) to the Persons entitled thereto or to the Stockholder Representative, on behalf of the Persons entitled thereto and (iii) pay the Escrow Amount into an escrow account to be held by the Escrow Agent in accordance with the terms of the Escrow Agreement. The Stockholder Representative shall distribute the Selling Expenses to the Persons entitled thereto.

2.3 Purchase Price Adjustment.

(a) *Working Capital Statement.* Within 90 days after the Closing Date, Buyer shall cause to be prepared and delivered to the Stockholder Representative a working capital statement (the "***Working Capital Statement***"), setting forth the calculation of the amount, if any, by which (i) the Company's current assets (which assets include only account receivables and inventory) as of the Closing Date exceed (ii) the Company's current liabilities (which liabilities include only trade payables) as of the Closing Date (the "***Final Working Capital***"). The Working Capital Statement is to be prepared in accordance with GAAP and the principles set forth on **Schedule 2.3(a)**.

(b) *Dispute.* Within 30 days following receipt by the Stockholder Representative of the Working Capital Statement, the Stockholder Representative shall deliver written notice to Buyer of any dispute it has with respect to the preparation or content of the Working Capital Statement. If the Stockholder Representative does not notify Buyer of a dispute with respect to the Working

Capital Statement within such 30-day period, such Working Capital Statement will be final, conclusive and binding on the parties. In the event of such notification of a dispute, Buyer and the Stockholder Representative shall negotiate in good faith to resolve such dispute. If Buyer and the Stockholder Representative, notwithstanding such good faith effort, fail to resolve such dispute within 30 days after the Stockholder Representative advises Buyer of its objections, then Buyer and the Stockholder Representative jointly shall engage the firm of KPMG LLP (the "***Arbitration Firm***") to resolve such dispute. As promptly as practicable thereafter, Buyer and the Stockholder Representative shall each prepare and submit a presentation to the Arbitration Firm. As soon as practicable thereafter, Buyer and the Stockholder Representative shall cause the Arbitration Firm to choose one of the parties positions based solely upon the presentation by Buyer and the Stockholder Representative. The party whose position is not accepted by the Arbitration Firm shall be responsible for all of the fees and expenses of the Arbitration Firm. All determinations made by the Arbitration Firm will be final, conclusive and binding on the parties.

(c) *Access.* For purposes of complying with the terms set forth in this **Section 2.3**, each party shall cooperate with and make available to the other parties and their respective representatives all information, records, data and working papers and shall permit access to its facilities and personnel, as may be reasonably required in connection with the preparation and analysis of the Working Capital Statement and the resolution of any disputes thereunder.

(d) *Downward Adjustment.* If the Final Working Capital (as finally determined pursuant to **Section 2.3(b)**) is below the bottom of the Target Working Capital Range, then the Purchase Price will be adjusted downward by the amount of such shortfall, and the Stockholder Representative shall cause the Escrow Agent to release an amount of cash equal to such shortfall from the Escrow Amount to Buyer, by wire transfer of immediately available funds to an account designated in writing by Buyer to the Stockholder Representative and the Escrow Agent. Such payment is to be made within five Business Days of the date on which Final Working Capital is finally determined pursuant to **Section 2.3(b)**. In no event shall an adjustment to the Purchase Price pursuant to this **Section 2.3(d)** exceed the Escrow Amount then available for distribution under the terms of the Escrow Agreement.

(e) *Upward Adjustment.* If the Final Working Capital (as finally determined pursuant to **Section 2.3(b)**) is greater than the top of the Target Working Capital Range, then the Purchase Price will be adjusted upward by the amount of such excess, and Buyer shall pay or cause to be paid an amount in cash equal to such excess, by bank wire transfer of immediately available funds, to an account designated in writing by the Stockholder Representative, for the benefit of the Stockholders, Optionholders and Warrantholders. Such payments are to be made within five Business Days from the date on which the Final Working Capital is finally determined pursuant to **Section 2.3(b)**. The Stockholder Representative shall distribute the amount of such excess to the Stockholders, Optionholders and Warrantholders.

ARTICLE III
CLOSING AND DELIVERIES

3.1 Closing. The closing of the transactions described in this Agreement (the "***Closing***") will take place at the offices of Jones Day, 901 Lakeside Avenue, Cleveland, Ohio, at noon local time on (a) the later of January 2, 2004, or the third Business Day following the satisfaction of the condition set forth in **Section 8.1(b)** or (b) such other date or at such other time and place as the parties mutually agree in writing (the "***Closing Date***"). All proceedings to be taken and all documents to be executed and delivered by all parties at the Closing will be deemed to have been taken and executed simultaneously and no proceedings will be deemed to have been taken nor documents executed or delivered until all have been taken, executed and delivered. The Closing shall be deemed to have occurred as of 11:59 p.m. Eastern time on the Closing Date.

3.2 Deliveries by the Stockholders. At the Closing, the Stockholders shall deliver or cause to be delivered to Buyer the following items:

(a) the stock certificates representing the Shares, with duly executed stock powers attached in proper form for transfer;

(b) all such documents reasonably requested by Buyer to evidence each Optionholder's surrender and termination of their respective Options in exchange for the payment contemplated by **Section 2.2(b)(ii)**;

(c) all such documents reasonably requested by Buyer to evidence each Warrantholder's surrender and termination of their respective Warrants in exchange for the payment contemplated by **Section 2.2(b)(iii)**, including a Form W-9 for each Warrantholder;

(d) the Payoff Letters reflecting all outstanding Company Debt as of the Closing Date and any necessary UCC termination statements or other releases as may be reasonably required to evidence the satisfaction of the Company Debt;

(e) invoices reflecting the Selling Expenses;

(f) the certificate of incorporation of the Company certified as of the most recent practicable date by the Secretary of State of Delaware and the certificate and articles of incorporation of Subsidiary certified as of the most recent practicable date by the government of New Brunswick;

(g) a certificate of the Secretary of State of Delaware as to the good standing as of the most recent practicable date of the Company in such jurisdiction and a certificate of compliance from New Brunswick as to the good standing as of the most recent practicable date of Subsidiary in such jurisdiction;

(h) a certificate of the Secretary of the Company, given by him on behalf of the Company and not in his individual capacity, certifying as to the bylaws of each of the Company and Subsidiary;

(i) certificates from an officer of the Company, given by him on behalf of the Company and not in his individual capacity, and from the Stockholder Representative, given by it on behalf of the Stockholders, to the effect that the conditions set forth in **Sections 8.3(a)** and **8.3(b)** have been satisfied;

(j) written resignations of the directors and officers of the Company and Subsidiary set forth on **Schedule 3.2(j)**;

(k) original corporate record books and stock record books of the Company and Subsidiary;

(l) duly executed counterparts to an agreement terminating the Stockholders Agreement, dated as of June 23, 1997, by and among the Company, Kirtland and the other stockholders parties thereto (the "***Company Stockholders Agreement***");

(m) duly executed counterparts to an agreement terminating the Advisory Agreement, dated as of June 23, 1997, by and between the Company and Kirtland Capital Corporation;

(n) an executed counterpart to the Escrow Agreement;

(o) a duly executed termination of the Confidentiality Agreement;

(p) executed copies of all Consents specified on **Schedule 3.2(p)**;

(q) evidence reasonably satisfactory to Buyer (including a copy of the binder for such policy) that the Stockholders have caused the Company to effect a six-year paid-up insurance policy covering acts or omissions occurring on or before the Closing Date with respect to those Persons who are currently covered by the Company's current directors' and officers' insurance policy and covering those matters for which the Company shall have indemnification obligations described in **Section 7.7(a)**;

(r) an amendment to this Agreement by which the Stockholders represent to Buyer that all of their representations and warranties contained in this Agreement are true and correct on the Closing Date;

(s) a statement provided by the Company to Buyer in accordance with Treasury Regulation Section 1.1445-2(c)(3) certifying under penalties of perjury that the shares of Class A Common Stock are not Untied States real property interests (and the Stockholder Representative shall mail the notice required under Treasury Regulation Section 1.897-2(h)(2) prepared and executed under penalties of perjury by the Company on or prior to the Closing Date to the Internal Revenue Service within five days following the Closing Date);

(t) certificates of insurance of the Company naming Buyer as an additional insured for those policies designated on **Schedule 4.17** as policies requiring that such certificates be delivered; and

(u) such other instruments and certificates as may be reasonably requested by Buyer.

3.3 Deliveries by Buyer. At the Closing, Buyer shall deliver or cause to be delivered to the Stockholders the following items:

(a) the Purchase Price and the other payments specified in **Section 2.2** paid in accordance with **Section 2.2** to the Person or Persons entitled thereto;

(b) the certificate of incorporation of Buyer certified as of the most recent practicable date by the Secretary of State of Delaware;

(c) a certificate of the Secretary of State of Delaware as to the good standing as of the most recent practicable date of Buyer in such jurisdiction;

(d) a certificate of the Secretary of Buyer, given by him on behalf of Buyer and not in his individual capacity, certifying as to the bylaws of Buyer and as to the resolutions of the Board of Directors of Buyer authorizing this Agreement and the transactions contemplated hereby;

(e) a certificate of an officer of Buyer, given by him on behalf of Buyer and not in his individual capacity, to the effect that the conditions set forth in **Sections 8.2(a)** and **8.2(b)** have been satisfied;

(f) an executed counterpart to the Escrow Agreement; and

(g) such other instruments and certificates as may be reasonably requested by the Stockholder Representative.

ARTICLE IV
REPRESENTATIONS AND WARRANTIES OF THE STOCKHOLDERS RELATING TO THE COMPANY

Each Stockholder represents and warrants to Buyer as follows:

4.1 Organization and Standing. Each of the Company and Subsidiary is a corporation duly organized, validly existing and in good standing under the Laws of its jurisdiction of incorporation or organization. Each of the Company and Subsidiary has all requisite corporate power and authority to own, lease and operate its properties and assets and to conduct its business as it is presently conducted. Each of the Company and Subsidiary is duly qualified to do business, and in good standing, in each jurisdiction in which the character of the properties owned or leased by it or in which the conduct of its business requires it to be so qualified. The jurisdictions in which the Company and Subsidiary are so qualified are set forth on **Schedule 4.1**.

4.2 Capitalization. The authorized capital stock of the Company consists solely of 200,000 shares of Common Stock, of which 100,000 are designated as Class A Common Stock and 100,000 are designated as Class B Common Stock. Of the Class A Common Stock, 79,797.502 shares are issued and outstanding as of the date of this Agreement and all of such issued and outstanding shares are duly authorized, validly issued, fully paid and nonassessable. The Shares represent the only issued and outstanding shares of capital stock of the Company. The Stockholders own all of such issued and outstanding shares in the amounts set forth on **Exhibit A**. Except as set forth on **Schedule 4.2**, there are no (a) outstanding securities convertible or exchangeable into shares of capital stock of the Company; (b) options, warrants, calls, subscriptions or other rights, agreements or commitments obligating the Company to issue, transfer or sell any shares of its capital stock, equity interests or any other securities of the Company or (c) voting trusts or other agreements or understandings to which the Company is a party or by which the Company is bound with respect to the voting, transfer or other disposition of its shares of capital stock, other than the Company Stockholders Agreement.

4.3 Subsidiary and Equity Ownership. Subsidiary is the only subsidiary of the Company. The authorized capital stock of Subsidiary consists solely of an unlimited number of common shares without nominal or par value (the "***Subsidiary Shares***") of which 100 shares are issued and outstanding. All of such issued and outstanding Subsidiary Shares are duly authorized, validly issued, fully paid and nonassessable. The Company owns all issued and outstanding Subsidiary Shares free and clear of all Liens other than Liens arising under the Credit Agreement. There are no (a) outstanding securities convertible or exchangeable into shares of capital stock of Subsidiary, (b) options, warrants, calls, subscriptions or other rights, agreements or commitments relating to the Subsidiary Shares or with respect to which Subsidiary may be obligated to issue, transfer or sell any shares of capital stock or equity interests or any other securities of Subsidiary or (c) voting trusts or other agreements or understandings to which Subsidiary or the Company is a party or by which Subsidiary or the Company is bound with respect to the voting, transfer or other disposition of any Subsidiary Shares. Except for the Company's equity interest in Subsidiary, neither the Company nor Subsidiary is a partner, member (of record or beneficially) or holder of any equity interest in any other Person.

4.4 No Conflict; Required Filings and Consents.

(a) Neither the execution and delivery of this Agreement or the Escrow Agreement by the Stockholders, nor the consummation by the Stockholders of the transactions contemplated herein or in the Escrow Agreement, nor compliance by the Stockholders with any of the provisions hereof, will (i) conflict with or result in a breach of any provisions of the certificate of incorporation or bylaws of the Company or the certificate and articles of incorporation or bylaws of Subsidiary, (ii) except as set forth on **Schedule 4.4(a)**, constitute or result in the breach of any term, condition or provision of, or constitute a default under, or give rise to any right of termination, cancellation or acceleration with respect to, or result in the creation or imposition of

a Lien upon any property or assets of the Company or Subsidiary, pursuant to any note, bond, mortgage, indenture, license, agreement, lease, Permit, Company Benefit Plan or other instrument or obligation to which either of them is a party or by which either of them or any of their respective properties or assets may be subject or by operation of Law or (iii) subject to receipt of the requisite approvals referred to on **Schedule 4.4(b)**, violate any Order or Law applicable to the Company or Subsidiary or any of their respective properties or assets.

(b) Other than as set forth on **Schedule 4.4(b)**, no Consent is required to be obtained by the Company or the Stockholders for the consummation by the Stockholders of the transactions contemplated in this Agreement or the Escrow Agreement.

4.5 Financial Statements.

(a) Complete and correct copies of the following financial statements have been delivered to Buyer for its review: (i) the audited consolidated balance sheet of the Company and Subsidiary as of December 31, 2002 and the related audited consolidated statements of operations, stockholders' equity

and cash flows for the year ended December 31, 2002, together with the notes thereto (the "***Audited Financial Statements***") and (ii) the unaudited consolidated balance sheet of the Company as of September 30, 2003 (the "***Balance Sheet Date***") and the related unaudited consolidated statements of operations for the nine-month period then ended (the "***Interim Financial Statements***" and, together with the Audited Financial Statements, the "***Company Financial Statements***").

(b) The Audited Financial Statements have been prepared in accordance with GAAP and fairly present, in all material respects, the financial position, results of operations, stockholders' equity and cash flows of the Company and Subsidiary, as of the date and for the period indicated. The Interim Financial Statements have been prepared by management in accordance with GAAP, applied consistently with the Audited Financial Statements and fairly present, in all material respects, the financial position, results of operations, stockholders' equity and cash flows of the Company and Subsidiary, as of the date and for the period indicated (except for the absence of footnote disclosure and any customary year-end adjustments listed on **Schedule 4.5(b)**). The Company Financial Statements were derived from the books and records of the Company.

4.6 Taxes. Except as set forth on **Schedule 4.6:**

(a) All Tax Returns of or relating to any Tax that are required to be filed on or before the Closing Date for, by, on behalf of or with respect to either the Company or the Subsidiary (whether on a separate, consolidated, affiliated, combined, unitary or any other basis), have been or will be timely filed with the appropriate Governmental Authority on or before the Closing Date and all Taxes shown to be due and payable on such Tax Returns or related to such Tax Returns have been or will be paid in full on or before the Closing Date.

(b) All such Tax Returns and the information and data contained therein have been or will be properly and accurately compiled and completed, fairly present or will fairly present the information purported to be shown therein and reflect or will reflect all liabilities for Taxes for the periods covered by such Tax Returns.

(c) None of such Tax Returns is under audit or examination by any Governmental Authority. Neither the Company nor Subsidiary has agreed to any extension or waiver of the statute of limitations applicable to any Tax Return, or agreed to any extension of time with respect to a Tax assessment or deficiency, which period (after giving effect to such extension or waiver) has not yet expired. No power of attorney granted by the Company or Subsidiary with respect to any Taxes is currently in force.

(d) Neither the Company nor Subsidiary is a party to, bound by or has any obligation under any Tax allocation or sharing agreement.

(e) Except Liens for current Taxes not yet due and payable, there are no Liens for unpaid Taxes on the assets of the Company or Subsidiary and no claim for unpaid Taxes has been made by any Governmental Authority that could give rise to any such Lien.

(f) There is no Action currently pending or threatened with respect to the Company or Subsidiary in respect of any Tax.

(g) Neither the Company nor Subsidiary (i) has been a member of an affiliated group of corporations within the meaning of Section 1504 of the Code (other than a group the common parent of which is the Company) or (ii) has any liability for Taxes of any Person (other than the Company and Subsidiary) under Treasury Regulation Section 1.1502-6 (or any similar provision of state, local or foreign law), as a transferee or successor, by contract or otherwise.

(h) The amount of any liability of the Company or Subsidiary for unpaid Taxes for all periods ending on or before the date of the Audited Financial Statements does not, in the aggregate exceed the amount of the current liability accrual for Taxes (excluding reserves for deferred Taxes) reflected on the date of the Audited Financial Statements solely with respect to the Company and Subsidiary, and the amount of current liability for unpaid Taxes of the Company or Subsidiary for all periods ending on or before the Closing Date (the "***Pre-Closing Period***") or Pre-Closing Straddle Period does not, in the aggregate, exceed the amount of current liability accruals for Taxes (excluding reserves for deferred Taxes) as such accruals are reflected on the Audited Financial Statements, as adjusted for operations and transactions in the ordinary course of business of the Company and Subsidiary consistent with past custom and practice.

(i) After the date of the Interim Financial Statements, neither the Company nor Subsidiary has incurred any Taxes other than Taxes incurred in the ordinary course of business.

(j) The Company and Subsidiary have withheld or collected and paid over to the appropriate Governmental Authorities all Taxes required by Law to be withheld or collected, including withholding of Taxes pursuant to Sections 1441 and 1442 of the Code or similar provisions under any foreign Laws.

(k) Neither the Company nor Subsidiary has agreed to make, and is not required to make, any adjustment under Section 481(a) of the Code or similar provision of any other applicable Law.

(l) None of the assets or properties of the Company or Subsidiary is an asset or property that is or will be treated as being (i) owned by any other Person pursuant to the provisions of Section 168(f)(8) of the Internal Revenue Code of 1954, as amended and in effect immediately before the enactment of the Tax Reform Act of 1986, or (ii) tax-exempt use property within the meaning of Section 168(h)(1) of the Code.

(m) No special agreements, rulings or compromises have been entered into between the Company or Subsidiary and any Governmental Authority regarding the assessment or payment of Taxes.

(n) Complete and correct copies of the following have been delivered to Buyer: (i) any audit reports issued by a Governmental Authority within the last three years relating to the United States federal, state, local or foreign Taxes due from or with respect to the Company or Subsidiary (each of which is also listed on **Schedule 4.6**) and (ii) the United States federal income Tax Returns, and those state, local and foreign income Tax Returns for each of the last three taxable years, filed by the Company and Subsidiary (including consolidated federal income tax returns).

(o) Neither the Company nor Subsidiary is a party to any agreement, contract, arrangement or plan that has resulted, or could result, individually or in the aggregate, in the payment of "excess parachute payments" within the meaning of Section 280G of the Code as a result of the transactions

contemplated hereby.

(p) Neither the Company nor Subsidiary has any deferred gain or loss from a deferred intercompany transaction within the meaning of Treasury Regulation Section 1.1502-13 (or any similar provision under state, local or foreign Law) or an excess loss account within the meaning of Treasury Regulation Section 1.1502-19 (or any similar provision of state, local or foreign Law).

(q) There are no intercompany agreements or other agreements or arrangements between the Company or Subsidiary and any other Person relating to any Tax matters.

(r) Neither the Company nor Subsidiary has distributed stock of another Person, or has had its stock distributed by another Person, in a transaction that was purported or intended to be governed by Sections 355 or 361 of the Code.

(s) The Company is not a United States real property holding corporation within the meaning of Section 897(c)(2) of the Code for the applicable period specified in Section 897(c)(1)(A)(ii) of the Code.

4.7 Title to Properties. The Company and Subsidiary have good and valid title to all of the properties and assets, tangible or intangible, real or personal, reflected in the Company Financial Statements as being owned by the Company or Subsidiary, free and clear of all Liens except for Permitted Liens, excluding inventory sold or disposed of by the Company or Subsidiary since the date of the Company Financial Statements in the ordinary course of business. Except as set forth on **Schedule 4.7**, none of the properties or assets of the Company or Subsidiary is in the possession of any Person other than the Company or Subsidiary. There is no contract, agreement, commitment or understanding, whether oral or written, between the Company or Subsidiary, on the one hand, and any other Person, on the other hand, whereby such Person has the right to acquire any of the properties or assets, or any interest therein, of the Company or Subsidiary, other than for the sale of inventory and application equipment by the Company or Subsidiary in the ordinary course of business.

4.8 Real Property. **Schedule 4.8** contains a complete and accurate description of all the Real Property and the interest therein of each of the Company and Subsidiary. The Real Property listed on **Schedule 4.8** comprises all real property interests used in the conduct of the business and operations of the Company and Subsidiary. All leased buildings and all leased fixtures, equipment and other property and assets are held under leases or subleases that are valid instruments enforceable in accordance with their terms, except as limited by (a) applicable bankruptcy, reorganization, insolvency, moratorium or other similar Laws affecting the enforcement of creditors' rights generally from time to time in effect and (b) the availability of equitable remedies (regardless of whether enforceability is considered in a proceeding at Law or in equity) (collectively, the "***General Enforceability Exceptions***"). Copies of all written leases and written descriptions of all oral leases pertaining to the Real Property have been delivered to Buyer. Except as set forth on **Schedule 4.8** and except for the Company or Subsidiary, there are no Persons in possession or occupancy of any part of the Real Property or the facilities located on the Real Property or who have possessory rights with respect to any part of the Real Property or those facilities. Neither the Company nor Subsidiary has received any notice of any alleged or real violations or any liability under any applicable Law of any Governmental Authority having jurisdiction over any part of the Real Property, the facilities located thereon or the operation of any part of the Real Property or those facilities. There is no existing, pending or threatened or anticipated condemnation or other taking of any part of the Real Property or the facilities located thereon.

4.9 Sufficiency of Property. **Schedule 4.9** identifies as such and contains a description, as of the Balance Sheet Date, of all of the machinery, equipment and other tangible personal property of the Company or Subsidiary having a book value of $5,000 or more (collectively, the "***Material Equipment***"). Except as set forth on **Schedule 4.9**, the Material Equipment is sufficient for Buyer to continue the Company's business in accordance with applicable Law as currently conducted by the Company. Except as set forth on **Schedule 4.9**, no Person, other than the Company or Subsidiary, owns or has the right to use any of the Material Equipment. All of the Material Equipment is in normal operating condition

and repair, subject to ordinary wear, tear and maintenance and has been operated or used in compliance with the requirements of Laws.

4.10 Compliance with Laws. Except as set forth on **Schedule 4.10**:

(a) each of the Company and Subsidiary is in compliance with all Laws and Orders applicable to its business or employees conducting its business;

(b) each of the Company and Subsidiary has received no notification or communication from any Governmental Authority (i) asserting that the Company or Subsidiary is not in compliance with any Law or (ii) threatening to revoke any Permit owned or held by the Company or Subsidiary; and

(c) no currently existing condition, circumstance or event would reasonably be expected to result in any material future expenditure to maintain the business of the Company and Subsidiary in compliance with requirements with Law.

4.11 Permits. **Schedule 4.11** contains a list of all Permits held by the Company or Subsidiary with respect to the business of the Company or the business of Subsidiary. Except as set forth on **Schedule 4.11**, the Permits listed on **Schedule 4.11** are all the Permits that are required in connection with the businesses of the Company or Subsidiary. Each of the Company and Subsidiary is in compliance with all Permits listed on **Schedule 4.11**, all of which Permits are in full force and effect and there has been no violation of the requirements pertaining to those Permits.

4.12 Employee Benefit Plans.

(a) **Schedule 4.12** contains a complete and correct list of all Company Benefit Plans. The term "***Company Benefit Plans***" means all employee welfare benefit and employee pension benefit plans as defined in Sections 3(1) and 3(2) of ERISA and all other employee benefit agreements or arrangements, including deferred compensation plans, incentive plans, bonus plans or arrangements, stock option plans, stock purchase plans, stock award plans, golden parachute agreements, severance pay plans, dependent care plans, cafeteria plans, employee assistance programs, scholarship programs,

employment contracts, retention incentive agreements, vacation policies and other similar plans, agreements and arrangements that are maintained or contributed to by the Company or Subsidiary or with respect to which the Company or Subsidiary may have any liability, contingent or otherwise.

(b) With respect to each Company Benefit Plan, the Company has heretofore made available to Buyer, as applicable, complete and correct copies of each of the following documents, as applicable:

(i) the Company Benefit Plan document and any amendments thereto (or if the Company Benefit Plan is not a written agreement, a description thereof);

(ii) the most recent annual Form 5500 report filed with the IRS;

(iii) the most recent annual Form 990 and 1041 reports filed with the IRS;

(iv) the most recent statement filed with the Department of Labor pursuant to 29 U.S.C. § 2520.104-23;

(v) the most recent actuarial report;

(vi) the most recent report prepared in accordance with statement of Financial Accounting Standards No. 87;

(vii) the most recent summary plan description and summaries of material modifications thereto;

(viii) the trust agreement, group annuity contract or other funding agreement that provides for the funding of each Company Benefit Plan;

(ix) the most recent financial statement;

(x) the most recent determination letter received from the IRS with respect to each Company Benefit Plan that is intended to qualify under Section 401 of the Code; and

(xi) any agreement directly relating to a Company Benefit Plan pursuant to which the Company or Subsidiary is obligated to indemnify any Person.

(c) No Company Benefit Plan is or at any time was (i) subject to Title IV of ERISA, (ii) subject to the minimum funding standards of Section 302 of ERISA or Section 412 of the Code, (iii) a "***multiemployer plan***" within the meaning of Section 3(37) or 4001(a)(13) of ERISA or Section 414(f) of the Code or (iv) a "***multiple employer plan***" within the meaning of Section 413(c) of the Code.

(d) Neither the Company nor any other entity has engaged in a transaction that could result in the imposition upon the Company or Subsidiary of a civil penalty under Section 409 or Section 502(i) of ERISA or a Tax under Sections 4971, 4972, 4975, 4976, 4980, 4980B or 6652 of the Code with respect to any Company Benefit Plan and no fact or event exists that could reasonably be expected to give rise to any such liability.

(e) Each Company Benefit Plan has been operated and administered in accordance with its terms and applicable Laws, including, if applicable, ERISA and the Code.

(f) Each Company Benefit Plan that is intended to qualify under Section 401(a) of the Code has received a favorable determination letter from the IRS and no condition exists that could be reasonably expected to result in the revocation of any such letter.

(g) Except as set forth on **Schedule 4.12**, no Company Benefit Plan provides medical, surgical, hospitalization or life insurance benefits (whether or not insured by a third party) for employees or former employees of the Company or Subsidiary, for periods extending beyond their retirements or other terminations of service, other than (i) coverage mandated by applicable Law, (ii) death benefits under any pension benefit plan as defined in Section 3(2) of ERISA or (iii) benefits the full cost of which is borne by the current or former employee (or his beneficiary) and no commitments have been made to provide such coverage.

(h) Except as set forth on **Schedule 4.12**, the consummation of the transactions described in this Agreement, either alone or in conjunction with another event (such as a termination of employment), will not (i) entitle any current or former employee of the Company or Subsidiary to severance pay or any other payment under a Company Benefit Plan, (ii) accelerate the time of payment or vesting of benefits under a Company Benefit Plan or (iii) increase the amount of compensation due any current or former employee of the Company or Subsidiary.

(i) Except as set forth on **Schedule 4.12**, there is no litigation, action, proceeding, audit, examination or claim pending or threatened relating to any Company Benefit Plan (other than routine claims for benefits).

(j) The most recent financial statements and actuarial reports, if any, for the Company Benefit Plans reflect the financial condition and funding of the Company Benefit Plans as of the dates of such financial statements and actuarial reports and no adverse change has occurred with respect to the financial condition or funding of the Company Benefit Plans since the dates of such financial statements and actuarial reports.

(k) Neither the Company nor Subsidiary has any potential liability, contingent or otherwise, under the Coal Industry Retiree Health Benefits Act of 1992 and neither the Company, Subsidiary

or any entity that has been treated as a single employer together with the Company or Subsidiary under Section 414 of the Code was, on July 20, 1992, required to be treated as a single employer under Section 414 of the Code together with an entity that was ever a party to any collective bargaining agreement or any other agreement with the United Mine Workers of America.

(l) Neither the Company nor Subsidiary has made any premium payments with respect to any split-dollar insurance arrangements since July 30, 2002 for any director or executive officer. Neither the Company nor Subsidiary has any obligation or liability under any plan, contract, policy or any other arrangement that limits its ability to terminate any split-dollar insurance arrangements, other than a requirement to provide 30 days' notice of termination.

(m) No Company Benefit Plan that is intended to satisfy the requirements of Section 401(a) of the Code has incurred a partial termination within the meaning of Section 411(d)(3) of the Code during the six-year period ending on the date of this Agreement.

(n) The Company has provided Buyer with a true and complete list of all non-bargaining unit employees of the Company and Subsidiary as of September 30, 2003, including the title and current compensation for each such employee.

4.13 Contracts.

(a) Set forth on **Schedule 4.13(a)** is a list of the following agreements (whether written, electronic or oral) (the "***Material Contracts***"):

(i) each partnership or joint venture agreement to which the Company or Subsidiary is a party;

(ii) each agreement limiting the right of the Company or Subsidiary to engage in or compete with any Person in any business or in any geographical area;

(iii) each management, consulting, severance or similar agreement and each employment agreement to which the Company or Subsidiary is a party;

(iv) each collective bargaining agreement to which the Company or Subsidiary is a party;

(v) each agreement between the Company or Subsidiary, on the one hand, and any Stockholder, Warrantholder, director, officer or Affiliate of the Company or Subsidiary, on the other hand;

(vi) each contract, agreement or arrangement, the term of which extends beyond the one-year anniversary date of this Agreement;

(vii) each contract, agreement or arrangement that obligates the Company and Subsidiary to future expenditures of $100,000 or more (or assets having that value);

(viii) each contract, agreement or arrangement that entitles the Company and Subsidiary to future receipts of $500,000 or more (or assets having that value); and

(ix) each contract, agreement or arrangement (other than purchase orders and sales orders of the Company or Subsidiary) the lack of which would reasonably be expected to have a Material Adverse Effect.

(b) Each of the Material Contracts is in full force and effect and is a legal, valid and binding contract or agreement of the Company or Subsidiary, as applicable, subject only to the General Enforceability Exceptions, and there is no default or breach by the Company or Subsidiary or any other party, in the timely performance of any obligation to be performed or paid thereunder or any other provision thereof. The Stockholders have provided Buyer with true, complete and correct copies of all Material Contracts (including all extensions, amendments, schedules, exhibits, addenda and supplements thereto) and a written description of all Material Contracts that are not in

writing. Neither the Company nor Subsidiary has affirmatively waived any right under any Material Contract.

(c) Without limiting the foregoing, each of the Company and Subsidiary is in substantial compliance with all purchase orders and sales orders applying to it to the extent it is obligated to perform under those orders. **Schedule 4.13** includes a list of all purchase orders and sales orders in excess of $100,000 relating to the business of the Company or the business of Subsidiary as of September 30, 2003.

(d) Each of the Company and Subsidiary is in substantial compliance with all contracts and agreements (other than Material Contracts) to which the Company or Subsidiary is a party or by which the properties of the Company or Subsidiary are bound.

4.14 Legal Proceedings. Except as set forth on **Schedule 4.14**, there are no Actions pending or threatened or contemplated against the Company or Subsidiary or naming the Company or Subsidiary as a party. Neither the Company nor Subsidiary is subject to any ongoing Order. None of the Actions described on **Schedule 4.14** could reasonably be expected to adversely affect the business or properties of the Company or Subsidiary or could reasonably be expected to (a) enjoin, restrict or prohibit the transfer of the Shares or the termination of the Options or the Warrants pursuant to this Agreement or (b) otherwise prevent the Company or Subsidiary from fulfilling all of its obligations set out in this Agreement or the Escrow Agreement. Except as set forth on **Schedule 4.14**, there are no Actions pending or threatened by the Company or Subsidiary against any other Person.

4.15 No Brokers. Except for the Persons set forth on **Schedule 4.15**, no broker, finder or similar agent has been employed by or on behalf of the Stockholders or the Company and no Person, with which the Stockholders or the Company has had any dealings or communications of any kind, is entitled to any brokerage commission, finder's fee or any similar compensation in connection with this Agreement or the transactions contemplated hereby.

4.16 Intellectual Property.

(a) **Schedule 4.16** sets forth an accurate and complete list of (i) all patents and patent applications, all registered and unregistered trademarks, trade names and service marks and applications for registrations of the foregoing, and all registered copyrights and domain names and applications for registrations of the foregoing, owned by the Company or the Subsidiary, (ii) all licenses, sublicenses and other agreements pursuant to which any Person is

authorized to use any of the Intellectual Property of the Company or Subsidiary and (iii) all licenses, sublicenses and other agreements pursuant to which the Company or Subsidiary is authorized to use any Person's Intellectual Property (other than commercial software). The Company or Subsidiary owns or has the right to use all the Intellectual Property used in the business of the Company or business of Subsidiary, free of all Liens (other than Permitted Liens) and such Intellectual Property of the Company and Subsidiary constitutes all the Intellectual Property necessary to conduct the businesses of the Company and Subsidiary as they are currently operated. Except as set forth on **Schedule 4.16**, neither the Company nor Subsidiary has entered into any arrangements granting rights in, and no other Person is authorized to use any of, the Intellectual Property of the Company or Subsidiary. Except as set forth on **Schedule 4.16**, neither the Company nor Subsidiary has any licenses or sublicenses pursuant to which it is authorized to use any other Person's Intellectual Property (other than commercial software).

(b) Except as set forth on **Schedule 4.16**, the operation of the businesses of the Company and Subsidiary, including the design, development, use, import, manufacture and sale of the products, technology and services of the Company and Subsidiary, does not infringe or misappropriate the Intellectual Property of any other Person and there is no Action currently pending or threatened that calls into question the validity, ownership or enforceability of the Intellectual Property of the

Company or Subsidiary, asserts that any of the Intellectual Property of the Company or Subsidiary infringes or violates the rights of any Person or alleges unauthorized use, disclosure, infringement, misappropriation or other violation by the Company or Subsidiary of any Intellectual Property of any other Person. Neither the execution and delivery of this Agreement or the Escrow Agreement, nor the consummation of the transactions described in this Agreement or the Escrow Agreement, will give any other Person the right or option to cause or declare a violation of a duty, right or obligation to such Person in connection with the Intellectual Property of the Company or Subsidiary.

(c) Except as set forth on **Schedule 4.16**, neither the Company nor Subsidiary has brought or continued any Action or given any notice to any Person asserting interference, misappropriation, conflict or infringement by such Person of any of the Intellectual Property of the Company or Subsidiary or breach of any agreement involving any Intellectual Property of the Company or Subsidiary and there is no basis for any such Action. There is no unauthorized use, disclosure, infringement or misappropriation of any of the Intellectual Property of the Company or Subsidiary or breach of any contract or agreement involving that Intellectual Property of the Company or Subsidiary.

4.17 Insurance. **Schedule 4.17** sets forth all policies of insurance covering the Company and Subsidiary, their respective businesses and assets, or their respective employees and agents and such policies are in full force and effect. **Schedule 4.17**, also sets forth a list of all unpaid or unsettled insurance claims other than workers compensation claims, made with respect to the business of the Company or Subsidiary. The Company has obtained insurance coverage for commercial general liabilities, including all liabilities relating to product produced or in process by the Company or Subsidiary on or before the Closing Date.

4.18 Labor Matters.

(a) Except as set forth on **Schedule 4.18**, neither the Company nor Subsidiary is a party to any collective bargaining agreement or other contract or agreement with any labor organization or other representative of employees. The Stockholders have provided Buyer with true and correct copies of all such agreements and contracts. The Company and Subsidiary are in compliance with each of the collective bargaining agreements or other contracts or agreements with any labor organization or other representative of employees to which the Company or Subsidiary is a party. The Company has made available to Buyer a list of all employees covered by each of such agreements, their classifications thereunder and their hourly compensation rates for active employees as of November 14, 2003.

(b) There is no unfair labor practice charge or complaint pending or threatened with regard to employees of the Company or Subsidiary.

(c) There is no labor strike, slowdown, work stoppage or other labor controversy in effect or threatened against the Company or Subsidiary.

(d) No union certification or decertification petition has been filed or threatened that relates to employees of the Company or Subsidiary and no union authorization campaign has been conducted within the past 24 months.

(e) Except as set forth on **Schedule 4.18**, no grievance proceeding or arbitration proceeding arising out of or under any collective bargaining agreement is pending or threatened against the Company or Subsidiary related to any of its employees.

(f) Neither the Company nor Subsidiary is a party to, or is otherwise bound by, any consent decree with any Governmental Authority relating to employees or employment practices of the Company or Subsidiary.

(g) Each of the Company and Subsidiary is in compliance with all applicable agreements, contracts and policies relating to employment, employment practices, wages, hours and terms and conditions of employment of the employees.

4.19 Environmental Matters. Except as set forth on **Schedule 4.19**:

(a) The Company and Subsidiary are operating, and in the past have operated, in compliance with all limitations, restrictions, conditions, standards, prohibitions, requirements and obligations established under Environmental Law.

(b) Neither the Company nor Subsidiary has generated, manufactured, refined, transported, treated, stored, handled, disposed, transferred, produced or processed any Hazardous Materials, except in compliance with all applicable Environmental Laws, and there has been no Release or threat of Release of any Hazardous Material by the Company or Subsidiary at or in the vicinity of the Real Property that requires reporting, investigation, assessment, cleanup, remediation or any other type of response action by the Company or Subsidiary pursuant to any Environmental Law.

(c) The Company and Subsidiary have obtained all Permits required by Environmental Laws to conduct their business activities and operations in the manner presently conducted. All such Permits are validly issued and are in full force and effect and the Company and Subsidiary are in compliance with such Permits.

(d) There are no pending or threatened Actions by or before any court or other Governmental Authority directed against the Company or Subsidiary, or any of their assets, that pertain or relate to (i) any obligations or liabilities, contingent or otherwise, under any Environmental Law, (ii) violations of Environmental Laws or (iii) personal injury or property damage claims relating to the use, Release or disposal of Hazardous Materials.

(e) No asbestos, asbestos-containing materials or polychlorinated biphenyls are present at or in any of the Real Property.

(f) Neither the Company nor Subsidiary owns or operates, or has owned or operated, any underground storage tanks.

(g) Neither the Company nor Subsidiary is conducting or required to be conducting any of its business activities or operations under any Order or agreement issued or entered into under Environmental Laws.

(h) Neither the Company nor Subsidiary has agreed to, assumed or retained any Environmental Liabilities by contract.

(i) There are no requirements under existing Environmental Laws that, based on the current condition of the assets and properties of the Company and Subsidiary, will obligate the Company or Subsidiary to make capital improvements to any of their assets or properties or incur material expenses after Closing, other than expenditures for routine, ongoing environmental compliance, to remain in compliance with Environmental Laws.

(j) There exists no Environmental Condition and there has been no Release of any Hazardous Material at the Real Property or at any other location by the Company or Subsidiary that requires reporting, investigation, assessment, cleanup, remediation or any other type of response action pursuant to any Environmental Law or that could be the basis for any Environmental Liabilities.

(k) The Stockholders have made available to Buyer or Buyer's representatives copies of all environmental audits, assessments, investigations or other environmental reports that are in the possession of the Company, Subsidiary, or Stockholders or subject to their control that pertain to actual or potential Environmental Liabilities of the Company or Subsidiary, non-compliance of the

Company or Subsidiary with Environmental Laws, or any of the assets or properties owned or operated by the Company or Subsidiary.

4.20 Conduct of Business in Ordinary Course. Except for the transactions contemplated hereby or as set forth on **Schedule 4.20**, since the Balance Sheet Date (a) each of the Company and Subsidiary have conducted its business and operations in the ordinary course of business consistent with past practices, (b) there has not been any change that would have a Material Adverse Effect on the Company and (c) neither the Company nor Subsidiary has taken any action that if taken after the date hereof would constitute a violation of **Section 7.1**.

4.21 Accounts Receivable. All accounts receivable of the Company and Subsidiary represent sales actually made in the ordinary course of business or valid claims as to which full performance has been rendered by the Company or Subsidiary. The reserve set forth in the Company Financial Statements against the accounts receivable for returns and bad debts has been calculated in a manner consistent with past practice. The accounts receivable reflected on the Company Financial Statements are, and the accounts receivable that will be reflected in the Final Working Capital will be, collectible using commercially reasonable collections practices net of the reserves for bad debt and reserves for credit memos set forth in the Company Financial Statements. **Schedule 4.21** contains a true and correct copy of the aging of the accounts receivable of the Company and Subsidiary as of September 30, 2003. None of those receivables are subject to any Liens (other than Permitted Liens). Since January 31, 2002, there has not been any material adverse change in the collectibility of the Company's accounts receivable.

4.22 Inventory. The inventories of the Company and Subsidiary are of a quality and quantity useable and saleable in the normal and ordinary course of business, subject to appropriate and adequate allowances, if any, reflected on the Company's Financial Statements for obsolete, excess, slow moving and other irregular items. **Schedule 4.22** is a list of all inventory of the Company and Subsidiary as of September 30, 2003. All inventory of the Company and Subsidiary as of September 30, 2003, is reflected in the Interim Financial Statements. All inventory of the Company and Subsidiary as of the Closing Date will, as of the Closing Date, be reflected on the books and records of the Company. All inventory of the Company and Subsidiary is valued at the lower of cost or market value. The inventory of the Company and Subsidiary does not include any materials held by either of them on consignment from any other Person. All inventory of the Company and Subsidiary disposed of since September 30, 2003, has been disposed of only in the ordinary course of business, consistent with past practices. The quantities of inventory of the Company and Subsidiary as of the Closing Date will be adequate to conduct their business as currently conducted. Except as set forth on **Schedule 4.22**, none of the inventory of the Company or Subsidiary is in the possession of others, except inventory in transit to the Company or Subsidiary in the ordinary course of business. Except as set forth on **Schedule 4.22**, none of the inventory of the Company or Subsidiary is subject to any claim with respect to the use of materials held on consignment.

4.23 Product Warranty. Other than claims for which provision has been made in the Company's Financial Statements, there have been no product warranty claims made against the Company in the past six years and no product warranty claims are currently pending or threatened against the Company.

4.24 Books and Records. The books and records of the Company (other than the financial books and records, accurately and fairly reflect the transactions of the Company and Subsidiary with respect to their businesses.

4.25 Customers, Distributors and Suppliers. **Schedule 4.25** sets forth the names of all customers of the Company and Subsidiary that order goods and services from the Company or Subsidiary with an aggregate value for each such customer of $100,000 or more during the nine-month period ended September 30, 2003, and the amount for which each such customer was invoiced during that period, net

of credits and discounts. Except as set forth on **Schedule 4.25**, no such customer has notified the Company that it will reduce purchases of products by more than 10% of the total amount of products such customer purchases from the Company or Subsidiary or has ceased, or will cease, to purchase products from the Company or Subsidiary. **Schedule 4.25** sets forth the names of all suppliers from which the Company or Subsidiary ordered raw materials, supplies, merchandise and other goods and services with an aggregate purchase price for each such supplier of $100,000 or more during the nine-month period ended September 30, 2003, and the amount for which each such supplier paid the Company or Subsidiary during such period. Except as set forth on **Schedule 4.25**, no such supplier has notified the Company or Subsidiary that it will reduce the amount of raw materials or equipment available for purchase by the Company or Subsidiary by more than 10% of the total amount of raw materials or equipment such supplier supplies to the Company or Subsidiary or has ceased, or will cease, to sell raw materials or equipment to the Company or Subsidiary.

4.26 Affiliate Transactions. Except as set forth on **Schedule 4.26**, no employee, officer or director of the Company or Subsidiary (a) owns, directly or indirectly, in whole or in part, any Permits, real property, leasehold interests or other property, the use of which is necessary for the operation of the businesses of the Company or Subsidiary, (b) individually owes any amounts to the Company or Subsidiary in excess of $5,000, or (c) is a party to any contract or participates in any arrangement, written or oral, pursuant to which the Company or Subsidiary provides to, or receives services of any nature from, any such Person, except as to any such individual in his capacity as a employee.

4.27 Backlog. All outstanding customer or distributor purchase orders for products of the Company or Subsidiary have been entered at prices and on terms and conditions consistent with the normal practices of the Company or Subsidiary, as applicable. Neither the Company nor Subsidiary has been informed by any customer or distributor that any order included in the backlog of the business of the Company or Subsidiary is likely to be canceled or terminated before its completion.

4.28 Derivative Contracts. Except as set forth on **Schedule 4.28**, the Company is not a party to any derivative or hedging contracts.

4.29 Absence of Undisclosed Liability. Except (a) as set forth on **Schedule 4.29**, (b) for liabilities or obligations that are accrued or reserved against in the Interim Financial Statements, (c) for liabilities and obligations arising in the ordinary course of business after the Balance Sheet Date, (d) for liabilities or obligations under Company Benefit Plans and (e) for liabilities and obligations pursuant to the terms of Material Contracts or other contracts and agreements to which the Company or Subsidiary is a party or otherwise bound, neither the Company nor Subsidiary has any liabilities or obligations of any nature, whether known or unknown, contingent or otherwise. For purposes of clarification, any liability or obligation of the Company or Subsidiary that results from a condition, event, circumstance, activity, practice, incident, action or omission that occurred or existed on or prior to the Closing Date shall constitute a liability or obligation of the Company or Subsidiary that existed as of the Closing Date, even if the claim related to such liability or obligation did not exist or is not asserted or known until after the Closing Date.

ARTICLE V
REPRESENTATIONS AND WARRANTIES OF THE STOCKHOLDERS RELATING TO ADDITIONAL MATTERS

Each Stockholder represents and warrants to Buyer as follows:

5.1 Authority, Validity and Effect. Each of the Stockholders has all requisite power and authority or capacity to execute, deliver and perform its or his obligations under this Agreement and to consummate the transactions contemplated herein and the execution, delivery and performance of this Agreement have been duly authorized by all necessary action on behalf of the Stockholders. This Agreement is the legal, valid and binding obligation of each of the Stockholders, enforceable against

each of the Stockholders in accordance with its terms, except as limited by the General Enforceability Exceptions.

5.2 Title. The Stockholders (a) are the record and beneficial owners of their respective Shares and, if applicable, Options; (b) have full power, right and authority, and any approval required by Law, to make and enter into this Agreement and to sell, assign, transfer and deliver their respective Shares to Buyer and, if applicable, to surrender their Options to Buyer and (c) have good and valid title to their respective Shares and, if applicable, Options free and clear of all Liens. Upon the consummation of the transactions contemplated by this Agreement in accordance with the terms hereof, at the Closing Buyer will acquire good and valid title to the Shares, free and clear of all Liens, other than Liens created by Buyer.

5.3 No Conflict. Neither the execution and delivery of this Agreement by the Stockholders, nor the consummation by the Stockholders of the transactions described in this Agreement, nor compliance by the Stockholders with any of the provisions of this Agreement will (a) constitute or result in a breach of any term, condition or provision of, or constitute a default under, any agreement or other instrument or obligation to which a Stockholder is a party or by which a Stockholder's assets are bound or (b) violate any Order or Law applicable to a Stockholder or its or his assets. Neither the execution and delivery of this Agreement by Kirtland, nor the consummation by Kirtland of the transactions described in this Agreement, nor compliance by Kirtland with any of the provisions of this Agreement will conflict with or result in a breach of any provisions of the partnership agreement, limited liability company agreement or other constituent documents of Kirtland. No Consent is required to be obtained by any Stockholder for the consummation of the transactions described in this Agreement.

ARTICLE VI
REPRESENTATIONS AND WARRANTIES OF BUYER

Buyer represents and warrants to the Stockholders as follows:

6.1 Investment Intent. The Shares are being purchased for Buyer's own account and not with the view to, or for resale in connection with, any distribution or public offering thereof within the meaning of the Securities Act and the rules and regulations promulgated thereunder.

6.2 Organization and Standing. Buyer is a corporation duly organized, validly existing and in good standing under the Laws of its jurisdiction of incorporation or organization. Buyer is duly qualified to do business, and in good standing, in each jurisdiction in which the character of the properties owned or leased by it or in which the conduct of its business requires it to be so qualified, except where the failure to be so qualified or to be in good standing would not have a Material Adverse Effect on Buyer.

6.3 Authorization, Validity and Effect. Buyer has the requisite corporate power and authority to execute and deliver this Agreement and all agreements and documents contemplated hereby to be executed and delivered by it and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and such other agreements and documents and the consummation of the transactions contemplated herein and therein have been duly and validly authorized by all necessary corporate action on the part of Buyer. This Agreement has been duly and validly executed and delivered by Buyer and constitutes the legal, valid and binding obligation of Buyer, enforceable against Buyer in accordance with its terms, except as limited by the General Enforceability Exceptions.

6.4 No Conflict Required Filings and Consents.

(a) Neither the execution and delivery of this Agreement by Buyer, nor the consummation by Buyer of the transactions contemplated herein, nor compliance by Buyer with any of the provisions hereof, will (i) conflict with or result in a breach of any provisions of the articles or certificate of incorporation or bylaws or equivalent organizational documents of Buyer, (ii) constitute or result in the breach of any term, condition or provision of, or constitute a default under, or give rise to any right of termination, cancellation or acceleration with respect to, or result in the creation or imposition of any Lien upon, any property or assets of Buyer or, pursuant to any note, bond, mortgage, indenture, license, agreement, lease or other instrument or obligation to which it is a party or by which it or any of its properties or assets may be subject or (iii) subject to receipt of the requisite approvals referred to on **Schedule 6.4(b)**, violate any Order or Law applicable to Buyer or any of its properties or assets.

(b) Other than as set forth on **Schedule 6.4(b)**, no Consent is necessary for the consummation by Buyer of the transactions contemplated by this Agreement.

6.5 No Brokers. Except for Aspen International Group, Inc., no broker, finder or similar agent has been employed by or on behalf of Buyer and no Person with which Buyer has had any dealings or communications of any kind is entitled to any brokerage commission, finder's fee or any similar compensation in connection with this Agreement or the transactions contemplated hereby.

6.6 No Reliance. Buyer or its representatives have inspected and conducted such reasonable review and analysis (financial and otherwise) of the Company as desired by Buyer. The purchase of the Shares by Buyer and the consummation of the transactions contemplated hereunder by Buyer are not done in reliance upon any warranty or representation by, or information from, the Stockholders or the Company of any sort, oral or written, except the representations and warranties specifically set forth in this Agreement (including the disclosure schedules and exhibits hereto) and in any certificates, instruments or other documents required to be delivered to Buyer by the Stockholders, the Company or Subsidiary hereunder. Such purchase and consummation are instead done on the basis of Buyer's own investigation, analysis, judgment and assessment of the present and potential value and earning power of the Company as well as those representations and warranties by the Stockholders, the Company and Subsidiary specifically set forth in this Agreement (including the disclosure schedules and exhibits hereto) and in any certificates, instruments or other documents required to be delivered to Buyer by the Stockholders, the Company or Subsidiary hereunder; *provided*, *however*, that nothing contained in this **Section 6.6** shall affect the rights of any Buyer Indemnitee under **Article X**.

6.7 Financing. Buyer has sufficient funds available to deliver the Purchase Price, to pay the other amounts specified in **Section 2.2(c)** and to consummate the transactions described in this Agreement.

ARTICLE VII
COVENANTS AND AGREEMENTS

7.1 Interim Operations of the Company. Prior to the Closing Date or the earlier termination of this Agreement, except as set forth on **Schedule 7.1** or as specified in this Agreement, unless Buyer has previously consented in writing thereto, the Stockholders shall not permit the Company or Subsidiary to:

(a) acquire, or dispose of, any material property or assets, mortgage or encumber any property or assets other than by means of Permitted Liens or cancel any debts owed to or claims held by the Company, except for the sale of inventory and application equipment in the ordinary course of business consistent with past practice;

(b) enter into, amend, terminate, settle or compromise any agreements, commitments or contracts, except agreements, commitments or contracts that are not Material Contracts and that are made in the ordinary course of business consistent with past practice;

(c) engage in any transactions with, or enter into any contracts or agreements with, any Affiliates of the Company, except to the extent required by Law or any existing agreements;

(d) enter into, adopt, amend or terminate any agreement relating to the compensation or severance of any employee of the Company or increase the amount of compensation to any employee, consultant or director, except to the extent required by Law or any existing agreements;

(e) make any material change to its accounting (including tax accounting) methods, principles or practices, except as may be required by GAAP;

(f) make any amendment to its certificate of incorporation or bylaws;

(g) declare or pay any dividends or distributions or repurchase any shares of capital stock;

(h) issue or sell any capital stock or options, warrants, calls, subscriptions or other rights to purchase any capital stock of the Company or Subsidiary or split, combine or subdivide the capital stock of the Company or Subsidiary, including the issuance of shares of Common Stock upon the exercise of Warrants or Options currently outstanding;

(i) except as set forth on **Schedule 7.1**, make any capital expenditures exceeding $50,000 in the aggregate;

(j) purchase any new or change any existing insurance policies; or

(k) agree to take any of the actions described in sub-clauses (a) through (j) above.

In addition, except as otherwise described in this Agreement, from the date of this Agreement until the Closing Date, the Stockholders shall cause each of the Company and Subsidiary to conduct its business in the usual and ordinary course in accordance with past practice, including the maintenance of inventory levels, the payment of accounts payable and compliance with the Company's warranty policies, and the Stockholders shall cause each of the Company and Subsidiary to use commercially reasonable efforts consistent with the Company's current business practices, to preserve the goodwill of the businesses of the Company and Subsidiary, including to preserve its current relationships with customers, suppliers, agents and employees.

7.2 Interim Actions of the Stockholders. From the date hereof until the Closing Date or the earlier termination of this Agreement, no Stockholder shall sell or otherwise transfer any of the Shares or exercise any of the Options.

7.3 Reasonable Access; Confidentiality.

(a) From the date hereof until the Closing Date or the earlier termination of this Agreement, and subject to applicable Law, the Stockholders shall cause the Company and Subsidiary to give Buyer and its representatives, upon reasonable notice to the Company, full and complete access, during normal business hours, to the assets, properties, books, records, agreements and employees of the Company and Subsidiary and shall cause the Company and Subsidiary to permit Buyer to make such inspections (except that additional Phase II environmental investigations, including, but not limited to, soil and groundwater sampling, shall not be permitted without the Company's consent) as it may reasonably require and to furnish Buyer during such period with all such information relating to the Company and Subsidiary as Buyer may from time to time reasonably request. No investigation by Buyer or its employees, representatives or agents shall modify, alter or negate any obligation or liability of the Stockholders with respect to any representation, warranty, covenant or agreement made in this Agreement or in any exhibit, schedule, certificate or other document executed or delivered in connection with this Agreement.

(b) Any information provided to or obtained by Buyer pursuant to paragraph (a) above will be subject to the Confidentiality Agreement, dated June 26, 2003, between McDonald Investments, Inc. and Buyer (the "***Confidentiality Agreement***") and must be held by Buyer in accordance with and be subject to the terms of the Confidentiality Agreement.

(c) Until the Closing, Buyer agrees to be bound by and comply with the provisions set forth in the Confidentiality Agreement as if such provisions were set forth herein and such provisions are hereby incorporated herein by reference. The Confidentiality Agreement shall terminate as of the Closing Date. The Confidentiality Agreement dated October 2, 2003, between Buyer and the Company shall also terminate as of the Closing Date.

(d) For a period of six years after the Closing Date and except as otherwise required by Law, each of the Stockholders shall, and shall cause their respective officers, directors, Affiliates, employees, agents and representatives to, hold in confidence and not disclose or use (A) any proprietary or other confidential and non-public information regarding Buyer disclosed to any

Stockholder or any representative of the Company in connection with the negotiation or preparation of this Agreement; (B) the nature or resolution of any disputes arising hereunder after the Closing and (C) any proprietary or other confidential non-public information relating to the Company, Subsidiary or any of their assets, operations or businesses, except for disclosures made pursuant to **Section 7.5**; *provided, however,* (i) the confidential and non-public information shall not include any information publicly known through no fault of a Stockholder, (ii) employees of the Company and Subsidiary may use the information described in clauses (B) and (C) insofar as is necessary and appropriate in connection with their duties as employees of, and for the benefit of, the Company and Subsidiary and (iii) Kirtland may disclose the information described in clause (C) that is not proprietary and does not include any trade secrets to its lenders, advisors, investors or potential lenders or investors in the ordinary course of Kirtland's business.

(e) For a period of six years after the Closing Date and except as otherwise required by Law, Buyer shall, and shall cause its officers, directors, Affiliates, employees, agents and representatives to, hold in confidence and not disclose or use (i) any proprietary or other confidential and non-public information (excluding information relating to the Company and its Subsidiary) regarding the Stockholders disclosed to Buyer in connection with the negotiation or preparation of this Agreement and (ii) the nature or resolution of any dispute arising under this Agreement after the Closing, except for disclosures made pursuant to **Section 7.5**; *provided*, *however*, the confidential and non-public information shall not include any information publicly known through no fault of Buyer. The Stockholders acknowledge that Buyer is a publicly held company and will be required to disclose information about the transactions described in this Agreement by Law and by the New York Stock Exchange and will be required by Law to file a copy of this Agreement with the Securities and Exchange Commission and the New York Stock Exchange and to include such filings as part of Buyer's website; all such filings and disclosures may be made by Buyer notwithstanding the provisions of this **Section 7.3** and **Section 7.5**.

(f) Notwithstanding the Confidentiality Agreement or anything in this Agreement to the contrary, each party to the transaction contemplated by this Agreement (and each employee, representative or other agent of each such party) may disclose to any and all Persons, without limitations of any kind, the tax treatment and tax structure of the transaction and all materials of any kind (including opinions or other tax analyses) that are provided to the party relating to such tax treatment and tax structure. This authorization is not intended to permit disclosure of any other information including (without limitation): (i) any portion of any materials to the extent not related to the tax treatment or tax structure of the transaction; (ii) the identities of participants or potential participants in the transaction; (iii) the existence or status of any negotiations relating to the transaction; (iv) any pricing or financial information (except to the extent such pricing or financial information is related to the tax treatment or tax structure of the transaction); (v) any other term or detail not relevant to the tax treatment or the tax structure of the transaction or (vi) any non-public financial information, including sales, cost, pricing or margin information, identification of any customer, vendor, supplier, employee or other party with whom the Company does business or any other non-public information that is not directly related to the potential tax consequences of entering into the transaction. In addition, no party is subject to any restriction concerning its consulting with its tax advisor regarding the tax treatment or tax structure of the transactions contemplated by this Agreement.

7.4 HSR. The Stockholders and Buyer shall, at Buyer's expense and as promptly as practicable, but in no event later than the end of the next Business Day following the execution and delivery of this Agreement, submit all filings required by the HSR Act (the "***HSR Filing***") to the DOJ, as appropriate and thereafter provide any supplemental information requested in connection therewith pursuant to the HSR Act. Any such notification and report form and supplemental information will be in substantial compliance with the requirements of the HSR Act or other applicable antitrust regulation. The

Stockholders and Buyer shall furnish to the other such necessary information and reasonable assistance as the other may request in connection with its preparation of any filing or submission which is necessary under the HSR Act or other applicable antitrust regulation. The Stockholders and Buyer shall request early termination of the applicable waiting period under the HSR Act and any other applicable antitrust regulation. Each of the Stockholders and Buyer, will promptly inform the other party of any material communication received by such party from any Governmental Authority in respect of the HSR Filing. None of the parties shall (i) extend any waiting period under the HSR Act or any applicable antitrust regulation or (ii) enter into any agreement with any Governmental Authority not to consummate the transactions contemplated by this Agreement, except, in each case, with the prior consent of the other parties, which consent shall not be unreasonably withheld.

7.5 Publicity. Except as may be required to comply with the requirements of any applicable Law or the rules and regulations of any stock exchange or national market system upon which the securities of Buyer are listed, no party will issue any press release or other public announcement relating to the subject matter of this Agreement or the transactions contemplated hereby without the prior approval (which approval will not be unreasonably withheld or delayed) of the other party; *provided, however*, that, after the Closing, each of Kirtland and Buyer will be entitled to issue any such press release or make any such other public announcement without obtaining such prior approval if it has previously provided a copy of the press release or other public announcement to the other party for a reasonable period of time for review and comment.

7.6 Records. With respect to the financial books and records and minute books of the Company and Subsidiary relating to matters on or prior to the Closing Date: (a) for a period of six years after the Closing Date, Buyer shall not cause or permit their destruction or disposal without first offering to surrender them to the Stockholders and (b) where there is legitimate purpose, including an audit of the Stockholders by the IRS or any other Taxing Authority, Buyer shall allow the Stockholders and its representatives access to such books and records during regular business hours.

7.7 Officers and Directors Indemnification.

(a) For six years after the Closing Date, Buyer shall cause the Company (and any of its successors) to indemnify and hold harmless, and provide advancement of expenses to, all past and present directors, officers and employees of the Company and Subsidiary to the same extent such Persons are indemnified or have the right to advancement of expenses as of the date of this Agreement by the Company pursuant to the Company's certificate of incorporation and bylaws in existence on the Closing Date for acts or omissions occurring at or prior to the Closing.

(b) Prior to the Closing Date, the Company shall procure the six-year paid-up insurance policy described in **Section 3.2(q).** The cost of such policy will be treated as a Selling Expense. Buyer shall furnish such necessary information and reasonable assistance to the Company as the Company may request in connection with the procurement of such insurance policy.

(c) The provisions of this **Section 7.7** are intended to be for the benefit of, and will be enforceable by, each indemnified party or insured Person, his or her heirs and his or her representatives and are in addition to (without duplication), and not in substitution for, any other right to indemnification or contribution that any such Person may have by contract or otherwise.

7.8 Notice of Events.

(a) During the period from the date hereof to the Closing Date or the earlier termination of this Agreement, Buyer shall notify the Stockholder Representative if it becomes aware of (i) the occurrence, or non-occurrence, of any event which has caused, or could reasonably be expected to cause, any representation or warranty made by it to be untrue or inaccurate at any time after the date hereof and prior to the Closing Date and (ii) any failure on its part to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by it hereunder.

(b) During the period from the date hereof to the Closing Date or the earlier termination of this Agreement, the Stockholder Representative shall notify Buyer if it becomes aware of (i) the occurrence, or non-occurrence, of any event of which it has knowledge which has caused, or could reasonably be expected to cause, any representation or warranty made by any Stockholder to be untrue or inaccurate at any time after the date hereof and prior to the Closing Date and (ii) any failure on the part of any Stockholder to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by any Stockholder hereunder. Should any such event require any change to the Stockholders' disclosure schedules to this Agreement, the Stockholder Representative shall promptly deliver to Buyer a supplement to the disclosure schedules specifying such change and such supplement shall be deemed part of the disclosure schedules upon Buyer's notice that it approves such supplement.

7.9 Allocation of Certain Taxes.

(a) The Stockholders and Buyer will, to the extent permitted by applicable Law, elect with the appropriate Taxing Authority to close the taxable periods of the Company and the Subsidiary as of and including the Closing Date. In any case in which applicable Law does not require or permit such a taxable period of the Company or Subsidiary to be closed as of and including the Closing Date, any Tax pertaining to a period that begins on or before the Closing Date and ends after the Closing Date (a "***Straddle Period***") shall be determined in accordance with the provisions of this **Section 7.9** hereof.

(b) For purposes of this Agreement, all Taxes and Tax liabilities with respect to the income, property or operations of the Company or Subsidiary, as the case may be, that relate to a Straddle Period will be apportioned between the period of the Straddle Period that extends before the Closing Date through the Closing Date (the "***Pre-Closing Straddle Period***") and the period of the Straddle Period that extends from the day after the Closing Date to the end of the Straddle Period (the "***Post-Closing Straddle Period***") in accordance with this **Section 7.9(b).** The portion of such Tax related to the Pre-Closing Straddle Period shall: (a) in the case of Taxes other than sales and use Taxes, value-added taxes, employment taxes and any Tax based on or measured by income, receipts or profits earned during a Straddle Period, be deemed to be the amount of such Tax for the entire taxable period multiplied by a fraction, the numerator of which is the number of days in the Pre-Closing Straddle Period and the denominator of which is the number of days in the entire Straddle Period and (ii) in the case of any sales or use taxes, value-added taxes, employment taxes and any Tax based on or measured by income, receipts or profits earned during a Straddle Period, be deemed equal to the amount which would be payable if the relevant taxable period or Tax year in which the income, receipts or profits were earned ended on and included the Closing Date. To the extent any Tax is based on the greater of a Tax on net income, on the one hand, and a Tax measured by net worth or some other basis not otherwise measured by income, on the other, the portion of such Tax related to the Pre-Closing Straddle Period shall be deemed to be the greater of (A) the amount of such Tax measured by net worth or other basis determined as though the taxable values for the entire Straddle Period equal the respective values as of the Closing Date and multiplying the amount of such Tax by a fraction the

numerator of which is the number of days during the Straddle Period that are in the Pre-Closing Straddle Period and the denominator of which is the number of days in the Straddle Period or (B) the amount of such Tax measured by net income determined as though the applicable Tax period terminated at the end of the day on the Closing Date. The portion of Tax related to the Post-Closing Straddle Period shall be calculated in a corresponding manner.

7.10 Preparation of Tax Returns.

(a) The Stockholder Representative shall cause the Company to properly prepare and timely file any and all Tax Returns, the due date of which (including extensions) is on or before the

Closing Date, which are required to be filed for, by, on behalf of or with respect to the Company or Subsidiary with the appropriate Taxing Authority and to be fully paid to the appropriate Taxing Authority the amount of Taxes shown to be due on such Tax Returns.

(b) Buyer will cause to be properly prepared and timely filed each Tax Return (other than any Tax Return described in, and covered by, **Section 7.10(a)**, covering Pre-Closing Periods or Straddle Periods which is required to be filed for, by, on behalf of or with respect to the Company or Subsidiary after the Closing Date. All such Tax Returns shall be prepared on a basis consistent with past custom and practices and to the extent any item is not covered by past practices, in accordance with reasonable Tax accounting practices. Notwithstanding anything to the contrary herein, Buyer shall cause the items listed on **Schedule 7.10** to be reported on the federal income Tax Return of the Company or Subsidiary, as the case may be, for the taxable period ending on the Closing Date, and any state, local or foreign Tax Returns to the extent allowed under applicable state, local or foreign Law. With respect to a Tax Return covering a Straddle Period, Buyer will cause to be properly prepared and timely filed each such Tax Return, which shall be prepared on a basis consistent with past custom and practices and to the extent any item is not covered by past practices, in accordance with reasonable Tax accounting practices and shall determine the portion of the Taxes shown as due on such Tax Return that is allocable to a Pre-Closing Straddle Period, which determination shall be made in accordance with **Section 7.9(b)** and set forth in a statement ("***Statement***") prepared by Buyer. Buyer shall deliver a copy of any such Tax Return required to be filed by it pursuant to this **Section 7.10(b)** and any related Statement to the Stockholder Representative at least 30 calendar days prior to the due date (including any extension thereof) for filing such Tax Return.

(c) The amount of Taxes shown to be due on any Tax Return or any Statement described in **Section 7.10(b)** shall be final and binding upon the Stockholders, unless the Stockholder Representative shall have delivered to Buyer (within 20 calendar days after the date of the Stockholder Representative's receipt of any such Tax Return or any related Statement) a written report containing all changes that the Stockholder Representative proposes to make to such Tax Return or any related Statement. Buyer and the Stockholder Representative shall undertake in good faith to resolve any issues raised in any such report prior to the due date (including any extension thereof) for filing such Tax Return and mutually to consent to the filing of such Tax Return and, if applicable, to agree on the determination set forth in the Statement. In the event the Stockholder Representative and Buyer are unable to resolve any dispute by the earlier of (i) 20 calendar days after the date of the Stockholder Representative's receipt of written notice from Buyer setting forth Buyer's proposed resolution of such dispute, or (ii) two calendar days prior to the due date for filing of the Tax Return in question (including any extension thereof), the Stockholder Representative and Buyer shall jointly engage the Arbitration Firm to make its independent determination with respect to the item or items in dispute and the amount or amounts related thereto. Buyer shall bear and pay one-half of the fees and other costs charged by the Arbitration Firm, and one-half of the fees and other costs charged by the Arbitration Firm shall be paid from the Escrow Amount. The determination of the Arbitration Firm shall be final and binding on the parties. Notwithstanding the foregoing, nothing in this **Section 7.10(c)** shall prohibit Buyer from causing the timely filing of any Tax Returns required to be filed under **Section 7.10(b)** but Buyer shall file, or cause to be filed, amended Tax Returns to the extent necessary to reflect the parties' resolution pursuant to the procedures set forth in this **Section 7.10(c).** Buyer shall timely pay, or cause to be timely paid, all Taxes shown to be due on the Tax Returns filed under **Section 7.10(b).** Buyer shall only be entitled to reimbursement from the Escrow Amount, without duplication for Damages referred to in **Section 10.5(e)**, for (i) Taxes shown as due and owing on Tax Returns required to be filed by it pursuant to this **Section 7.10** for Pre-Closing Periods (not including Straddle Periods) of the Company or Subsidiary and (ii) the Taxes shown on a Statement for Straddle Periods of the Company or Subsidiary, only to the extent

such Taxes have become final and binding on the Stockholders pursuant to this **Section 7.10** and to the extent such Taxes exceed (prior to application of the provisions of **Section 10.5**), in the following order, the aggregate of: (A) the Tax Accrual, provided that the Tax Accrual shall reduce the amount of such Taxes only to the extent that such Tax Accrual is related to such type of Taxes (and the Seller agrees that no reserve shall have been included in the Tax Accrual with respect to the disallowance or deferral of items listed in **Schedule 7.10**). To the extent such Taxes exceed the Tax Accrual, (B) the NOL Tax Benefit, provided that the NOL Tax Benefit shall reduce only Income Taxes (as reduced if at all by **Section 7.10(c)(i)**). To the extent such Taxes exceed the NOL Tax Benefit, (C) the Tax Refund, provided that the Tax Refund shall reduce the amount of such Taxes (as reduced if at all by **Section 7.10(c)(i)** or **(ii)**) only to the extent such Tax Refund relates to the taxing jurisdiction and type of such Taxes, as such Tax Accrual, NOL Tax Benefit, or Tax Refund (the "***Tax Basket Items***") may have been reduced by previous application of this **Section 7.10(c)** or pursuant to **Section 10.5(e)**.

(d) In connection with the preparation of Tax Returns, audit examinations and any administrative or judicial proceedings relating to the tax liabilities imposed on the Company or Subsidiary for all Pre-Closing Periods, Buyer, the Company and Subsidiary, on the one hand, and the Stockholder Representative, on the other hand, shall reasonably cooperate with each other, including, without limitation, the furnishing or making available during normal business hours of records, personnel (as reasonably required), books of accounts, or other materials reasonably necessary or helpful for the preparation of such Tax Returns, the conduct of audit examinations or the defense of claims by Taxing Authorities as to the imposition of Taxes.

(e) Buyer shall not allow the Company to waive the carryback period with respect to any net operating loss for any Pre-Closing Period.

7.11 Controversies. Written notice of any inquiries, claims, assessments, audits or similar events with respect to Taxes for which the Stockholders may be liable under this Agreement (any such inquiry, claim, assessment, audit or similar event, a "***Tax Matter***") shall be governed in accordance with the procedures in **Section 10.7**.

7.12 Amended Tax Returns. Buyer shall not file or cause to be filed any amended Tax Returns covering any period or adjusting any Taxes for a Pre-Closing Period that would, or would reasonably be expected to, increase Taxes for which Seller was responsible under this Agreement without the prior written consent of the Stockholder Representative, which consent shall not be unreasonably withheld.

7.13 Nature of Payments. Buyer and the Stockholders agree that any indemnity payments made pursuant to this Agreement shall constitute an adjustment to the Purchase Price, unless otherwise required by law.

7.14 Obligations With Respect to Product Warranties and Liabilities.

(a) From time to time as requested by Buyer following the Closing Date, the Stockholder Representative shall cause the Escrow Agent to reimburse Buyer for 80% of any out-of-pocket costs and expenses incurred by Buyer, the Company or Subsidiary arising from product warranty obligations of the Company or Subsidiary for products manufactured or shipped prior to the Closing, to the extent that those costs exceed an aggregate of $3,000,000 from and after the Closing Date. For purposes of this **Section 7.14**, "product warranty obligations" means those warranty obligations arising after the installation in a customer's product containing any Company products that are produced or shipped by the Company or Subsidiary on or before the Closing. The cost of product warranty obligations shall include reworked, repaired, repurchased or replaced products or payments of cash and settlement of accounts receivable and issuance of credits and incidental out-of-pocket costs; *provided, however*, that "product warranty obligations" shall not include amounts otherwise reimbursed following a good faith effort by the Company to collect any

amounts reimbursable pursuant to the Supplemental Products Claims Agreement, dated June 23, 1997, among RPM, Inc., an Ohio corporation, Tremco Incorporated, an Ohio corporation, Tremco Ltd., a Canadian corporation and the Company (the "***Product Claims Agreement***").

(b) From time to time as requested by Buyer following the Closing Date, the Stockholder Representative shall cause the Escrow Agent to reimburse Buyer for 85% of any Damages incurred by Buyer, the Company or Subsidiary in connection with any product recall of, or Action arising from or relating to, products produced or shipped by the Company or Subsidiary on or before the Closing Date (excluding product warranty obligations described in **Section 7.14(a)**). For purposes of this **Section 7.14(b)**, Damages do not include Damages otherwise reimbursed following a good faith effort by the Company to collect any amounts reimbursable pursuant to the Product Claims Agreement.

7.15 Transaction Taxes and Other Closing Costs. The Stockholders shall pay and be responsible for the aggregate amount of all federal, state, county, provincial, municipal, local or foreign sales, use, value-added, transfer, stamp and other similar Taxes, and transfer, recording or similar fees and charges, imposed in connection with, or as a result of, this Agreement or the consummation of the transactions contemplated by this Agreement (such aggregate amount referred to herein as the "***Stock Transfer Taxes and Costs***").

7.16 Exclusivity Agreement. For so long as this Agreement remains in effect, neither the Stockholders nor any Affiliate of the Stockholders, the Company or Subsidiary nor any of their directors, officers, employees, representatives or agents, nor anyone acting on their behalf shall, directly or indirectly, solicit, encourage (including furnishing information to any third party), negotiate or assist in any manner any offers, bids or proposals involving, directly or indirectly, (a) the sale or other disposition of the Company's assets (other than sales of inventory and application equipment in the ordinary course of business) or (b) the sale or exchange (whether through a merger or otherwise) of all or any portion of the Shares or the Subsidiary Shares, other than to Buyer. The Stockholders shall cause the Company not enter into any letter of intent, agreement in principle or other agreement with respect to any matter involving such a transaction.

7.17 Noncompete. Each Optionholder acknowledges and agrees that Section 3 of the option agreement (the "***Noncompete Provision***") entered into by each Optionholder and the Company when such Optionholder's Options were granted survives the termination of the Options and each Optionholder will be bound by the Noncompete Provision in accordance with its terms.

ARTICLE VIII
CONDITIONS TO CLOSING

8.1 Conditions to Obligations of the Parties. The respective obligations of the Stockholders and Buyer to consummate the transactions contemplated by this Agreement are subject to the satisfaction or waiver (if permitted by applicable Law) at or prior to the Closing of each of the following conditions:

(a) None of the parties hereto will be subject to any Order of a court of competent jurisdiction that prohibits the consummation of the transactions contemplated by this Agreement. In the event any such Order has been issued, each party shall use its commercially reasonable efforts to have any such Order overturned or lifted.

(b) The applicable waiting period under the HSR Act and any other relevant antitrust Law will have expired or been terminated.

8.2 Conditions to Obligations of the Stockholders. The obligations of the Stockholders to consummate the transactions contemplated by this Agreement are subject to the satisfaction or waiver

(if permitted by applicable Law) at or prior to the Closing of each of the following additional conditions:

(a) The representations and warranties of Buyer set forth in this Agreement will be true and correct in all respects (*provided* that any representation or warranty of Buyer contained herein that is subject to a materiality, Material Adverse Effect or similar qualification will not be so qualified for purposes of determining the existence of any breach thereof on the part of Buyer) as of the Closing Date as though made on and as of the Closing Date (except to the extent such representations and warranties speak as of an earlier date), except for such breaches that would not, individually or in the aggregate with any other breaches on the part of Buyer, materially and adversely affect the ability of Buyer to consummate the transactions contemplated by this Agreement.

(b) Each of the agreements and covenants of Buyer to be performed and complied with by Buyer pursuant to this Agreement prior to the Closing Date will have been duly performed and complied with in all material respects.

(c) Buyer will have delivered to the Stockholders the items required by **Section 3.3** of this Agreement.

8.3 Conditions to Obligations of Buyer. The obligations of Buyer to consummate the transactions contemplated by this Agreement are subject to the satisfaction or waiver (if permitted by applicable Law) at or prior to the Closing of each of the following additional conditions:

(a) The representations and warranties of the Stockholders set forth in this Agreement will be true and correct in all respects (*provided* that any representation or warranty of the Stockholders contained herein that is subject to a materiality, Material Adverse Effect or similar qualification will not be so qualified for purposes of determining the existence of any breach thereof on the part of the Stockholders) as of the Closing Date as though made on and as of the Closing Date (except to the extent such representations and warranties speak as of an earlier date), except for such breaches that would not, individually or in the aggregate with any other breaches on the part of the Stockholders, reasonably be expected to have a Material Adverse Effect on the Company.

(b) Each of the agreements and covenants of the Stockholders to be performed and complied with by the Stockholders pursuant to this Agreement prior to or as of the Closing Date will have been duly performed and complied with in all material respects.

(c) The Stockholders will have delivered to Buyer the items required by **Section 3.2** of this Agreement.

(d) No event, occurrence, fact, condition, change, development or effect shall have occurred, exist or come to exist since the date of this Agreement that, individually or in the aggregate, constitutes or is reasonably expected to constitute a Material Adverse Effect on the Company and Subsidiary.

ARTICLE IX
TERMINATION OF AGREEMENT

9.1 Termination. Notwithstanding any other provision of this Agreement, this Agreement may be terminated at any time prior to the Closing Date:

(a) by the mutual written consent of Buyer and the Stockholder Representative;

(b) by Buyer or the Stockholder Representative, upon written notice to the other party, if the transactions contemplated by this Agreement have not been consummated on or prior to

January 30, 2004, unless such failure of consummation shall be due to the failure of the party seeking such termination to perform or observe in all material respects the covenants and agreements hereof to be performed or observed by such party;

(c) by Buyer or the Stockholder Representative, upon written notice to the other party, if a Governmental Authority of competent jurisdiction has issued an Order or any other action permanently enjoining or otherwise prohibiting the consummation of the transactions contemplated by this Agreement and such Order has become final and non-appealable; *provided*, *however*, that the party seeking to terminate this Agreement pursuant to this clause (c) has used its commercially reasonable efforts to remove such Order; or

(d) by Buyer or the Stockholder Representative if before the Closing Date, any Stockholder or Buyer (as applicable) is in default or breach in any material respect of any representation, warranty, covenant or agreement contained in this Agreement, and such default or breach shall not be cured within five Business Days after the date notice of such breach is delivered by the party claiming such default or breach to the defaulting or breaching party or parties.

9.2 Effect of Termination. In the event of termination of this Agreement pursuant to **Section 9.1**, no party will have any liability or any further obligation to any other party, except as provided in this **Section 9.2** and except that nothing herein releases, or may be construed as releasing, any party hereto from any liability or damage to any other party hereto arising out of the breaching party's material breach in the performance of any of its covenants, agreements, duties or obligations arising under this Agreement. The obligations of the parties to this Agreement under **Section 7.3** (as such Section relates to confidentiality), **Section 7.5**, **Section 9.2** and **Article XI** will survive any termination of this Agreement.

ARTICLE X
REMEDIES

10.1 Survival. The representations, warranties, covenants and agreements of the Stockholders, on the one hand, and Buyer, on the other hand, contained in this Agreement will survive the Closing Date, but only to the extent specified below.

(a) The representations and warranties contained in this Agreement will survive the Closing Date until the fourth anniversary of the Closing Date, at which point such representations and warranties and any claim for reimbursement out of the Escrow Amount or claim for indemnification by any Stockholder Indemnitee, as applicable, on account thereof will terminate.

(b) All covenants and agreements contained in this Agreement that contemplate performance thereof following the Closing Date will survive the Closing Date until the earlier of (i) the fourth anniversary of the Closing Date or (ii) the expiration of such covenant or agreement in accordance with its terms (such date, the "***Covenant Termination Date***").

10.2 Claims Against the Escrow Amount by Buyer Indemnitees. From and after the Closing Date, the Stockholders shall indemnify and hold harmless Buyer and the Company and their successors and permitted assigns, officers, employees, directors and stockholders (collectively, the "***Buyer Indemnitees***") for, and will pay to Buyer Indemnitees, the amount of any and all losses, costs, liabilities, encumbrances, damages, claims, fines, penalties, assessments, judgments, expenses (including reasonable fees and expenses of outside attorneys), reasonable costs of investigation (including reasonable fees and expenses of outside accountants, consultants and experts reasonably engaged), amounts paid in settlement, court costs, and other expenses of litigation but excluding any and all internal costs and expenses incurred by any of the Buyer Indemnitees in connection with any of the foregoing (collectively, "***Damages***") incurred by a Buyer Indemnitee arising out of (a) any breach of any representation or warranty of any Stockholder, Optionholder or Warrantholder contained in this

Agreement or any related agreements, (b) any breach by any of the Stockholders, Optionholders or Warrantholders or the Stockholder Representative of any of their covenants or agreements contained in this Agreement or any related agreement or (c) any of the matters described on, or incorporated by reference in, **Schedule 4.6, 4.14 or 4.19.** Any amounts payable to the Buyer Indemnitees under this **Article X** shall be payable solely out of the Escrow Amount. It is the specific intention of the Stockholders to provide the Buyer Indemnitees indemnification for Damages based on undisclosed liabilities or obligations of the Company or Subsidiary that exist as of the Closing Date, whether known or unknown, contingent or otherwise, except for those exceptions specified in **Section 4.29**. For purposes of clarification, any liability or obligation of the Company or Subsidiary that results from a condition, event, circumstance, activity, practice, incident, action or omission that occurred or existed on or prior to the Closing Date shall constitute a liability or obligation of the Company or Subsidiary that existed as of the Closing Date, even if the claim related to such liability or obligation is not asserted until after the Closing Date.

10.3 Indemnification of Stockholder Indemnitees. Buyer will indemnify and hold harmless the Stockholder Representative, the Stockholders and Optionholders and their respective successors and permitted assigns, heirs and personal representatives and the officers, employees, directors and stockholders of the Stockholder Representative and the Stockholders (collectively, the "**Stockholder Indemnitees**") for, and will pay to the Stockholder Indemnitees the amount of any, Damages actually incurred by a Stockholder Indemnitee arising out of (a) any breach of any representation or warranty of Buyer contained in this Agreement or (b) any breach by Buyer of any of its covenants or agreements contained in this Agreement that survive the Closing Date.

10.4 Exclusive Remedy. The parties agree that, from and after the Closing Date, the exclusive remedies of the parties for any Damages arising out of or based upon the matters set forth in this Agreement are the reimbursement obligations described in **Section 7.14** and the indemnification obligations of the parties set forth in this **Article X.** The provisions of this **Section 10.4** shall not, however, prevent or limit a cause of action (a) on account of fraud, (b) under **Section 11.1** to obtain an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof or (c) under **Section 2.3(b)** to enforce any decision or determination of the Arbitration Firm.

10.5 Limitations on Reimbursement to Buyer Indemnitees. Notwithstanding anything herein to the contrary, the right of the Buyer Indemnitees to reimbursement from the Escrow Amount is limited as follows:

(a) Except as set forth in the immediately following sentence, the Buyer Indemnitees will not be entitled to reimbursement from the Escrow Amount pursuant to **Section 10.2** for any Damages until the total of all such Damages suffered by the Buyer Indemnitees exceeds the sum of $500,000, in which event the Buyer Indemnitees will be entitled to reimbursement out of the Escrow Amount for all Damages exceeding such amount up to a maximum of the Escrow Amount; *provided*, *however*, that the foregoing sentence shall not apply with respect to any Damages arising out of any breach of any representation or warranty in **Section 4.19** or the matters listed on **Schedule 4.19** or the product warranty and liability matters described in **Section 7.14** and Buyer shall be entitled to reimbursement from the Escrow Account for all such Damages up to a maximum of the Escrow Amount. Any Damages of a Buyer Indemnitee shall not be included in calculating the $500,000 threshold described in this **Section 10.5(a)** to the extent it arises out of a contract (other than a Material Contract) entered into by the Company or Subsidiary in the ordinary course of business since the date of this Agreement.

(b) The Buyer Indemnitees' right to reimbursement from the Escrow Amount pursuant to **Section 10.2** on account of any Damages will be reduced by all insurance or other third party indemnification proceeds actually received by the Buyer Indemnitees. Buyer and the Company

shall use commercially reasonable efforts to claim and recover any Damages suffered by the Buyer Indemnitees under any such insurance policies or other third party indemnities.

(c) Except with respect to Damages actually awarded to a third party in an action brought against a Buyer Indemnitee, the Buyer Indemnitees are not entitled to reimbursement from the Escrow Amount pursuant to **Section 10.2** for punitive damages, or for lost profits, consequential, exemplary or special damages.

(d) The Buyer Indemnitees shall not be entitled to reimbursement from the Escrow Amount pursuant to **Section 10.2** to the extent that any Buyer Indemnitee has been compensated therefor pursuant to **Section 2.3**.

(e) The Buyer Indemnitees shall be entitled to reimbursement from the Escrow Amount pursuant to **Section 10.2**, without duplication for any Taxes attributable to the Pre-Closing Period or Pre-Closing Straddle Period as determined under **Section 7.10**, for Damages arising solely out of any breach of any representation or warranty contained in **Section 4.6** or matters listed on **Schedule 4.6** only to the extent such Damages exceed (prior to application of the other provisions of **Section 10.5**), in the following order, the aggregate of: (A) the Tax Accrual, provided that the Tax Accrual shall reduce the amount of such Damages only to the extent that such Tax Accrual is related to such type of Taxes (and the Seller agrees that no reserve shall have been included in the Tax Accrual with respect to the disallowance or deferral of items listed in **Schedule 7.10**). To the extent such Damages exceed the Tax Accrual, (B) the NOL Tax Benefit, provided that the NOL Tax Benefit shall reduce the amount of such Damages (as reduced if at all by **Section 10.5(e)(A)**) only to the extent such Damages are incurred as a result of Income Taxes. To the extent such Damages exceed the NOL Tax Benefit, (C) the Tax Refund, provided that the Tax Refund shall reduce the amount of such Damages (as reduced if at all by **Section 10.5(e)(A)** or **(B)**) only to the extent such Tax Refund relates to the taxing jurisdiction and type of Tax that is the subject matter of the Damages, as such Tax Basket Items may have been reduced by previous application of this **Section 10.5(e)** or pursuant to **Section 7.10**.

(f) (i) With respect to any claim based on a Remedial Action, the Buyer Indemnitees shall be entitled to reimbursement from the Escrow Account pursuant to Section 10.2(a) only if the Remedial Action is undertaken (A) in response to a claim by a third party, including a Governmental Authority, against a Buyer Indemnitee, or (B) to correct, eliminate or otherwise address a matter or condition that constitutes a violation of Environmental Laws.

(ii) With respect to a claim based on a Remedial Action undertaken in response to a claim by a Governmental Authority, it is a condition precedent to the right of the Buyer Indemnitees to indemnification or to be held harmless for such claim that the Buyer Indemnitees shall not solicit or importune any Governmental Authority to require such Remedial Action, unless the Buyer Indemnitees reasonably believe that they are required to do so by Environmental Laws; *provided* that this provision shall not preclude a Buyer Indemnitee from conducting, subsequent to the Closing, any environmental investigation or assessment activities, including soil and groundwater sampling, the Buyer Indemnitee deems necessary or desirable, or, to the extent Buyer Indemnitees reasonably believe that they are required to do so by Environmental Laws, from

reporting to the appropriate Governmental Authority the results of any environmental investigation or assessment activities, including the results of the soil and groundwater sampling described in the Limited Phase II Environmental Site Assessment Report prepared by GZA GeoEnvironmental, Inc., dated November 7, 2003, with respect to the Real Property located at 403 Treuhaft Boulevard, Barbourville, Kentucky.

(iii) Buyer Indemnitees shall have no right to indemnification or to be held harmless with respect to a Remedial Action that is not required to be conducted by Environmental Law or by a pre-Closing contractual agreement of the Company or Subsidiary. In this regard, the

Stockholders acknowledge that some form of Remedial Action is required by Environmental Laws with respect to the ethylbenzene discovered in the Limited Phase II Environmental Site Assessment conducted by GZA GeoEnvironmental, Inc. at the Real Property located at 403 Treuhaft Boulevard, Barbourville, Kentucky, and the Stockholders shall indemnify Buyer Indemnitees for any such Remedial Action required by Environmental Laws.

(iv) Buyer Indemnitees shall have no right to indemnification or to be held harmless to the extent (A) a Remedial Action is based on a cleanup standard that is more stringent or costly than the cleanup standard applicable to non-residential properties, unless the more stringent or costly Remedial Action is required by a pre-Closing contractual agreement of the Company or Subsidiary or (B) the Buyer Indemnitees fail to take reasonable actions to mitigate any Damages attributable to the Remedial Action, including where appropriate and reasonable, the use of environmental deed restrictions and the installation of engineering controls on the owned Real Property, *provided* that such restrictions or controls do not prevent, inhibit or increase the cost of either the business operations conducted on the owned Real Property or any construction or development plan the Company or Subsidiary has for such owned Real Property as non-residential property, and do not materially decrease the value of the owned Real Property as non-residential property. The cost of any actions required with respect to such restrictions and controls, including any post-closure monitoring or maintenance, shall be Damages for which Buyer Indemnitees shall be entitled to indemnification under the provisions of **Section 10.2**.

10.6 Limitations on Indemnification by Buyer Indemnitees.

(a) The Stockholder Indemnitees will not be entitled to indemnification pursuant to **Section 10.3** for any Damages until the total of all such Damages suffered by the Stockholder Indemnitees exceeds the sum of $500,000, in which event the Stockholder Indemnitees will be entitled to indemnification for all Damages up to a maximum of $12,000,000.

(b) The Stockholder Indemnitees' right to indemnification pursuant to **Section 10.3** on account of any Damages will be reduced by all insurance or other third party indemnification proceeds actually received by the Stockholder Indemnitees. The Stockholders shall use commercially reasonable efforts to claim and recover any Damages suffered by the Stockholder Indemnitees under any such insurance policies or other third party indemnities.

(c) Except with respect to Damages actually awarded to a third party in an action brought against a Stockholder Indemnitee, the Stockholder Indemnitees are not entitled to indemnification pursuant to **Section 10.3** for punitive damages, or for lost profits, consequential, exemplary or special damages.

10.7 Procedures.

(a) *Notice of Damages by Stockholder Indemnitee.* Subject to the limitations set forth in this **Article X,** if any Stockholder Indemnitee believes in good faith that it has a claim for Damages, the Stockholder Indemnitee shall, as soon as is reasonably practicable after it becomes aware of the claim, give written notice of such Damages (a "***Claims Notice***") to Buyer describing the Damages in reasonable detail and indicating the amount (estimated, if necessary and to the extent feasible) of Damages that have been or may be suffered by the applicable Stockholder Indemnitee. No delay in or failure to give a Claims Notice by the Stockholder Representative to Buyer pursuant to this **Section 10.7(a)** will adversely affect any of the other rights or remedies that the Stockholder Representative has under this Agreement, or alter or relieve Buyer of its obligation to indemnify the applicable Stockholder Indemnitee except to the extent that they are materially prejudiced thereby. Buyer shall respond to the Stockholder Representative (a "***Claim Response***") within 30 days (the "***Response Period***") after the date that the Claims Notice is sent by the

Stockholder Representative. Any Claim Response must specify whether or not Buyer disputes the claim described in the Claims Notice. If Buyer fails to give a Claim Response within the Response Period, Buyer will be deemed not to dispute the claim described in the related Claims Notice. If Buyer elects not to dispute a claim described in a Claims Notice, whether by failing to give a timely Claim Response or otherwise, then the amount of Damages alleged in such Claims Notice will be conclusively deemed to be an obligation of Buyer and Buyer shall pay, in cash to the Stockholder Representative within 30 days after the last day of the applicable Response Period, the amount specified in the Claims Notice. If Buyer delivers a Claim Response within the Response Period indicating that it disputes one or more of the matters identified in the Claims Notice, Buyer and the Stockholder Representative shall promptly meet and use their reasonable efforts to settle the dispute. If Buyer and the Stockholder Representative are unable to reach agreement within 30 days after the conclusion of the Response Period, then the dispute must be resolved in accordance with **Section 10.8**.

(b) *Notice of Damages by Buyer Indemnitee.*

(i) *Claims with Determinable Damages.* Subject to the limitations set forth in this **Article X** if any Buyer Indemnitee believes in good faith that it has a claim for reimbursement against the Escrow Amount (an "***Escrow Claim***") the amount of which is then known, Buyer shall, as soon as reasonably practicable after it becomes aware of such Escrow Claim, notify the Stockholder Representative of such Escrow Claim by means of a written notice specifying the nature, circumstances and amount of such Escrow Claim setting forth in reasonable detail the underlying facts actually known or in good faith believed by the Buyer Indemnitee to exist sufficient to establish, as of the date of such notice, the basis for the Escrow Claim and setting forth Buyer Indemnitee's good faith calculation of the Damages incurred by the applicable Buyer Indemnitee with respect thereto (an "***Escrow Claim Notice***" and, together with a Claims Notice, a "***Notice***"). The failure by Buyer to promptly deliver an Escrow Claim Notice under this **Section 10.7(b)(i)** will not adversely affect the applicable Buyer Indemnitee's right to reimbursement from the Escrow Amount except to the extent the Stockholder Representative is prejudiced thereby. If, by 5:00 p.m. Eastern time on the 30th day following receipt

by the Stockholder Representative of an Escrow Claim Notice (the "***Dispute Period***"), Buyer has not received from the Stockholder Representative notice in writing that the Stockholder Representative objects to the Escrow Claim (or the amount of Damages set forth therein) asserted in such Escrow Claim Notice (a "***Dispute Notice***"), Buyer and the Stockholder Representative shall deliver a joint written instruction to the Escrow Agent instructing the Escrow Agent to pay to Buyer from the Escrow Amount the amount of Damages specified in the Claim Notice subject to the limitations contained in this **Article X**.

(ii) *Claims without Determinable Damages.* Subject to the limitations set forth in this **Article X**, if any Buyer Indemnitee believes in good faith that it has an Escrow Claim the amount of which cannot reasonably be determined, Buyer shall, as soon as reasonably practicable after it becomes aware of such Escrow Claim, notify the Stockholder Representative by means of an Escrow Claim Notice that contains the information required by **Section 10.7(b)(i)** and a good faith estimate, if possible, of Buyer's calculation of the Damages incurred by the applicable Buyer Indemnitees with respect thereto. The failure by Buyer to promptly deliver an Escrow Claim Notice under this **Section 10.7(b)(ii)** will not adversely affect the applicable Buyer Indemnitee's right to reimbursement from the Escrow Amount except to the extent the Stockholder Representative is prejudiced thereby. If Buyer has not received a Dispute Notice from the Stockholder Representative within the Dispute Period, Buyer and the Stockholder Representative shall deliver one or more joint written instructions to the Escrow Agent instructing the Escrow Agent to pay to Buyer from the Escrow Amount the amount of Damages specified from time to time as the amount of any such Escrow Claim becomes known, *provided, however*, that the Stockholder Representative will be under no obligation to agree to any such payments and the making of any one such payment will be without prejudice to the continuing right of the Stockholder Representative to object to any further payment.

(iii) *Disputes.* If the Stockholder Representative delivers a Dispute Notice to Buyer within the Dispute Period, Buyer and the Stockholder Representative shall promptly meet and use their reasonable efforts to settle the dispute as to whether and to what extent the Buyer Indemnitees are entitled to reimbursement on account of such Escrow Claim. If Buyer and the Stockholder Representative are able to reach agreement within 30 days after Buyer receives such Dispute Notice, Buyer and the Stockholder Representative shall deliver a joint written instruction to the Escrow Agent setting forth such agreement and instructing the Escrow Agent to release funds held under the Escrow Agreement in accordance with such agreement. If Buyer and the Stockholder Representative are unable to reach agreement within 30 days after Buyer receives such Dispute Notice, then the dispute must be resolved in accordance with **Section 10.8.** For all purposes of this **Article X** (including, without limitation, those pertaining to disputes under **Section 10.7(a)** and this **Section 10.7(b)(iii)**), Buyer and the Stockholder Representative shall cooperate with and make available to the other party and its respective representatives all information, records and data and shall permit reasonable access to its facilities and personnel, as may be reasonably required in connection with the resolution of such disputes.

(c) *Opportunity to Defend Third Party Claims.* In the event of any claim by a third party against any Buyer Indemnitee or Stockholder Indemnitee for which indemnification is available hereunder, the Indemnifying Party has the right, exercisable by written notice to Buyer or the Stockholder Representative, as applicable, within 30 days of receipt of a Notice from Buyer or the Stockholder Representative, as applicable, of the commencement or assertion of any Damages arising out of such claim, to assume and conduct the defense of such claim with counsel selected by the Indemnifying Party and reasonably acceptable to Buyer or the Stockholder Representative, as applicable. If the Indemnifying Party is the Stockholder Representative, such Indemnifying Party will be entitled to defend and, subject to the provisions of **Section 10.7(d)**, settle such claim using the Escrow Amount, and the Stockholder Representative and Buyer shall jointly instruct the Escrow Agent to release funds held under the Escrow Agreement for this purpose in accordance with the provisions of the Escrow Agreement. If the Indemnifying Party is Buyer, such Indemnifying Party shall not be entitled to defend such claim using the Escrow Amount. If the Indemnifying Party has assumed such defense as provided in this **Section 10.7(c)**, the Indemnifying Party will not be liable for any legal expenses subsequently incurred by any Indemnitee in connection with the defense of such claim. Notwithstanding the foregoing, such Indemnitee has the right to employ counsel separate from the counsel employed by the Indemnifying Party in the defense of any claim that the Indemnifying Party is defending and to participate in such defense, but the fees and expenses of such counsel will be at the Indemnitee's own expense, unless (i) the employment of such counsel has been specifically authorized by the Indemnifying Party or (ii) such Indemnitee has been advised by counsel reasonably satisfactory to the Indemnifying Party that there may be one or more legal defenses available to it that are different from or additional to those available to the Indemnifying Party and in the reasonable judgment of such counsel it is advisable for such Indemnitee to employ separate counsel in order to effectively assert such defense or defenses. In such event, if the Indemnifying Party is the Stockholder Representative, then the fees and expenses of such counsel will be borne from the Escrow Amount, and the Stockholder Representative and Buyer shall jointly instruct the Escrow Agent to release funds held under the Escrow Agreement for this purpose in accordance with the provisions of the Escrow Agreement. If the Indemnifying Party does not assume the defense of any third party claim in accordance with this **Section 10.7(c)**, the Indemnitee may continue to defend such claim at the sole cost of the Indemnifying Party subject to the limitations set forth in this **Article X**. The Indemnitee will not consent to a settlement of, or the entry of any judgment arising from, any such claim, without the prior written consent of the Indemnifying Party (which consent shall not be unreasonably withheld or delayed). Except with the prior written consent of the Indemnitee (such

consent not to be unreasonably withheld or delayed), no Indemnifying Party, in the defense of any such claim, shall consent to the entry of any judgment or enter into any settlement that (i) provides for injunctive or other nonmonetary relief affecting the Indemnitee or (ii) does not include as an unconditional term thereof the giving by each claimant or plaintiff to such Indemnitee of a release from all liability with respect to such claim or litigation. In any such third party claim, the Indemnifying Party shall keep the Indemnitee reasonably apprised of all proceedings associated therewith and shall provide to the Indemnitee all information reasonably requested by the Indemnitee.

(d) *Settlement.* The party responsible for the defense of any third party claim (the "***Responsible Party***") shall promptly notify the other party of each settlement offer with respect to a third party claim. Such other party shall notify the Responsible Party with reasonable promptness whether or not such party is willing to accept the proposed settlement offer. The Responsible Party shall not consent to any settlement of any third party claim without obtaining the prior written consent (not to be unreasonably withheld or delayed) of the other party.

(e) *Cooperation.* From and after the Closing, and subject to applicable Law, Buyer shall (i) cause the Company and Subsidiary to give the Stockholder Representative and its representatives, upon reasonable notice to Buyer, full and complete access, during normal business hours, to the assets, properties, books, records, agreements and employees of the Company and Subsidiary, (ii) cause the Company and Subsidiary to cooperate with the Stockholder Representative and its representatives and (iii) permit the Stockholder Representative and its representatives to make such inspections, in each case described in clauses (i) through (iii) of this **Section 10.7(e)**, as the Stockholder Representative may reasonably require to permit the Stockholder Representative to evaluate, defend, or participate in the defenses or settlement of any claim (i) by a third party against any Buyer Indemnitee for which indemnification is available hereunder and that may result in Damages payable to the Buyer Indemnitees or (ii) by a Buyer Indemnitee for which

indemnification is available hereunder and that has not yet become an Action. The Stockholder Representative shall, and shall cause its representatives to, hold in confidence and not disclose or use any information acquired pursuant to the foregoing sentence except as may be necessary to defend or participate in the defense or settlement of any such claim. In the case of any claim by a third party against any Buyer Indemnitee for which indemnification is available hereunder for matters under **Section 7.14(b)** or any other matter with respect to which both a Buyer Indemnitee, on the one hand, and the Company or Subsidiary, on the other hand, are parties, the Stockholder Representative and the Buyer Indemnitee shall enter into an appropriate joint defense agreement.

(f) *Other Releases of Escrow Amount.* Buyer and the Stockholder Representative shall jointly instruct the Escrow Agent to release funds held under the Escrow Agreement as described in **Section 2.3** (regarding adjustment to the Purchase Price) and **Section 7.14** (regarding reimbursement for certain product warranty and liability expenses and claims) or as otherwise described in the Escrow Agreement on the relevant release dates.

10.8 Dispute Resolution. Except as provided for in **Section 2.3** (regarding adjustments to the Purchase Price), any claim, controversy or other matter in question arising out of this Agreement after the Closing Date (any "***Dispute***") shall be first submitted for resolution pursuant to the following procedure. First, a senior executive officer of each of Buyer and the Stockholder Representative shall meet in person to resolve the dispute within five days after written notice of the Dispute as provided by one party to the other. If the executive officers are unable to resolve the Dispute within three days after their meeting, the Chief Executive Officer of each of Buyer and the Stockholder Representative shall promptly attempt to resolve the Dispute. If the Chief Executive Officers are unable to resolve the Dispute within 15 days following the original notice of the Dispute, then Buyer and the Stockholder Representative shall submit the Dispute to mediation in accordance with such rules as they shall agree

upon. If the Dispute is not resolved through such mediation proceedings within 60 days following the original notice of the Dispute, then any party may seek any remedy available under Law, including bringing an action for any relief in any court specified in **Section 11.14** having appropriate jurisdiction.

ARTICLE XI
MISCELLANEOUS AND GENERAL

11.1 Enforcement of Agreement. The parties hereto agree that irreparable damage would occur in the event that any provision of this Agreement was not performed in accordance with its specific terms or was otherwise breached. It is accordingly agreed that the parties will be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof, this being in addition to (a) any other remedy to which they are entitled hereunder, at Law or in equity prior to the Closing Date or (b) any other remedy to which they are entitled hereunder after the Closing Date.

11.2 Stockholder Representative. The Stockholder Representative is hereby constituted and appointed as agent and attorney in fact for and on behalf of the other Stockholders. Without limiting the generality of the foregoing, the Stockholder Representative has full power and authority, on behalf of each Stockholder and his, her or its successors and assigns, to (a) interpret the terms and provisions of this Agreement and the documents to be executed and delivered by the Stockholders in connection herewith, including the Escrow Agreement, (b) execute and deliver and receive deliveries of all agreements, certificates, statements, notices, approvals, extensions, waivers, undertakings, amendments and other documents required or permitted to be given in connection with the consummation of the transactions contemplated by this Agreement and the Escrow Agreement (including amendments thereto), (c) receive service of process in connection with any claims under this Agreement or the Escrow Agreement, (d) agree to negotiate, enter into settlements and compromises of, assume the defense of claims, demand arbitration and comply with orders of courts and awards of arbitrators with respect to such claims and to take all actions necessary or appropriate in the judgment of the Stockholder Representative for the accomplishment of the foregoing, (e) give and receive notices and communications, (f) authorize delivery to Buyer of the Escrow Amount or any portion thereof in satisfaction of claims brought by Buyer for Damages, (g) object to such deliveries, (h) distribute the Escrow Amount and any earnings and proceeds thereon and (i) take all actions necessary or appropriate in the judgment of the Stockholder Representative on behalf of the Stockholders in connection with this Agreement and the Escrow Agreement.

11.3 Disclaimer. The Stockholders do not make, and have not made, any representations or warranties relating to the Stockholders, the Company or the business of the Company or otherwise in connection with the transactions contemplated hereby other than those expressly set forth herein. It is understood that any cost estimate, projection or other prediction, any data, any financial information or any memoranda or offering materials or presentations, including, without limitation, any memoranda and materials provided by any representative of the Stockholders (including, without limitation, McDonald Investments, Inc.) are not and shall not be deemed to be or to include representations or warranties of the Stockholders. Except as set forth in **Section 11.2**, no Person has been authorized by the Stockholders to make any representation or warranty relating to the Stockholders, the Company or the business of the Company or otherwise in connection with the transactions contemplated hereby and, if made, such representation or warranty may not be relied upon as having been authorized by the Stockholders and shall not be deemed to have been made by the Stockholders.

11.4 Expenses. Whether or not the transactions contemplated by this Agreement are consummated, all costs and expenses (including all legal, accounting, broker, finder or investment banker fees) incurred in connection with this Agreement and the transactions contemplated hereby are to be paid by the party incurring such expenses except as expressly provided herein.

11.5 Successors and Assigns. This Agreement is binding upon and inures to the benefit of the parties hereto and their respective successors and assigns, but is not assignable by any party without the prior written consent of the other parties hereto.

11.6 Third Party Beneficiaries. Except as provided in **Section 7.7** and **Article X**, each party hereto intends that this Agreement does not benefit or create any right or cause of action in or on behalf of any Person other than the parties hereto.

11.7 Further Assurances. The parties shall execute such further instruments and take such further actions as may reasonably be necessary to carry out the intent of this Agreement. Each party hereto shall cooperate affirmatively with the other parties, to the extent reasonably requested by such other parties, to enforce rights and obligations herein provided.

11.8 Notices. Any notice or other communication provided for herein or given hereunder to a party hereto must be in writing and sent by facsimile transmission (electronically confirmed), delivered in person, mailed by first class registered or certified mail, postage prepaid, or sent by Federal Express or other overnight courier of national reputation, addressed as follows:

If to the Company (only after Closing) or Buyer:

Quanex Corporation
1900 West Loop South
Suite 1500
Houston, TX 77027
Attention: Terry M. Murphy
Fax: (713) 552-1630

and

Quanex Corporation
1900 West Loop South
Suite 1500
Houston, TX 77027
Attention: Kevin Delaney
Fax: (713) 626-7549

with a copy to:

Fulbright & Jaworski L.L.P.
1301 McKinney
Suite 5100
Houston, TX 77010-3095
Attention: Harva R. Dockery
Fax: (713) 651-5246

If to the Company (only prior to Closing) or the Stockholders:

TruSeal Technologies, Inc.
23150 Commerce Park
Beachwood, OH 44122
Attention: August J. Coppola
Fax: (216) 910-1505

with a copy to:

Kirtland Capital Partners
2550 SOM Center Road, Suite 105
Willoughby Hills, OH 44094
Attention: Michael T. DeGrandis
Fax: (440) 585-9699

and

Jones Day
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
Attention: Charles W. Hardin, Jr., Esq.
Fax: (216) 579-0212

If to the Stockholder Representative:

KCP Services, LLC
2550 SOM Center Road, Suite 105
Willoughby Hills, OH 44094
Attention: Michael T. DeGrandis
Fax: (440) 585-9699

with a copy to:

Jones Day
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
Attention: Charles W. Hardin, Jr., Esq.
Fax: (216) 579-0212

or to such other address with respect to a party as such party notifies the other in writing as above provided.

11.9 Complete Agreement. This Agreement and the disclosure schedules and exhibits hereto and the other documents delivered by the parties in connection herewith, together with the Confidentiality Agreement, contain the complete agreement between the parties hereto with respect to the transactions

contemplated hereby and thereby and supersede all prior agreements and understandings between the parties hereto with respect thereto. The letter of intent dated September 5, 2003, is hereby terminated.

11.10 Captions. The captions contained in this Agreement are for convenience of reference only and do not form a part of this Agreement.

11.11 Amendment. This Agreement may be amended or modified only by an instrument in writing duly executed by the Stockholder Representative and Buyer.

11.12 Waiver. At any time prior to the Closing Date, the Stockholder Representative and Buyer may (a) extend the time for the performance of any of the obligations or other acts of the parties hereto, (b) waive any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto or (c) waive compliance with any of the agreements or conditions contained herein, to the extent permitted by applicable Law. Any agreement to any such extension or waiver will be valid only if set forth in a writing signed by the Stockholder Representative and Buyer.

11.13 Governing Law. This Agreement is to be governed by, and construed and enforced in accordance with, the Laws of the State of New York, without regard to its rules of conflict of Laws.

11.14 Submission to Jurisdiction. Each party to this Agreement irrevocably agrees that the courts of the State of New York or the United States District Court for the Southern District of New York are to have jurisdiction and settle any claims, differences or disputes that may arise out of or in connection with this Agreement. Each of the parties to this Agreement irrevocably waives any objection it or he may now or hereafter have to the laying of venue in any proceedings in any court referred to in this **Section 11.14** and any claim that any proceedings brought in any such court have been brought in an inconvenient forum and further irrevocably agrees that a judgment in any proceedings brought in a court of the State of New York or of the United States District Court for the Southern District of New York shall be conclusive and binding on the parties to this Agreement and may be enforced in the courts of any other jurisdiction.

11.15 Waiver of Jury Trial. The parties to this Agreement waive any right to trial by jury in any proceeding arising out of or relating to this Agreement or the Escrow Agreement, whether now existing or hereafter arising, and whether grounded in contract, tort, strict liability or otherwise. The parties to this Agreement agree that any of them may file a copy of this **Section 11.15** with any court as written evidence of the knowing, voluntary and bargained for agreement among the parties to this Agreement irrevocably to waive trial by jury and that any proceeding whatsoever between or among them relating to this Agreement or any of the transactions described in this Agreement shall instead be tried in a court of competent jurisdiction by a judge sitting without a jury.

11.16 Severability. Any term or provision of this Agreement that is invalid or unenforceable in any jurisdiction will, as to that jurisdiction, be ineffective to the extent of such invalidity or unenforceability without rendering invalid or unenforceable the remaining terms and provisions of this Agreement or affecting the validity or enforceability of any of the terms or provisions of this Agreement in any other jurisdiction. If any provision of this Agreement is so broad as to be unenforceable, the provision will be interpreted to be only so broad as is enforceable.

11.17 Counterparts. This Agreement may be executed in two or more counterparts, each of which will be deemed an original but all of which will constitute but one instrument.

11.18 Interpretation. The headings preceding the text of articles and sections included in this Agreement and the headings to schedules and exhibits attached to this Agreement are for convenience only and shall not be deemed part of this Agreement or be given any effect in interpreting this Agreement. The terms as set forth in this Agreement have been arrived at after mutual negotiation with the advice of counsel representing all parties to this Agreement and, therefore, it is the intention of those parties that its terms may not be construed against any of them by reason of the fact that it was prepared by one of the parties. Unless the context otherwise requires, (a) the gender (or lack of gender) of all pronouns used in this Agreement includes the masculine, feminine and neuter; (b) references to articles, sections, exhibits and schedules refer to articles and sections of, or exhibits and schedules to this Agreement and (c)"including" means "including without limitation."

IN WITNESS WHEREOF, Buyer and the Stockholders have executed or have caused this Agreement to be executed as of the day and year first above written.

QUANEX CORPORATION

By: _____

Name:
Title:

TRUSEAL INVESTMENTS LTD.

By: KIRTLAND CAPITAL CORPORATION
Its: Managing Member

By: _____

Name:
Title:

KIRTLAND CAPITAL PARTNERS II L.P.

By: KIRTLAND CAPITAL CORPORATION
Its: General Partner

By: _____

Name:
Title:

KIRTLAND CAPITAL PARTNERS II LLC

By: KIRTLAND CAPITAL CORPORATION
Its: Managing Member

By: _____

Name:
Title:

JAMES L. BARATUCI

LINDA A. BARATUCI

LEE S. BURROUGHS

PENNY BURROUGHS

B. S. CASSELDEN

SANDI CASSELDEN

AUGUST J. COPPOLA

KAREN A. COPPOLA

WILLIE DOAN

THERESA DOAN

JOEL M. FALCK

JULIE R. FALCK

CLARK HALLADAY

MARION D. HALLADAY

ERIC W. JACKSON

ANGELA DAWN MICHELLE JACKSON

JOHN A. KESSLER

GLENLYN KESSLER

DONALD KITCHEN

SUE KITCHEN

JOSEPH STEVENOT

LORI E. STEVENOT

KEVIN C. ZUEGE

SUSAN JEAN ZUEGE

EDWARD JONES, CUSTODIAN
FBO RICHARD MACK IRA

By:
Name:
Title:

Exhibit A

STOCKHOLDERS

NAME	SHARES
Kirtland Capital Partners II L.P.	48,859.529
Kirtland Capital Company II LLC	4,240.232
TruSeal Investments Ltd.	24,231.705
Donald Kitchen	120.000
August J. Coppola and Karen A. Coppola	591.000
Joel M. and Julie R. Falck	147.502
James L. and Linda A. Baratuci	177.000
Lee S. Burroughs	175.527

B.S. Casselden	105.000
Clark Halladay	265.502
Eric W. and Angela Dawn Michelle Jackson	147.500
John A. Kessler	383.503
Kevin C. and Susan Jean Zuege	106.000
Joseph Stevenot	73.751
Willie Doan	100.000
Edward Jones, Custodian FBO Richard Mack IRA	73.751

Exhibit B

OPTIONHOLDERS

NAME	OPTIONS
August J. Coppola	2,371.00
Joel M. Falck	665.30
James L. Baratuci	665.30
Lee S. Burroughs	665.30
B.S. Casselden	580.60
Clark Halladay	580.60
Eric W. Jackson	665.30
John A. Kessler	665.30
Kevin C. Zuege	580.60

Exhibit C

ESCROW AGREEMENT

This ESCROW AGREEMENT (this "***Agreement***") is made and entered into as of , 200 , by and among KCP Services, LLC, a Delaware limited liability company (the "***Stockholder Representative***"), on behalf of the former holders (the "***Former Holders***") of common stock of TruSeal Technologies, Inc., a Delaware corporation (the "***Company***"), Comerica Bank as escrow agent (the "***Escrow Agent***") and Quanex Corporation, a Delaware corporation ("***Buyer***").

Recitals

A. Concurrently with the execution of this Agreement, Buyer is acquiring all of the outstanding shares of capital stock of the Company pursuant to a Stock Purchase Agreement, dated as of November , 2003, by and among the Company, Kirtland Capital Partners II L.P., a Delaware limited partnership, Kirtland Capital Company II LLC, a Delaware limited liability company, TruSeal

Investments Ltd., an Ohio limited liability company, the other stockholders of the Company listed therein and Buyer (the "***Purchase Agreement***").

B. In connection with the Purchase Agreement, a portion of the Purchase Price is to be held in an escrow account from which reimbursement is available to Buyer or any of the Buyer Indemnitees upon the terms and subject to the conditions specified in this Agreement and the Purchase Agreement.

C. Capitalized terms used but not defined herein will have the meanings ascribed to such terms in the Purchase Agreement.

NOW, THEREFORE, in consideration of the covenants set forth in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged the Stockholder Representative, the Escrow Agent and Buyer hereby agree as follows:

ARTICLE I
ESCROW

Section 1.1 ***Escrow Amount.*** Simultaneously with the execution and delivery of this Agreement, Buyer shall deposit with the Escrow Agent $12,000,000 (the "***Escrow Amount***") via wire transfer of immediately available funds to an account maintained by the Escrow Agent (the "***Escrow Account***"). The Escrow Agent acknowledges receipt of the Escrow Amount and agrees to hold the Escrow Amount in an interest-bearing Escrow Account and to administer the Escrow Account in accordance with this Agreement.

Section 1.2 ***Investment.*** The Escrow Agent shall invest and reinvest the Escrow Amount and Earnings (as defined below) in certificates of deposit of federally insured financial institutions, treasury bills or other direct federally guaranteed investments or in mutual funds invested primarily in obligations of the type described above or in such other instruments as are mutually acceptable to the Stockholder Representative and Buyer. Interest, earnings, gains on and proceeds from investment of the Escrow Amount are hereinafter referred to collectively as the "***Earnings***." The Escrow Agent is authorized to liquidate in accordance with its customary procedures any portion of the Escrow Account consisting of investments to provide for payments required to be made under this Agreement.

ARTICLE II
DISBURSEMENTS AND CLAIMS

Section 2.1 ***Disbursements.*** The Escrow Agent shall release from the Escrow Account and distribute the Escrow Amount to the Stockholder Representative and/or Buyer as set forth in this ***Article II***.

Section 2.2 ***Working Capital Adjustment.*** The Escrow Agent shall pay to Buyer a portion of the Escrow Amount upon receipt by the Escrow Agent of written notice by Buyer and the Stockholder Representative (i) stating that, based on the Final Working Capital (as finally determined pursuant to Section 2.3(b) of the Purchase Agreement), the Purchase Price will be adjusted downward pursuant to Section 2.3(d) of the Purchase Agreement, (ii) setting forth the appropriate portion of the Escrow Amount to be distributed to Buyer and (iii) instructing the Escrow Agent to release the appropriate portion of the Escrow Amount to Buyer.

Section 2.3 ***Disbursements to the Stockholder Representative.***

(a) Subject to ***Section 2.4***, on the first anniversary of the date of this Agreement (the "***First Release Date***"), the Escrow Agent shall pay the portion of the Escrow Amount to the Stockholder Representative on behalf of the Former Holders equal to (to the extent a positive number) $3,000,000 (plus all accumulated Earnings) *less* the sum of (i) all Damages (as defined below) paid to Buyer

pursuant to ***Section 2.4*** prior to the First Release Date and (ii) all Damages under all pending Notices (as defined below).

(b) Subject to ***Section 2.4***, on the second anniversary of the date of this Agreement (the "***Second Release Date***"), the Escrow Agent shall pay the portion of the Escrow Amount to the Stockholder Representative on behalf of the Former Holders equal to (to the extent a positive number) $3,000,000 (plus all accumulated Earnings) *less* the sum of (i) all Damages (as defined below) paid to Buyer pursuant to ***Section 2.4*** after the First Release Date but prior to the Second Release Date and (ii) all Damages under all pending Notices (as defined below).

(c) Subject to ***Section 2.4***, on the third anniversary of the date of this Agreement (the "***Third Release Date***"), the Escrow Agent shall pay the portion of the Escrow Amount to the Stockholder Representative on behalf of the Former Holders equal to (to the extent a positive number) $3,000,000 (plus all accumulated Earnings) *less* the sum of (i) all Damages (as defined below) paid to Buyer pursuant to ***Section 2.4*** after the Second Release Date but prior to the Third Release Date and (ii) all Damages under all pending Notices (as defined below).

(d) Subject to ***Section 2.4***, on the fourth anniversary of the date of this Agreement (the "***Final Release Date***"), the Escrow Agent shall pay the portion of the Escrow Amount to the Stockholder Representative on behalf of the Former Holders equal to the difference between (i) the remaining Escrow Amount (including all accumulated Earnings) and (ii) the sum of all Damages under all pending Notices.

Section 2.4 ***Damages and Other Disbursements.***

(a) Buyer shall be entitled to recover from the Escrow Amount the amounts necessary to satisfy the indemnification obligations of the Former Holders under Section 10.2 of the Purchase Agreement (the "***Damages***").

(b) If Buyer is entitled to collect Damages from the Escrow Amount, the Escrow Agent shall pay to Buyer a portion of the Escrow Amount equal to the amount of any Damages specified in a certificate signed by the Stockholder Representative and Buyer (the "***Joint Certificate***"), setting forth the appropriate amount of the Escrow Amount to be distributed to Buyer and instructing the Escrow Agent to release the appropriate portion of the Escrow Amount to Buyer. If Buyer provides written notice (a "***Notice***") to the Escrow Agent and the Stockholder Representative, setting forth in reasonable detail the nature and dollar amount of any claim pursuant to which Buyer may be entitled to Damages, the Escrow Agent will hold the amount of the Escrow Amount specified in such Notice until Buyer and the Stockholder Representative deliver a Joint Certificate setting forth the appropriate amount of the Escrow Amount to be distributed to Buyer pursuant to such Notice.

(c) Following the resolution between Buyer and the Stockholder Representative (in accordance with Sections 10.7 and 10.8 of the Purchase Agreement) of the claim for Damages set forth in each Notice that is pending as of the First Release Date, Second Release Date and Third Release Date, the Escrow Agent shall pay to the Stockholder Representative a portion of the Escrow Amount equal to (to the extent a positive number) the amount by which the remaining Escrow Amount as of such date exceeds: (i) $9,000,000 (plus all accumulated Earnings) (if any such resolution is after the First Release Date but before the Second Release Date), (ii) $6,000,000 (plus all accumulated Earnings) (if any such resolution is after the Second Release Date but before the Third Release Date) or (iii) $3,000,000 (plus all accumulated Earnings) (if any such resolution is after the Third Release Date but before the Final Release Date), in each case *less* all Damages under all pending Notices, upon receipt by the Escrow Agent of a Joint Certificate setting forth the appropriate amount of the Escrow Amount to be distributed to the Stockholder Representative and instructing the Escrow Agent to release the appropriate portion of the Escrow Amount to the Stockholder Representative on behalf of the Former Holders.

(d) The Escrow Agent shall pay to the Stockholder Representative a portion of the Escrow Amount determined from time to time after the Final Release Date equal to (to the extent a positive number) the difference between (i) the entire remaining Escrow Amount (including any Earnings thereon) and (ii) the amounts of all claims specified in Notices that were pending as of the Final Release Date and that continue to be unresolved, upon receipt by the Escrow Agent of a Joint Certificate setting forth the appropriate amount of the Escrow Amount to be distributed to the Stockholder Representative and instructing the Escrow Agent to release the appropriate portion of the Escrow Amount to the Stockholder Representative on behalf of the Former Holders. The Escrow Account will be closed upon the distribution of the entire Escrow Amount (including any Earnings thereon) in accordance with this ***Article II***.

Section 2.5 ***Distributions by the Escrow Agent.*** The Escrow Agent shall make distributions of the Escrow Amount pursuant to this ***Article II*** within two Business Days after the Escrow Agent's receipt of the requisite documentation specified in this ***Article II.*** The Escrow Agent shall make all distributions by wire transfer of immediately available funds as specified in the requisite documentation to the Escrow Agent, or in the case of the distributions to the Stockholder Representative, to the account set forth on ***Exhibit A***.

Section 2.6 ***Taxes.*** The Stockholder Representative shall request that the Former Holders report their allocable share of the Earnings as their respective income, for income tax purposes, in the taxable year or years in which such income is properly includible and pay all Taxes attributable thereto. The Escrow

Agent shall report the Earnings as aforesaid on Internal Revenue Service Form 1099 (or any other required Internal Revenue Service forms or tax returns) consistent with such treatment, unless otherwise required by Law, and the Escrow Agent shall withhold income tax from the Earnings to the extent required by Law (and file any required Tax Returns) and deposit such amounts with the appropriate Governmental Authority as required by Law. Promptly following the conclusion of each calendar year, the Escrow Agent shall deliver to the Stockholder Representative and Buyer a written statement of account with respect to any Earnings realized on the Escrow Amount.

ARTICLE III
MATTERS CONCERNING THE ESCROW AGENT

Section 3.1 ***General.*** The Stockholder Representative, on behalf of the Former Holders, and Buyer acknowledge and agree that the Escrow Agent (a) is not responsible for any of the other agreements referred to herein but is obligated only for the performance of such duties as are specifically set forth in this Agreement, (b) will not be obligated to take any legal or other action hereunder that might in its judgment involve expense or liability unless it has been furnished with indemnity acceptable to it, (c) may rely on and will be protected in acting or refraining from acting upon any written notice, instruction, instrument, statement, request or document furnished to it hereunder and believed by it to be genuine and to have been signed or presented by the proper person, and has no responsibility for determining the accuracy thereof and (d) may consult counsel satisfactory to it in respect of any question relating to its duties or responsibilities under this Agreement and shall not be liable for any action taken, suffered or omitted by it in good faith on the reasonable advice of that counsel.

Section 3.2 ***Fees of the Escrow Agent.*** The Escrow Agent is entitled to compensation for performing the duties and obligations imposed under this Agreement in accordance with the fee schedule set forth on ***Exhibit B.*** The Stockholder Representative, on the one hand, and Buyer, on the other hand, shall share equally the fees of the Escrow Agent.

Section 3.3 ***Liability of the Escrow Agent.*** Upon disbursement of the entire Escrow Amount and all of the Earnings thereon in accordance with the terms hereof, the Escrow Agent will be fully and finally released and discharged from any and all duties, obligations and liabilities hereunder. In the

event of a dispute between any of the parties hereto as to their respective rights and interests hereunder, the Escrow Agent will be entitled to hold any and all Escrow Funds then in its possession hereunder until such dispute has been resolved by the parties in dispute and the Escrow Agent has been notified by a Joint Certificate or a decision pursuant to Section 10.8 of the Purchase Agreement. None of the Escrow Agent or any of its directors, officers or employees will be liable to anyone for any action taken or omitted to be taken by it or any of its directors, officers or employees hereunder except in the case of gross negligence, willful misconduct or fraud. The Stockholder Representative and Buyer shall, jointly and severally, indemnify the Escrow Agent and hold it harmless without limitation from and against any loss, liability or expense of any nature incurred by the Escrow Agent arising out of or in connection with this Agreement or with the administration of its duties hereunder, including, without limitation, legal fees and expenses and other costs and expenses of defending or preparing to defend against any claim of liability, unless such loss, liability or expense is caused by the Escrow Agent's gross negligence, willful misconduct or fraud.

Section 3.4 ***Resignation.*** The Escrow Agent may at any time resign as the Escrow Agent hereunder by providing 30 calendar days' prior written notice of resignation to the Stockholder Representative and Buyer. Prior to the effective date of the resignation as specified in such notice, the Stockholder Representative and Buyer shall issue to the Escrow Agent a Joint Certificate authorizing delivery of the Escrow Amount (and any Earnings thereon) to a successor escrow agent. If no successor escrow agent is named prior to the effective date of the resignation, the Escrow Agent may apply to a court of competent jurisdiction for the appointment of a successor escrow agent. After the effective date of the resignation, the Escrow Agent will be under no further obligation to perform any of the duties under this Agreement other than to deliver the Escrow Amount (and any Earnings thereon) and any notices, written communications, or documents received by the Escrow Agent to the successor escrow agent. The provisions of ***Section 3.3*** will survive the resignation of the Escrow Agent.

Section 3.5 ***Removal.*** The Escrow Agent may be removed (with or without cause) and a new escrow agent may be appointed upon the mutual agreement of the Stockholder Representative and Buyer. In such event, the Stockholder Representative and Buyer shall deliver a Joint Certificate to the Escrow Agent notifying the Escrow Agent of such removal together with written instructions authorizing delivery of the Escrow Amount (and any Earnings thereon) to a successor escrow agent. All power, authority, duties and obligations of the Escrow Agent will apply to any successor escrow agent. The provisions of ***Section 3.3*** will survive the removal of the Escrow Agent.

Section 3.6 ***Successors.*** If the bank acting as the Escrow Agent merges or consolidates with another bank or sells or transfers all or substantially all of its assets or trust business, then the successor or resulting bank will be the Escrow Agent hereunder without the necessity of further action or the execution of any document, so long as such successor or resulting bank meets the requirements of a successor escrow agent hereunder.

ARTICLE IV
MISCELLANEOUS

Section 4.1 ***Termination.*** This Agreement will terminate and be of no further force or effect at the close of business on the date on which the Escrow Agent delivers to the Stockholder Representative and/or Buyer, as the case may be, all of the Escrow Funds (and any Earnings thereon) in accordance with the terms of this Agreement.

Section 4.2 ***Entire Agreement.*** This Agreement constitutes the entire agreement of the parties to this Agreement with respect to the subject matter hereof and supersedes all prior agreements and undertakings, both written and oral, with respect to the subject matter hereof.

Section 4.3 ***Notices.*** All notices, requests and other communications to any party hereunder must be in writing (including facsimile) and must be given,

if to the Stockholder Representative, to:

KCP Services, LLC
2550 SOM Center Road, Suite 105
Willoughby Hills, OH 44094-9655
Facsimile: (440) 585-9699
Phone: (440) 585-9010
Attention: Michael T. DeGrandis

with a copy to:

Jones Day
901 Lakeside Ave.
Cleveland, Ohio 44114
Facsimile: (216) 579-0212
Phone: (216) 586-3939
Attention: Charles W. Hardin, Jr.

if to the Escrow Agent, to:

Comerica Bank

_____

_____

Facsimile:
Phone:
Attention:

if to Buyer, to:

Quanex Corporation
1900 West Loop South
Suite 1500
Houston, TX 77027
Attention: Terry M. Murphy
Facsimile: (713) 552-1630
Phone: (713) 877-5307

and

Quanex Corporation
1900 West Loop South
Suite 1500
Houston, TX 77027
Attention: Kevin Delaney
Facsimile: (713) 626-7549
Phone: (713) 877-5349

with a copy to:

Fulbright & Jaworski L.L.P.
1301 McKinney
Suite 5100
Houston, TX 77010-3095
Attention: Harva R. Dockery
Facsimile: (713) 651-5246
Phone: (713) 651-5196

or such other address or facsimile number as such party may hereafter specify for such purpose by written notice to the other party to this Agreement. Each such notice, request or other communication will be effective (a) if given by facsimile transmission, when such facsimile is transmitted to the facsimile number specified in this ***Section 4.3*** or such other facsimile number as such party may hereafter specify in accordance with this ***Section 4.3*** and the appropriate confirmation is received or (b) if given by any other means, when delivered at the address specified in this ***Section 4.3*** or such other address as such party may hereafter specify in accordance with this ***Section 4.3***.

Section 4.4 ***Amendments and Waivers.***

(a) *Writing Required*. Any provision of this Agreement may be amended or waived if, and only if, such amendment or waiver is in writing and signed, in the case of an amendment, by the Stockholder Representative, the Escrow Agent and Buyer or in the case of a waiver, by the party against whom the waiver is to be effective.

(b) *No Implied Waiver.* No failure or delay by any party hereto in exercising any right, power or privilege hereunder shall operate as a waiver thereof nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege.

Section 4.5 ***Successors and Assigns.*** The provisions of this Agreement are binding upon and inure to the benefit of the parties to this Agreement and their respective successors and assigns. Notwithstanding anything to the contrary contained in this Agreement, nothing in this Agreement, expressed or implied, is

intended to confer on any person other than the parties to this Agreement or their respective successors and permitted assigns, any rights, remedies, obligations or liabilities under or by reason of this Agreement.

Section 4.6 ***Certain Interpretive Matters.***

(a) *Certain References.* Unless the context otherwise requires, (i) all references in this Agreement to Articles, Sections or Exhibits are to Articles, Sections or Exhibits of or to this Agreement and (ii) words in the singular include the plural and vice versa. All references to "$" or dollar amounts are to lawful currency of the United States of America.

(b) *Titles and Headings.* Titles and headings to Sections in this Agreement are inserted for convenience of reference only and are not intended to be a part of or to affect the meaning or interpretation of this Agreement. No provision of this Agreement is to be interpreted in favor of, or against, either of the parties to this Agreement by reason of the extent to which any such party or its counsel participated in the drafting thereof or by reason of the extent to which any such provision is inconsistent with any prior draft hereof or thereof.

Section 4.7 ***Governing Law.*** This Agreement is to be construed in accordance with and governed by the internal substantive law of the State of New York regardless of the laws that might otherwise govern under principles of conflict of laws applicable thereto. If Buyer and the Stockholder Representative have any dispute with respect to any Notice delivered by Buyer to the Escrow Agent pursuant to ***Section 2.4***, such dispute will be resolved in accordance with Sections 10.7 and 10.8 of the Purchase Agreement.

Section 4.8 ***Severability.*** If any provision of this Agreement is determined by a Governmental Authority to be invalid, void or unenforceable, the remainder of the provisions of this Agreement will remain in full force and effect and shall in no way be affected, impaired or invalidated.

Section 4.9 ***Counterparts; Effectiveness.*** This Agreement may be signed in any number of counterparts, each of which will be an original, with the same effect as if the signatures thereto and to this Agreement were upon the same instrument. This Agreement will become effective when each party to this Agreement has received counterparts hereof signed by the other party to this Agreement.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, the parties to this Agreement have caused this Agreement to be duly executed by their respective authorized officers as of the day and year first above written.

STOCKHOLDER REPRESENTATIVE:
KCP SERVICES, LLC

By: _____

Name:
Title:

ESCROW AGENT:
COMERICA BANK

By: _____

Name:
Title:

BUYER:
QUANEX CORPORATION

By: _____

Name:
Title:

Exhibit 2.7

AMENDED AND RESTATED

ASSET PURCHASE AND SALE AGREEMENT

Between

North Star Steel Company,

(as "Seller")

And

MACSTEEL Monroe, Inc. (formerly Quanex Two, Inc.)

(as "Buyer")

And

Quanex Corporation

Dated December 23, 2003

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AMENDED AND RESTATED

ASSET PURCHASE AND SALE AGREEMENT

This AMENDED AND RESTATED ASSET PURCHASE AND SALE AGREEMENT is made on the 23rd day of December, 2003, but effective as of the 30th day of September, 2003, by and between North Star Steel Company, a Minnesota corporation (the "Seller"), MACSTEEL Monroe, Inc. (formerly Quanex Two, Inc.), a Delaware corporation (the "Buyer"), and Quanex Corporation, a Delaware corporation ("Quanex").

The Seller, the Buyer and Quanex have executed and delivered that certain Asset Purchase Agreement dated September 30, 2003 (the "Original Agreement") and wish to amend and restate the Original Agreement to change certain provisions of the Original Agreement, as set forth herein. The Original Agreement is hereby amended and restated as follows in its entirety:

WITNESSETH:

WHEREAS, the Buyer desires to purchase from the Seller and the Seller desires to sell to the Buyer substantially all of the assets constituting the Business (as defined below), and the Buyer is willing to assume certain obligations of the Seller relating to the Business, all on the terms and conditions set forth in this Agreement.

WHEREAS, the Buyer is a wholly owned subsidiary of Quanex;

NOW, THEREFORE, in consideration of the foregoing and the mutual warranties, representations, covenants and agreements contained in the Agreement, the Seller and the Buyer and Quanex (the Buyer and Quanex collectively the "Buying Parties") agree as follows:

ARTICLE 1

DEFINITIONS

Certain capitalized terms used in this Agreement have the meanings set forth below.

"*Accounts Payable*" shall mean all trade payables and accrued expenses of the Seller which are payable as a result of goods sold to, or services provided for or to, the Seller as a part of the Business, excluding any Taxes payable, and excluding any accrued expenses for which the Seller retains the corresponding liability pursuant to the terms of this Agreement, and amounts due by the Seller to its affiliates for short-term intercompany borrowings.

"*Accounts Receivable*" shall mean all trade receivables of the Seller, which in any case are payable as a result of goods sold or services provided by the Seller as a part of the Business, excluding any Tax refunds or credits.

"*Acquisition Proposal*" has the meaning set forth in Section 7.11.

"*Affected Employees*" shall mean, as of any determination date, all employees of the Seller principally employed at the Business facility located in Monroe, Michigan (including Persons on vacation, temporary layoff, approved leave of absence, sick leave, family medical leave under the Family and Medical Leave Act, or short-term disability leave; and excluding Persons on long-term disability leave under a long-term disability plan maintained by the Seller or any Affiliate of the Seller) as of such date, plus other employees of the Seller as mutually agreed by the parties in writing.

"*Affiliate*" shall mean, with respect to any specified Person, any other Person who, directly or indirectly, owns or controls, is under common ownership or control with, or is owned or controlled by, the specified Person. Without limiting the generality of the foregoing, a Person shall be deemed to "own" another Person if it owns, directly or indirectly, more than 50% of the capital stock or other

equity interest of the other Person generally entitled to vote, without regard to specified contingencies, for the election of directors or equivalent governing body of such other Person.

"*Agreement*" shall mean this Asset Purchase and Sale Agreement, including all exhibits and schedules to this Agreement, as it may be amended from time to time in accordance with its terms.

"*Air Compliance Matters*" shall mean compliance or alleged noncompliance by the Seller with the Federal Clean Air Act, 42 U.S.C. § 7401 et seq., as amended prior to the Closing Date, the regulations promulgated thereunder or any analogous Michigan law or regulation with regard to air quality, air monitoring,

air emissions or air permitting.

"*Ancillary Agreements*" shall mean the Assignment and Assumption Agreement, the Bill of Sale, the Trademark License Agreement, the Escrow Agreement, the Conveyance Documents, the Transition Services Agreement, the Licensed Intellectual Property Agreement and all other documents to be delivered pursuant to the terms of this Agreement or the terms of any of the aforementioned agreements.

"*Assigned Contracts*" has the meaning set forth in Section 2.1(j).

"*Assignment and Assumption Agreement*" shall mean the Assignment and Assumption Agreement to be executed by the Seller and the Buyer on the Closing Date, substantially in the form of Exhibit A.

"*Assumed Obligations*" has the meaning set forth in Section 2.4.

"*Audited Financial Statements*" shall mean the audited balance sheets of the Business as of May 31, 2001, 2002 and 2003, and the related statements of income and cash flow as of the periods ending on those dates.

"*Baseline Working Capital Amount*" shall mean an amount equal to $45,502,127, which is the amount of the Working Capital of the Business as of February 28, 2003, as more particularly calculated on Schedule 3.2(a).

"*BEA*" has the meaning set forth in Section 7.12(a).

"*BEA Affirmation*" has the meaning set forth in Section 7.12(c).

"*BEA Consultant*" has the meaning set forth in Section 7.12(a).

"*BEA Petition*" has the meaning set forth in Section 7.12(c).

"*Bill of Sale*" shall mean the Bill of Sale to be executed and delivered by the Seller on the Closing Date, substantially in the form of Exhibit B.

"*Books and Records*" has the meaning set forth in Section 2.1(i).

"*Business*" shall mean the steel products business as presently conducted by the Seller at its facility located at 3000 East Front Street, Monroe, Michigan.

"*Business Day*" shall mean any day of the year other than (a) any Saturday or Sunday; or (b) any other day on which banks located in New York, New York are generally closed for business.

"*Business Financial Statements*" shall mean the balance sheet of the Business as of February 28, 2003, and the related income statement for the Business for the nine-month period ended February 28, 2003.

"*Buyer*" has the meaning set forth in the preamble to this Agreement.

"*Buyer Group*" has the meaning set forth in Section 13.2(a).

"*Buyer's Basket*" has the meaning set forth in Section 13.3(b).

"*Buyer's Maximum Indemnity Amount*" has the meaning set forth in Section 13.3(b).

"*Buying Parties*" has the meaning set forth in the recitals to this Agreement.

"*Closing*" shall mean the consummation of the transactions described in this Agreement in accordance with Article XI.

"*Closing Date*" shall mean December 31, 2003.

"*COBRA*" shall mean the Consolidated Omnibus Budget Reconciliation Act of 1985.

"*Code*" shall mean the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

"*Confidentiality Agreement*" shall mean the Confidentiality Agreement dated as of September 6, 2002 between the Buyer and the Seller.

"*Consent*" has the meaning set forth in Section 4.3.

"*Contract*" shall mean any contract, lease, easement, license, sales order, purchase order, supply agreement, or any other agreement, commitment or understanding whether oral or written, other than Permits and Seller Benefit Plans.

"*Conveyance Documents*" shall mean the Assignment and Assumption Agreement, the Bill of Sale, the Special Warranty Deed and other instruments of transfer reasonably requested by the Buyer to evidence the transfer of the Purchased Assets.

"*DEQ*" has the meaning set forth in Section 7.12(b)

"*Direct Claim*" has the meaning set forth in Section 13.8.

"*Dollars*" or numbers preceded by the symbol "$" shall mean amounts in United States Dollars.

"*Effective Time*" shall mean midnight, Eastern Standard Time, on the evening of December 31, 2003.

"*Encumbrance*" shall mean any charge, claim, community or other marital property interest, condition, equitable interest, lien, option, pledge, security interest, mortgage, judgment, attachment, restriction on transfer, right of way, easement, encroachment, servitudes, right of first option, right of first refusal, or similar restriction or encumbrance.

"*Environmental Audits*" means those environmental reports set forth on Schedule 4.15.

"*Environmental Laws*" shall mean Laws (including common law) in effect as of the Closing Date relating to pollution or protection of the environment (including air, water or land), including such Laws relating to (a) protection of human health from any Hazardous Substance; (b) the generation, handling, treatment, storage, disposal or transportation of any Hazardous Substance; or (c) the regulation of or liability for emissions into the environment, or cleanup of or exposure to any Hazardous Substance; provided, however, that Environmental Laws shall not include the federal Occupational Safety & Health Act, regulations promulgated thereunder or analogous Michigan law or regulation unless incorporated into what otherwise would be defined hereunder as an "Environmental Law."

"*Environmental Losses*" has the meaning set forth in Section 13.10.

"*Environmental Permits*" shall mean all permits authorizations, licenses, certificates, variances, consents, interim permits, approvals and rights under any Environmental Laws which are required by Environmental Laws for the Seller to engage in the Business as currently conducted.

"*ERISA*" shall mean the Employee Retirement Income Security Act of 1974, as amended.

"*ERISA Affiliate*" means the Seller and all other trades or businesses, whether or not incorporated, which together with the Seller would be deemed a "single employer" within the meaning of Section 414(b), (c) or (m) of the Code.

"*Escrow Agent*" means Comerica Bank.

"*Escrow Agreement*" shall mean the Escrow Agreement to be executed by the Parties and Comerica Bank on the Closing Date, substantially in the form of Exhibit C.

"*Excluded Assets*" has the meaning set forth in Section 2.3.

"*Excluded Businesses*" shall mean all the businesses performed or conducted by the Seller and its Affiliates except for the Business.

"*Excluded Obligations*" has the meaning set forth in Section 2.5.

"*Existing Contamination*" shall mean the release of a Hazardous Substance or the potential release of a discarded Hazardous Substance at or from the Owned Real Property on or prior to the Closing Date in a quantity which is or may become injurious to the environment or to the public health, safety or welfare.

"*Existing Contamination Obligations*" has the meaning set forth in Section 2.5(g).

"*Final Statement*" has the meaning set forth in Section 3.2(b).

"*GAAP*" shall mean generally accepted accounting principles in the United States applied in a consistent manner throughout the periods specified.

"*Governmental Authority*" shall mean the government of the United States, any foreign country or any state, provincial, local or other political subdivision of the United States or any foreign country, and any entity, body or authority exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government.

"*Hazardous Substances*" shall mean (a) any substance or material that (i) is listed, defined or otherwise designated as a "hazardous substance" under Section 101(14) of the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. § 9601 *et seq*., (ii) constitutes a "hazardous substance" as defined by 1994 PA 451, MCL 324.20101, as amended, "hazardous waste" as defined by the Resource Conservation and Recovery Act, as amended, or "hazardous material", "hazardous chemical", "toxic air contaminant", or "regulated substance" within the meaning of any applicable Environmental Law, or (iii) is otherwise regulated or controlled by or that otherwise gives rise to environmental liability under any applicable Environmental Law; (b) any substance that contains petroleum or any petroleum product; (c) any radiation or radioactive material; and (d) any substance that contains urea formaldehyde, asbestos or polychlorinated biphenyls.

"*HSR Act*" shall mean the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

"*Indemnified Person*" shall mean the Person entitled to, or claiming a right to, indemnification under Article XIII.

"*Indemnifying Person*" shall mean the Person claimed by the Indemnified Person to be obligated under Article XIII.

"*Independent Accounting Firm*" has the meaning set forth in Section 3.2(b).

"*Intellectual Property*" shall mean intellectual property of every kind and nature, including all inventions, information, data, samples, formulae, specifications, plans, drawings, blueprints, compositions, processes, designs, technology, know-how, confidential information and trade secrets (whether or not patentable or reduced to practice), confidential or proprietary technical and business information, computer software, domain names, United States and foreign patents and petty patents

(including continuations, continuations-in-part, divisions, reissues, re-examinations, extensions and renewals), patent applications, registered and unregistered trade names, brand names, trademarks, service names, service marks, logos and designs (and applications for registration of the same), goodwill symbolized or associated with any of them, copyrights and copyright registrations (and applications for the same), extensions, renewals, United States and foreign registrations and applications to register copyrights, technical manuals and documentation made or used in connection with any of the foregoing.

"*Inventory*" has the meaning set forth in Section 2.1 (c).

"*Knowledge*" shall mean the actual knowledge of the applicable Knowledge Party, after reasonable inquiry regarding the matter, including the Knowledge Party's discussions with appropriate employees of the Seller or of the Buying Parties (as applicable).

"*Knowledge Party*", with respect to a particular section of this Agreement, shall mean the Person or Persons whose names are set forth beside the designation of that section below:

Section 4.6(b)	Steve Filips, Terry Forrest and Mike Roper
Section 4.8(f)	Terry Forrest
Section 4.9	Steve Filips, Terry Forrest, Mike Roper, Michael Salamon and Jim Thompson
Section 4.11(b)	Steve Filips, Terry Forrest, Mike Roper, Michael Salamon and Jim Thompson
Section 4.12(b)	Steve Filips, Mike Roper and Chuck Stanley
Section 4.14	Robert Cryderman, Steve Filips and Mike Roper
Section 4.15	Chris Avent, Steve Filips, Terry Forrest, Dennis Garbig, Mike Roper and Jim Thompson
Section 4.20	Terry Forrest
Section 4.21	Steve Filips, Terry Forrest, Mike Roper, Michael Salamon, Chuck Stanley and Jim Thompson
Section 4.23(a)	Steve Filips, Terry Forrest, Mike Roper and Jim Thompson
Section 4.25	Terry Forrest and Jim Thompson
Section 5.3	Raymond A. Jean and Terry Murphy
Section 5.5	Raymond A. Jean and Terry Murphy
Section 6.3	Steve Filips, Terry Forrest, Mike Roper, Michael Salamon and Jim Thompson

"*Law*" shall mean, any law, statute, code, regulation, ordinance, or rule enacted or promulgated by any Governmental Authority.

"*Licensed Intellectual Property*" shall mean all Intellectual Property owned by the Seller and used in the Business, other than Transferred Intellectual Property.

"*Licensed Intellectual Property Agreement*" shall mean the Licensed Intellectual Property Agreement to be executed by the Seller and the Buyer substantially in the form of Exhibit D.

"*Litigation*" has the meaning set forth in Section 4.9.

"*Loss*" or "*Losses*" shall mean any and all damages, losses, actions, proceedings, causes of action, liabilities, claims, encumbrances, penalties, assessments, judgments, costs and expenses, including removal or remediation costs, other environmental investigation or cleanup costs, sales credits, court costs, costs of litigation, reasonable attorneys' and consultants' fees and direct fixed overhead, costs (including labor costs) associated with any facility shutdown, but shall not include any consequential (including lost profits), indirect, special, exemplary, punitive or incidental damages (except with respect to damages actually awarded to a Third Party in an action brought against a Buyer Indemnitee).

"*Material Adverse Effect*" shall mean any event, circumstance, change or effect that has a material and adverse effect on the operational or financial condition of the Business, taken as a whole, but specifically excluding an effect resulting from (a) general, financial, economic or industry conditions also affecting other similarly situated Persons; or (b) business changes due to the announcement of an impending sale of the Business to the Buyer.

"*Material Contract*" has the meaning set forth in Section 4.11(a).

"*Owned Real Property*" shall mean the real property described on Schedule 2.1(d).

"*Parties*" shall mean the Seller and the Buying Parties.

"*Permits*" shall mean permits, tariffs, authorizations, licenses, certificates, variances, consents, interim permits, approvals, franchises and rights under any Law or otherwise issued or required by any Governmental Authority which are required by Law for the Seller to engage in the Business as currently conducted.

"*Permitted Encumbrances*" shall mean (a) mechanics', carriers', workmen's, repairmen's or other like liens arising or incurred in the ordinary course of business, which have not yet become due and payable; (b) liens for Taxes, assessments and other governmental charges (i) which are not due and payable, (ii) which may hereafter be paid without penalty or (iii) which are being contested in good faith by appropriate proceedings and are listed on Schedule 4.6(b); and (c) those Encumbrances listed on Schedule 4.6(b).

"*Person*" shall mean any individual, corporation, business trust, proprietorship, firm, partnership, limited partnership, limited liability partnership, limited liability company, trust, association, joint venture, Governmental Authority or other entity.

"*Product Liability*" shall mean liability or obligations to Third Parties arising from the manufacture or sale of goods which (a) are defective and cause personal injury, death, or property damage (other than damage to the goods themselves) or (b) result from any product recall by a Person other than (i) a direct customer of the Business or an Affiliate of such a direct customer (in the case of customers who are not service or distribution centers) or (ii) a direct customer of a service or distribution center (or an Affiliate of such a direct customer) that is a direct customer of the Business. For purposes of this definition, a product recall means a call by a manufacturer for the return of a product that may be defective or contaminated.

"*Product Warranty Obligations*" has the meaning set forth in Section 2.4(c).

"*Purchase Price*" has the meaning set forth in Section 3.1.

"*Purchased Assets*" has the meaning set forth in Section 2.1.

"*Quanex*" has the meaning set forth in the preamble to this Agreement.

"*Scheduled Environmental Compliance Matters*" shall mean any violation or alleged violation of any applicable Environmental Law by the Seller in connection with the Business as of or prior to the Closing Date identified as such on Schedule 4.15 hereto.

"*Seller*" has the meaning set forth in the preamble to this Agreement.

"*Seller Benefit Plan*" shall mean (a) any employee welfare benefit plan or employee pension benefit plan as defined in sections 3(1) and 3(2) of ERISA, including a plan that provides retirement income or results in deferrals of income by employees for periods extending to their terminations of employment or beyond, and a plan that provides medical, surgical or hospital care benefits or benefits in the event of sickness, accident, disability, death or unemployment and (b) any other material employee benefit agreement or arrangement that is not an ERISA plan, including any deferred compensation plan, incentive plan, bonus plan or arrangement, stock option plan, stock purchase plan, stock award plan, golden parachute agreement, severance pay plan, dependent care plan, cafeteria plan, employee assistance program, scholarship program, employment contract, retention incentive agreement, noncompetition agreement, consulting agreement, confidentiality agreement, vacation policy, or other similar plan, agreement or arrangement (i) that is maintained by the Seller or any of its Affiliates for the benefit of Affected Employees, (ii) has been approved by the Seller or any of its Affiliates but is not yet effective for the benefit of Affected Employees or their beneficiaries, or (iii) that was previously maintained by the Seller or any of its Affilaites for the benefit of the Affected Employees or their beneficiaries and with respect to which Seller or any of its Affilaites may have any liability, contingent or otherwise.

"*Seller's Basket*" has the meaning set forth in Section 13.2(b).

"*Seller Group*" has the meaning set forth in Section 13.3(a).

"*Seller Intellectual Property*" shall mean Licensed Intellectual Property and Transferred Intellectual Property of the Seller.

"*Seller's Maximum Indemnity Amount*" has the meaning set forth in Section 13.2(b).

"*Severance Period*" has the meaning set forth in Section 10.2.

"*SOW*" has the meaning set forth in Section 13.10.

"*SPCC/PIPP*" has the meaning set forth in Section 7.12(d).

"*Special Warranty Deed*" shall mean the Special Warranty Deed to be executed by the Seller, substantially in the form of Exhibit E.

"*Statement of Working Capital*" has the meaning set forth in Section 3.2(a).

"*Tangible Assets*" has the meaning set forth in Section 2.1(a).

"*Tax*" (and, with correlative meaning, "*Taxes*" and "*Taxable*") shall mean any federal, state, provincial, county, local or foreign taxes, charges, fees, duties (including customs duties), levies or other assessments, including income, gross receipts, net proceeds, ad valorem, turnover, real and personal property (tangible and intangible), sales, gains, use, franchise, excise, value added, alternative, add-on minimum, stamp, leasing, lease, user, transfer, fuel, excess profits, occupational, interest equalization, windfall profits, license, payroll, environmental, capital stock, disability, severance, employee's income withholding, other withholding, unemployment and Social Security taxes, which are imposed by any Governmental Authority, and such term shall include any interest, penalties,

fines or additions to tax attributable to or associated with any of the foregoing (whether or not disputed), and any transferee or successor liability in respect of Taxes (whether by contract or otherwise).

"*Tax Return*" shall mean any report, return, statement, notice, form, declaration, claim for refund or other document or information filed, submitted to, or required to be supplied to a Governmental Authority in connection with the determination, assessment, collection or payment of any Tax, including any schedule or attachment to or amendment of any of the foregoing.

"*Third Party*" shall mean a Person other than the Seller, a Buying Party or any Affiliate of the Seller or a Buying Party.

"*Third Party Claim*" shall mean any claim, action, suit or proceeding made or brought by a Third Party.

"*Trademark License Agreement*" means the Trademark License Agreement executed by the Seller and the Buyer, substantially in the form of Exhibit F.

"*Transferred Employee*" has the meaning set forth in Section 10.1.

"*Transferred Intellectual Property*" has the meaning set forth in Section 2.1(e).

"*Transition Services Agreement*" means the Transition Services Agreement between the Seller and the Buyer, substantially in the form of Exhibit G.

"*Vacation Amount*" has the meaning set forth in Section 10.3.

"*Working Capital*" has the meaning set forth in Section 3.2(a).

ARTICLE 2

SALE AND PURCHASE OF PURCHASED ASSETS; ASSUMPTION OF ASSUMED OBLIGATIONS

2.1 *Purchased Assets.* Subject to the other conditions and provisions of this Agreement and on the terms set forth in this Agreement, on the Closing Date, but effective as of the Effective Time, the Seller shall sell, assign, convey, transfer and deliver to the Buyer, and the Buyer shall purchase, acquire and take assignment and delivery of all of the right, title and interest of the Seller in and to the assets, properties and rights described in Sections 2.1(a) through 2.1(m) below (but specifically excluding the Excluded Assets):

(a) *Tangible Assets.* The tangible personal property set forth on Schedule 2.1(a) and any replacements of that property acquired prior to the Effective Time, and all other tangible personal property of every kind and description that is used primarily in the operation of the Business, including, without limitation, all buildings, structures, improvements, plants, facilities, fixtures, machinery, equipment, fixed assets, furniture, tools, dies, automobiles, trucks, loaders, vehicles and other rolling stock, maintenance equipment and materials (collectively, the "Tangible Assets");

(b) *Data Processing Hardware and Software.* The data processing hardware and software listed on Schedule 2.1(b) and all other data processing hardware and software necessary for the operation of the Business (but excluding the hardware and software described in Section 2.3(j));

(c) *Inventory.* All supplies, materials (including raw materials), work-in-progress, semi-finished goods, finished goods, components, stores, goods in transit, spare parts, packaging materials, and other inventories used in the operation of the Business and other consumables used in the Business, packaging, spare parts and equipment warehoused and consigned inventories and inventories covered by purchase orders or held by distributors as of the Effective Time, (collectively, the "Inventory");

(d) *Owned Real Property.* The Owned Real Property, including all appurtenant easements related to the Owned Real Property and except to the extent set forth in Schedule 4.6(b), all buildings, structures, improvements, plants, facilities, and fixtures located on the Owned Real Property;

(e) *Intangibles.* All Intellectual Property owned by the Seller and used exclusively in the Business (the "Transferred Intellectual Property"), including the Intellectual Property listed on Schedule 2.1(e) and all goodwill and going concern value, if any, relating to the Business;

(f) *Other Current Assets.* All prepaid expenses, credits, deposits, letters of credit supporting or in lieu of deposits, claims, prepayments, refunds, rebates, warranties, choses-in-action, accounts, rights to payment, existing and future instruments, chattel paper, documents of title, commodity contracts, and other similar items to the extent they relate to or are associated exclusively with the Business;

(g) *Permits.* All Permits and permit applications pertaining to the Business that are legally capable of being transferred;

(h) *Accounts Receivable.* All Accounts Receivable as of the Effective Time;

(i) *Books and Records.* Copies or originals of all records (whether in hard copy or electronic format) related exclusively to the operation of the Business, wherever located, and all records to the extent related to the Business which are located on the Owned Real Property, including specifications, service records, plans and designs of fixtures and equipment, monitoring and testing records, customer lists and files, customer and supplier records, production records, quality control analysis, sales and warranty records, operating guides and manuals, financial and accounting records, studies, reports, correspondence and other similar documents and records ("Books and Records");

(j) *Assigned Contracts.* All Contracts for the purchase, sale, lease or license by the Seller of Inventory, Tangible Assets, Intellectual Property, data processing hardware or software, or other goods, materials or services and all other Contracts which relate exclusively to the Business and to which the Seller is a party including those which are listed on Schedule 2.1(j) (collectively, the "Assigned Contracts");

(k) *Certain Warranty and Indemnification Rights.* Express or implied warranties from the Seller's suppliers related to the Purchased Assets and all rights of the Seller to indemnification with respect to any of the Purchased Assets;

(l) *Licensed Intellectual Property.* A royalty-free, fully paid, non-exclusive, perpetual license to use the Licensed Intellectual Property, as more fully set forth in the Licensed Intellectual Property Agreement; and

(m) *Other Assets.* All other assets owned by the Seller as of the Effective Time and relating exclusively to the Business, wherever located, even if not named or described on a schedule to this Agreement or the Business Financial Statements, including goodwill, supplies, contract rights and other tangible assets.

All of the foregoing assets described in this Section 2.1 (excluding the Excluded Assets) are referred to collectively as the "Purchased Assets."

2.2 *Procedures for Assets Not Transferable.* The Buying Parties acknowledge that the Seller's ability to assign its rights under the Permits and under the Contracts included within the Purchased Assets may be subject to receipt of Consent from other Persons. The Parties shall cooperate to obtain those Consents as soon as possible after the date of this Agreement. To the extent that any Consent is required, this Agreement and the Assignment and Assumption Agreement shall not constitute an agreement to assign a Permit or a Contract or to assume the obligations under a Permit or a Contract if an attempted assignment would constitute a breach of the Permit or Contract. If any Permit or Contract cannot be transferred without the Consent of a Third Party, and the Parties are unable to obtain that Consent prior to the Effective Time, the Seller shall use commercially reasonable efforts to provide the Buyer the benefit of any such Contract or Permit including the right to elect to terminate in accordance with its terms on the advice of the Buyer (to the extent legally permissible) and to cooperate in any commercially reasonable and lawful arrangement designed to provide the benefit to the Buyer; provided, however, that in no event shall the Seller's obligation to provide the benefit of any

Contract or Permit extend beyond the 90th day following the Closing Date. The Seller shall cooperate with the Buyer to obtain any Consents for the transfer of Contracts or Permits after the Closing, to the extent that those Consents could not be obtained before the Closing.

2.3 *Excluded Assets.* The Seller shall not sell to the Buyer, and the Buyer shall not purchase any assets of the Seller other than the Purchased Assets pursuant to this Agreement (the "Excluded Assets"), including the assets described in Sections 2.3(a) through 2.3(m) below:

(a) *Cash.* All cash and marketable securities;

(b) *Employee Plans and Assets.* All Seller Benefit Plans and all assets of any Seller Benefit Plans;

(c) *Intellectual Property.* All Licensed Intellectual Property except to the extent granted by the Licensed Intellectual Property Agreement;

(d) *Insurance Policies.* All insurance policies maintained by the Seller, and all rights to receive payment thereunder;

(e) *Records.* Employee medical records and other personnel records expressly described in the last sentence of Section 10.7, corporate accounting, legal files and other privileged documents, records which relate to the Excluded Assets, Tax Returns (including all related schedules, records, files and other documents and all other records required by applicable Law to be maintained to support such Tax Returns), strategy studies, corporate internal communication and information received from third parties on a confidential basis that such third parties have not consented to disclose to the Buyer;

(f) *Non-Transferable Contracts and Permits.* The rights of the Seller under legally non-transferable Contracts or Permits applicable to the Business;

(g) *Excluded Business.* Except as otherwise expressly assigned to the Buyer, all assets used primarily in the Excluded Businesses, including the scrap metal recycling business of the Seller and its North Star Recycling Company subsidiary;

(h) *Hedge Positions.* The rights of the Seller under any hedge or swap position relating to the Business;

(i) *Electrodes Antitrust Claims.* Any claims of the Seller against suppliers of graphite electrodes regarding alleged antitrust law violations by such suppliers, and any amounts that may become payable to the Seller as a result of such claims;

(j) *Certain Compute Software and Hardware.* All rights of the Seller in the following: "Xpedio" software; "Cargill Steel Direct" Extranet software; IMS sales system software; Cargill Global Office software; JD Edwards Accounting system software; "TIBCO" integration software; Fixed Asset Accounting Software; Cargill Benefits HRIC Software; Lotus Notes Client Licenses; E-Invoicing Software; Oracle database software on NSS shared servers licensed by Seller; and certain hardware (including routers) with respect to such software;

(k) *Rights in Litigation.* All rights of the Seller in or resulting from the Litigation described in Schedule 4.9 or 4.12(b) or any other Litigation brought by the Seller or pending or threatened against the Seller as of the Closing Date;

(l) *Derivative Contracts.* Any derivative or hedging Contracts relating to the Business; and

(m) *Scrapped Finished Goods.* Any scrapped finished goods not reflected in the Business Financial Statements.

2.4 *Assumed Obligations.* Subject to the other conditions and provisions of this Agreement and on the terms set forth in this Agreement, on the Closing Date but effective as of the Effective Time, the Buyer shall assume, and agree to discharge, the following obligations of the Seller, (but specifically excluding the Excluded Obligations) (the "Assumed Obligations"). The Buyer shall not assume, and the Buying Parties shall have no obligation with respect to any obligation or liability of the Seller that is not specifically assumed pursuant to this Section 2.4.

(a) *Contract Obligations.* The obligations of the Seller under the Assigned Contracts;

(b) *Accounts Payable.* All Accounts Payable attributable to the Business and held by the Seller as of the Effective Time;

(c) *Product Warranties.* Subject to the provisions of Section 7.13, all warranty obligations to rework, repair, repurchase or replace products produced by the Seller in connection with the Business with respect to products that are either in process at the Effective Time or produced by the Seller before the Effective Time and returned by the purchasers thereof after the Effective Time, including amounts payable in commercial settlements regarding product that was not produced in accordance with specifications or that did not meet quality standards (but only up to the amount of the value of the product) and incidental out-of-pocket costs associated with shipping and handling the rework, repair, repurchase and replacement of such products, but excluding any obligations with respect to Product Liability ("Product Warranty Obligations");

(d) *Sales Tax Obligations.* Sales tax obligations with respect to the Accounts Receivable transferred to the Buyer under Section 2.1(h); and

(e) *Other Liabilities.* All other liabilities and obligations of the Seller, known or unknown, to the extent they relate to the Seller's ownership or use of the Purchased Assets before the Effective Time or the conduct of the Business before the Effective Time.

Notwithstanding the foregoing, nothing contained in this Section 2.4 shall affect in any manner the Seller's obligations under Section 13.2.

2.5 *Excluded Obligations.* The Buyer shall not assume and the Buying Parties shall have no obligation with respect to the following obligations, "Excluded Obligations," which shall be retained by the Seller or the other Persons liable for such obligations:

(a) *Excluded Assets.* Any liabilities or obligations relating to the Excluded Assets;

(b) *Tax Matters.* Any liability or obligation for any Tax of the Seller including any Tax liability or obligation (i) with respect to the Seller's business operations prior to the Effective Time (other than for sales tax accrued and not past due as of the Effective Time), (ii) with respect to the ownership, possession, purchase, lease, sale, disposition, use or operation of the Business or the Purchased Assets prior to the Effective Time; (iii) with respect to Taxes of any Third Party for which the Seller is or may be liable as a transferee or successor, by contract, or otherwise, it being understood and agreed that any sales tax obligation with respect to any Accounts Receivable transferred to the Buyer under this Agreement shall be assumed by the Buyer;

(c) *Employees and the Seller Benefit Plans.* All obligations with respect to the employment of the Affected Employees by the Seller or its Affiliates prior to the Effective Time or the cessation of such employment prior to the Effective Time (including unfair labor practice charges, employment discrimination charges, wrongful termination claims, workers' compensation claims, and any employment-related tort claims); and any Seller Benefit Plan or other benefit liabilities of the Seller or its Affiliates;

(d) *Fees and Expenses.* Fees and expenses incurred by the Seller or any Affiliate of the Seller in connection with the negotiation, execution, performance and delivery of this Agreement

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and the transactions described in the Agreement, including the fees and expenses of counsel, investment bankers, and brokers or finders fees;

(e) *Certain Payables.* Amounts reflected on the Seller's books and records as of the Effective Time as payables by the Seller to any stockholder, officer, director or Affiliate of the Seller (other than trade payables incurred in the ordinary course of the Business);

(f) *Litigation.* The Litigation described on Schedule 4.9 or 4.12(b) or any other Litigation pending against the Seller as of the Closing Date; and

(g) *Existing Contamination.* Liabilities or obligations arising out of Existing Contamination ("Existing Contamination Obligations").

Notwithstanding the foregoing, nothing contained in this Section 2.5 shall affect in any manner the limitations and conditions on the Seller's obligations set forth in Sections 7.13, 13.1, 13.2 and 13.10.

ARTICLE 3

PURCHASE PRICE AND PAYMENT

3.1 *Payment of Purchase Price.* On the Closing Date, in consideration for the sale, assignment, conveyance, transfer and delivery of the Purchased Assets to the Buyer pursuant to the terms of this Agreement, the Buyer shall assume the Assumed Obligations and shall pay to the Seller an aggregate amount equal to One Hundred Fifteen Million Dollars ($115,000,000) (the "Purchase Price"), subject to adjustment as provided in Section 3.2. The Purchase Price shall be paid as follows: (a) to the Seller, $113,000,000 by wire transfer of immediately available funds to such accounts of the Seller designated by the Seller in writing at least two (2) Business Days prior to the Closing Date; and (b) to the Escrow Agent, $2,000,000 pursuant to the Escrow Agreement, to cover certain post-closing contingencies as more particularly set forth in the Escrow Agreement.

3.2 *Purchase Price Adjustment.*

(a) As soon as practicable, but in no event later than 60 days after the Closing Date, the Seller shall provide the Buyer with a statement of Working Capital of the Business as of the Closing Date (the "Statement of Working Capital") setting forth a true, correct and complete listing of each of the components making up the Working Capital and setting forth in reasonable detail the calculation of the Working Capital as of the Closing Date. The Statement of Working Capital shall be based on a balance sheet of the Business as of the Effective Time prepared by the Seller in accordance with GAAP using the same methodology as was used to prepare the Business Financial Statements and the Baseline Working Capital Amount without regard to any effects of the transactions related to the Closing. The Buyer and its independent auditors and other representatives shall have the right to review and to verify the Statement of Working Capital when received and the Seller shall provide the Buyer with access to all related working papers. For purposes of this Agreement, the term "Working Capital" consists of the following items relating to the Business: (i) Accounts Receivable net of reserves; *plus* (ii) Inventory; minus (iii) Accounts Payable; minus (iv) all other Current Liabilities assumed by the Buyer. The calculation of the Baseline Working Capital Amount is set forth on Schedule 3.2(a).

(b) The Buyer shall have 30 days following receipt by it of the Statement of Working Capital during which to dispute the Statement of Working Capital. The Buyer shall notify the Seller of any dispute by delivering written notice to the Seller, which shall specifically describe each line item of the Statement of Working Capital in dispute and the reasons for the dispute. If the Buyer fails to notify the Seller in writing of any such dispute within that 30 day period, the Statement of Working Capital shall be final and binding on both the Buyer and the Seller and shall be the "Final Statement". If the Buyer timely notifies the Seller of a dispute, and the Seller and the Buyer

cannot resolve the dispute within 20 days after receipt by the Seller of the notice, the dispute shall be resolved by an independent accounting firm agreed to by the Seller and the Buyer (the "Independent Accounting Firm"). The Seller and the Buyer shall cause the Independent Accounting Firm to make its determination as promptly as practicable and in any event within 45 days after the submission of the dispute to the Independent Accounting Firm. The determination of the Independent Accounting Firm shall be final and binding on both the Buyer and the Seller. Any expenses relating to engagement of the Independent Accounting Firm shall be shared equally by the Buyer and the Seller. In the event of a dispute, the Statement of Working Capital, as modified in writing by the Buyer and the Seller, or by the Independent Accounting Firm, shall be the "Final Statement".

(c) If the Working Capital, as set forth in the Final Statement exceeds the Baseline Working Capital Amount, then the Purchase Price shall be increased by that excess, and the Buyer shall pay to the Seller an amount equal to the excess. If the Working Capital, as set forth in the Final Statement, is less than the Baseline Working Capital Amount, then the Purchase Price shall be decreased by that deficit, and the Seller shall pay to the Buyer an amount equal to the deficit.

(d) Any payments to be made by the Buyer or the Seller, as the case may be, pursuant to Section 3.2(c) shall be made by wire transfer in immediately available funds within five (5) Business Days after the date on which the Statement of Working Capital becomes the Final Statement (either upon expiration of the 30 day period referred to in Section 3.2(b) or resolution of any dispute with respect to the Statement of Working Capital), in an amount determined pursuant to Section 3.2(c), together with interest on that amount from the Closing Date through the date the payment is made at the average prime lending rate for the 30 day period prior to the date of the payment as announced by Citibank, N.A.

3.3 *Allocation of Purchase Price.* The Purchase Price and the Assumed Obligations shall be allocated among the Purchased Assets as set forth on Schedule 3.3 for all Tax purposes. This allocation shall be appropriately adjusted, no later than 30 days following the date on which the Statement of Working Capital becomes the Final Statement, to reflect any increase or decrease in the Purchase Price under Section 3.2. Each of the Parties shall file IRS Form 8594 with its applicable federal income tax return (or the federal income tax return of the consolidated group of which the Party is a member) as required by Law. Each of the Seller and the Buyer shall provide the other with such assistance as is reasonably necessary to satisfy its reporting obligations under section 1060 of the Code, including as a result of adjustments to the Purchase Price under Section 3.2. If either the Buyer or the Seller receives a notice from a Governmental Authority disputing its allocation, the Party receiving the notice shall promptly notify the other Parties and shall forward to the other Party copies of all correspondence with the Governmental Authority in respect of the disputed allocation.

3.4 *Prorations as of the Closing Date.* Prior to the Closing Date, the Seller and the Buying Parties shall each use their reasonable efforts to notify all applicable electric, gas, telephone and other utility companies of the transaction contemplated by this Agreement and of the Closing Date. To the extent any utility companies have not otherwise made arrangements with the Seller and the Buying Parties with respect to the charges related to the Business for the billing period in which the transaction contemplated by this Agreement occurs, the Seller and the Buying Parties shall mutually agree on the proration of all such charges, which shall fairly allocate the charges as of the Effective Time. The prorations shall be reflected in the Final Statement. Sales, use, deed and other transfer taxes and customary closing fees attributable to the sale of the Purchased Assets or the Business on the Closing Date pursuant to this Agreement shall be borne equally by the Seller and the Buyer. Recording fees and documentary taxes shall be paid by the Buyer.

ARTICLE 4

REPRESENTATIONS AND WARRANTIES OF THE SELLER

The Seller represents and warrants as of the date hereof and as of the Closing Date as follows:

4.1 *Existence, Good Standing, Residency.* The Seller is a corporation duly organized, validly existing and in good standing under the laws of its state of incorporation. The Seller has all requisite corporate power and authority to own, lease and operate the Purchased Assets and to conduct the Business as it is presently conducted and is duly qualified to transact business as a foreign corporation and is in good standing in each jurisdiction in which the Purchased Assets are owned, leased or operated by it or the nature of the operation of the Business requires the Seller to qualify to transact business as a foreign corporation. The jurisdictions in which the Seller is so qualified are set forth on Schedule 4.1.

4.2 *Due Authorization.* The Seller has all requisite corporate power and authority to execute, deliver and perform this Agreement and the Ancillary Agreements to which it is a party and to consummate the transactions described in this Agreement and the Ancillary Agreements. The execution, delivery and performance by the Seller of this Agreement and the Ancillary Agreements to which it is a party and the consummation by the Seller of the transactions described in this Agreement and the Ancillary Agreements have been duly and validly authorized by all necessary corporate action on the part of the Seller and no other corporate actions or proceedings on the part of the Seller are necessary to authorize the execution, delivery and performance by the Seller of this Agreement and the Ancillary Agreements to which it is a party or the transactions described in this Agreement and the Ancillary Agreements. The Seller has duly and validly executed and delivered this Agreement and has duly and validly executed and delivered (or prior to or at the Closing shall duly and validly execute and deliver) the Ancillary Agreements to which it is a party. This Agreement constitutes, and upon execution and delivery of (assuming due execution and delivery thereof by all other parties thereto) the Ancillary Agreements to which the Seller is a party shall constitute, legal, valid and binding obligations of the Seller, enforceable against the Seller in accordance with their respective terms, except as may be limited by (a) applicable bankruptcy, insolvency, moratorium, reorganization or similar laws in effect which affect creditors' rights generally; or (b) principles of equity including legal or equitable limitations on the availability of specific remedies.

4.3 *Consents.* Except as set forth on Schedule 4.3, no consent, authorization, order or approval of, or filing or registration with, or notification to (collectively, a "Consent") any Person is required in connection with the execution, delivery and performance of this Agreement and the Ancillary Agreements by the Seller, the consummation of the transactions described in this Agreement or the Ancillary Agreements or the conduct of the Business after the Closing, in substantially the same manner presently conducted (assuming the Buyer needs no Consents other than those needed by the Seller), other than Consents of Third Parties required to transfer a Contract that is not a Material Contract or to transfer a Permit. For purposes of this Section 4.3, a Consent to the transfer of a Material Contract shall be deemed "required" only if the Contract affirmatively states that Consent is required.

4.4 *Absence of Conflicts.* Except as set forth on Schedule 4.4, neither the execution and delivery of this Agreement or any of the Ancillary Agreements to which the Seller is a party, nor the consummation of the transactions described in this Agreement or the Ancillary Agreements will, with or without notice or the lapse of time, result in the creation of, or adverse change in, any lien, security interest, mortgage, restriction on transfer, easement or claim on any of the Purchased Assets or violate, conflict with or result in the breach of (a) the charter, by-laws or other organizational documents of the Seller; (b) any judgment, decree or order of any Governmental Authority to which the Seller is subject or by which the Seller is bound; (c) any requirements of Law applicable to the Seller, the Business, or the Purchased Assets; (d) any Material Contracts to which the Seller is a party or by which the Seller's

assets are bound (assuming all Consents listed on Schedule 4.3 are obtained); or (e) any permits or licenses issued by any Governmental Authority.

4.5 *Financial Statements.* Schedule 4.5 contains true, complete and correct copies of the Business Financial Statements. The Business Financial Statements have been prepared in accordance with GAAP, and fairly present in all material respects the financial position of the Business as of the date thereof and the results of the operations for the period covered thereby. The Audited Financial Statements to be delivered to the Buying Parties by the Seller will be prepared in accordance with GAAP consistent with the principles used in preparation of the Business Financial Statements and will fairly present in all material respects the financial position of the Business as of the dates thereof and the results of operations for the periods covered thereby. Since February 28, 2003, there has been no adverse change to the financial condition, results of operations, business, properties, assets or liabilities of the Business or of the Seller with respect to the Business, which when taken as a whole, would result in a Material Adverse Effect.

4.6 *Title to Assets.*

(a) Except as set forth on Schedule 4.6(a) and other than Owned Real Property which is addressed in Section 4.6(b), the Seller has, and as of the Effective Time the Buyer shall have good, valid and marketable title to all of the Purchased Assets (including the rights to use assets relating to the Business that are the subject of the Trademark License Agreement and the Licensed Intellectual Property Agreement), free and clear of all Encumbrances, other than Permitted Encumbrances or (with respect to Buyer) other limitations and restrictions contained in the Trademark License Agreement or the Licensed Intellectual Property Agreement. Except as set forth on Schedule 4.6(a), none of the Purchased Assets is in the possession of any Person other than the Seller and all the Tangible Assets are located on the Owned Real Property.

(b) Schedule 2.1(d) sets forth a true and correct description of the Owned Real Property. Except as set forth on Schedule 4.6 (b)(i), (i) the Seller has good, valid and marketable fee title to the Owned Real Property free and clear of all Encumbrances, except Permitted Encumbrances; and (ii) except for the Seller, there are no persons in possession or occupancy of any part of the Owned Real Property or the facilities located on the Owned Real Property or who have possessory rights with respect to any part of the Owned Real Property or the facilities located on the Owned Real Property. There are no pending or, to the Seller's Knowledge, threatened condemnation or eminent domain proceedings with respect to all or any part of the Owned Real Property.

(c) Seller is not a party to any Contract that contains any right of, option, or commitment to any Person to acquire any of the Purchased Assets or any interest in the Purchased Assets other than Contracts entered into in the ordinary course of business consistent with past practices.

4.7 *Compliance with Laws; Permits.* Schedule 4.7 contains a list of all Permits (other than Environmental Permits) currently held by the Seller with respect to the Business and any pending applications therefor. Each Permit listed on Schedule 4.7 is valid and in full force and effect. Except as set forth in Schedules 4.7, 4.9, or 4.12(b), the Seller is not in violation of any of the requirements pertaining to those Permits and the Business is in compliance with all applicable Laws (other than Environmental Laws). Neither the execution and delivery of this Agreement nor the consummation of the transactions described in this Agreement will cause any of the Permits listed on Schedule 4.7 to terminate, to become null or void, or to be otherwise adversely affected. All Permits (other than Environmental Permits) necessary to conduct the Business as currently conducted have been acquired and are in full force and effect.

4.8 *Taxes.*

(a) All Tax Returns of the Seller with respect to the Business or the Purchased Assets that are required to have been filed through the date of this Agreement or the Closing Date (as

applicable) have been or will be properly prepared and duly filed (taking into account any and all extensions). All Tax Returns filed or to be filed by the Seller are and will be true, correct and complete. All Taxes shown to be due on such Tax Returns or otherwise required to be paid have been and will be paid in full, other than Taxes that are being contested in good faith and Taxes that, if not paid when due, would not reasonably be expected to have a Material Adverse Effect.

(b) The Seller has complied with all applicable Laws relating to the withholding of Taxes (including withholding of Taxes pursuant to sections 1441 and 1442 of the Code), has, within the time and in the manner prescribed by applicable Law, withheld and paid over to the proper Governmental Authority all amounts required to be so withheld and paid over under all applicable Law and has, within the time and in the manner prescribed by those Laws, filed all Tax Returns with respect to the withholding of Taxes.

(c) There are no Encumbrances for Taxes on any of the Purchased Assets except for liens for real and personal property Taxes not yet delinquent.

(d) None of the Purchased Assets is property that the Seller will be required to treat as being owned by another person pursuant to the provisions of section 168(f)(8) of the Code as in effect before amendment by the Tax Reform Act of 1986, or is "tax-exempt use property" within the meaning of section 168(h)(1) of the Code.

(e) The Seller is not a "foreign person" within the meaning of section 1445 of the Code.

(f) No deficiency or claim has been formally proposed, asserted or assessed or to the Knowledge of the Seller, threatened with regard to any Taxes or Tax Returns relating to the Business or the Purchased Assets which has not been resolved or paid in full.

(g) No audit or other administrative proceeding or court proceeding is pending and no written notification of any such proceeding has been received by the Seller with regard to any Taxes or Tax Returns related to the Business or the Purchased Assets.

(h) The Seller (i) is not a party to any Contract, agreement or arrangement that could result, separately or in the aggregate, in the payment of any "excess parachute payments" within the meaning of section 280G of the Code and (ii) has not made any such excess parachute payments, in each case in respect to the Business or the Affected Employees.

4.9 *Litigation and Claims.* As of the date of this Agreement and except for those matters described on Schedule 4.9 or 4.12(b), there is no legal, administrative or arbitration proceeding, suit, action, claim, order, judgment, investigation, inquiry, writ, injunction, award, or decree in, by or before any Governmental Authority ("Litigation") pending or, to the Knowledge of the Seller, threatened against the Seller. There is no Litigation that could reasonably be expected to (a) result in any injunction, restriction or prohibition on the transfer of any of the Purchased Assets; (b) prevent the Seller from fulfilling all of its obligations set out in this Agreement or arising under this Agreement or any Ancillary Agreement; or (c) reasonably be expected to result in a Material Adverse Effect. For purposes of this Section 4.9, the items listed on Schedule 4.15 are not deemed to be "Litigation". The Seller has no pending claims related to the Purchased Assets or the Assumed Obligations pursuant to any insurance policies under which the Seller is an insured party.

4.10 *Brokers.* Except for CIBC World Markets and Merrill Lynch & Co. Inc., the Seller has not used any broker or finder in connection with the transactions described in this Agreement, and neither the Buyer nor any of its Affiliates shall have any liability or otherwise suffer or incur any Loss as a result of or in connection with any brokerage or finder's fee or other commission of any Person retained by the Seller or an Affiliate of the Seller in connection with any of the transactions described in this Agreement or any of the Ancillary Agreements.

4.11 *Contracts.*

(a) All Material Contracts relating to the Business to which the Seller is a party as of the date of this Agreement are included on Schedule 2.1(j). A "Material Contract" means a Contract relating to the Business (i) the term of which extends beyond the one-year anniversary date of this Agreement, (ii) that obligates the Seller or the Business to future expenditures of $250,000 or more or that entitles the Seller or the Business to future receipts of $1,000,000 or more; or (iii) the lack of which would have a Material Adverse Effect; provided, however, that "Material Contract" shall not include (y) a Contract that may be terminated by the Seller upon giving notice to the other parties to the Contract within 60 days before the termination or (z) any purchase order issued by the Seller to a supplier, purchase order issued to the Seller by a customer or customer pricing letter or other written or verbal understanding between the Seller and any of its customers.

(b) Each Material Contract is in full force and effect and is the valid and binding obligation of the Seller and to the Knowledge of the Seller, the other parties to it. Neither the Seller nor to the Knowledge of the Seller any other party to each Material Contract is in breach of any Material Contract and to the Knowledge of Seller no default exists under any Material Contract. Except for those Contracts which are subject to confidentiality obligations and which are identified on Schedule 4.11(b), the Seller has provided the Buyer with true, complete and correct copies of or access to all written Material Contracts and all extensions, amendments and schedules to them and a written description of all Material Contracts that are not in writing. Except for Seller Benefit Plans listed in Schedule 4.13 or as described in Schedule 4.11, the Seller has no Contract with any director, officer or employee of the Seller or (except in the ordinary course of the Business) any other Affiliate of the Seller. The Seller has not affirmatively waived any right under any Material Contract. Without limiting the foregoing, the Seller is in substantial compliance with all purchase orders and sales orders to the extent it is obligated to perform under those orders. Except as disclosed in Schedule 4.11, Seller has not, expressly or by operation of Law, guaranteed the obligations of any Person that will become the obligations of the Buyer pursuant to this Agreement.

(c) As of the date of this Agreement, there are no purchase orders issued to the Seller by a customer and no customer pricing letters or other written or verbal understandings or arrangements between the Seller and any of its customers regarding pricing of products that extend beyond December 31, 2003, except as specified on Schedule 4.11(c). None of such items listed on Schedule 4.11(c) extends beyond December 31, 2004 or requires any change in base pricing terms through such date. As of the date of this Agreement, the Seller has received no written notice of termination or cancellation by a supplier with respect to any purchase order issued by the Seller requiring the payment of $250,000 or more. As of the date of this Agreement, there is no purchase order issued by the Seller and requiring the payment of $250,000 or more whose terms extend beyond December 31, 2004.

4.12 *Employment Matters.*

(a) Schedule 4.12(a) contains a true, complete and accurate list of all Affected Employees, together with each Affected Employee's title or job description and work location. The Seller has separately delivered to the Buyer a list of each Affected Employee's annualized salary or hourly wage rate.

(b) Except as set forth in Schedule 4.12(b),

(i) The Seller is not a party to any collective bargaining or similar agreement with regard to the Affected Employees;

(ii) The Seller and its Affiliates are in substantial compliance with all Laws applicable to the Business or the Affected Employees with regard to employment and employment practices, terms and conditions of employment, wages, and occupational safety and health; and are not engaged in any unfair labor or unfair employment practices;

(iii) There is no unfair labor practice charge or complaint against the Seller or an Affiliate of the Seller involving or related to Affected Employees pending (with service of process having been made, or written notice of investigation or inquiry having been served, on the Seller or any of its Affiliates), or to the Knowledge of the Seller threatened (or pending without service of process having been made, or written notice of investigation or inquiry having been served, on the Seller or any of its Affiliates), before the National Labor Relations Board or any court;

(iv) As of the date of this Agreement, there is no labor strike or other material dispute, slowdown or stoppage pending against the Seller involving the Affected Employees;

(v) No union certification or decertification petition has been filed (with service of process having been made on the Seller or any of its Affiliates), or to the Knowledge of the Seller threatened, that relates to Affected Employees and no union authorization campaign has been conducted, in each case, within the past 24 months;

(vi) The Business has employees sufficient to operate the Business in the ordinary course consistent with past practices. During the last year, other than changes in the ordinary course of operation of the Business consistent with past practices, no material changes have occurred in the work force of the Business, including material employee terminations, employee transfers in or out, employee leasing arrangements, secondments, reallocations of duties and outsourcing of duties or functions;

(vii) There are no charges, investigations, administrative proceedings or formal complaints of discrimination (including discrimination based on sex, sexual harassment, age, marital status, race, national origin, sexual preference, handicap, disability or veteran status) pending (with service of process having been made, or written notice of investigation or inquiry having been served, on the seller or any of its Affiliates), or to the Knowledge of the Seller threatened, before the Equal Employment Opportunity Commission or any federal, state or local agency or court against the Seller or any Affiliate of the Seller involving or related to Affected Employees;

(viii) There are no charges, investigations, administrative proceedings or formal complaints of overtime or minimum wage violations involving the Business pending (with service of process having been made, or written notice of investigation or inquiry having been served on the Seller or any of its Affiliates), or to the Knowledge of the Seller threatened, before the Department of labor or any other federal, state or local agency or court; and

(ix) There are no citations, investigations, administrative proceedings or formal complaints of violations of local, state or federal occupational safety and health Laws pending (with service of process having been made, or written notice of investigation or inquiry having been served, on the Seller or any of its Affiliates), or to the Knowledge of the Seller pending on the Seller or any of its Affiliates before the Occupational Safety and Health Administration or any federal, state or local agency or court against the Seller or any affiliate of the Seller involving or related to the Business.

4.13 *Employee Benefit Matters.*

(a) Schedule 4.13 contains a true, complete and accurate list of all Seller Benefit Plans. The Seller has made available for review by the Buyer summary descriptions of all Seller Benefit Plans.

(b) No pension benefit plan as defined in section 3(2) of ERISA that is maintained or contributed to by the Seller or any of its ERISA Affiliates or with respect to which Seller or an ERISA Affiliate of the Seller may have any liability had an accumulated funding deficiency as defined in section 302 of ERISA and section 412 of the Code, whether or not waived, as of the last day of the most recent fiscal year of the plan ending on or prior to the Closing Date.

(c) Neither the Seller nor any entity that was at any time during the last six years an ERISA Affiliate has ever maintained, contributed to, had an obligation to contribute to or incurred any liability with respect to a plan that is both a pension benefit plan (as defined in section 3(2) of ERISA) and a multiemployer plan (as defined in section 3(37) of ERISA).

(d) To the extent applicable, all Seller Benefit Plans have been operated in compliance with COBRA.

4.14 *Intellectual Property.* Except as set forth on Schedule 4.14:

(a) The Seller owns, or possesses legally enforceable rights to use, free and clear of all Encumbrances other than Permitted Encumbrances, all Transferred Intellectual Property. There are no patents, patent applications, registered or unregistered trademarks, trade names or service marks, registered copyrights and domain names owned by the Seller and used in the operation of the Business. To the Seller's Knowledge, no Person is authorized to use the Seller Intellectual Property other than the Seller. The Seller has no licenses or sublicenses pursuant to which the Seller is authorized to use any Person's Intellectual Property in the Business (other than commercial software). Neither the execution and delivery of this Agreement or any of the Ancillary Agreements nor the consummation of the transactions described in this Agreement or the Ancillary Agreements will give any Third Party the right or option to cause or declare a violation of a duty, right or obligation to such Person in connection with any Seller Intellectual Property.

(b) (i) No claim that calls into question the validity, ownership or enforceability in any of in the Seller Intellectual Property is pending, or to the Seller's Knowledge, has been threatened, and to the Seller's Knowledge, there is no basis for any Person to assert such a claim, (ii) no claim, notice, suit, demand or action of any nature is currently pending or to the Knowledge of the Seller, has been or could, in good faith be, threatened or asserted, alleging unauthorized use, disclosure, infringement, misappropriation or other violation of any Intellectual Property of any other Person by the Seller in the conduct of the Business.

(c) The Seller has not entered into any arrangements granting exclusive rights in the Seller Intellectual Property to any Person. To the Knowledge of the Seller, there is no unauthorized use, disclosure, infringement or misappropriation of any of the Seller Intellectual Property or material breach of any Contract involving the Seller Intellectual Property, and there are no pending, or to the Knowledge of the Seller, threatened claims, suits, demands or actions of any nature affecting the Seller Intellectual Property. The Seller has not brought any action, suit or proceeding or asserted any claim against any Person for interfering with, infringing on, misappropriating or otherwise coming into conflict with any Seller Intellectual Property or breach of any Contract involving any Seller Intellectual Property and, to the Seller's Knowledge, there is no basis for any such action, suit, proceeding or claim.

(d) The Seller Intellectual Property constitutes all the Intellectual Property needed for the Buyer to run the Business as it is currently operating.

(e) Seller has the full right and ability to transfer to the Buyer the Transferred Intellectual Property and any and all rights therein as provided for in this Agreement.

4.15 *Environmental.* Except as identified by the Environmental Audits or as otherwise set forth on Schedule 4.15:

(a) The Business and the Purchased Assets are in material compliance with all limitations, restrictions, conditions, standards, prohibitions, requirements and obligations established under applicable Environmental Laws. Without limiting the generality of the foregoing, the Business is in material compliance with all terms and conditions of the State of Michigan Renewable Operating Permit as revised on or about June 9, 2003.

(b) The Seller is not in receipt of any pending notice of violation of Environmental Law with respect to the Business or the Purchased Assets.

(c) There has been no disposal or release of Hazardous Substances at, in or under or from any of the Purchased Assets or from the Business that reasonably could be expected, now or with the passage of time, to result in material liability to the Buying Parties after the Closing.

(d) There are no pending or, to the Knowledge of the Seller, threatened actions, suits, claims, investigations, inquiries or proceedings by or before any court or other Governmental Authority directed against the Seller in connection with the Business or any of the Purchased Assets that pertain or relate to (i) any obligations or liabilities, contingent or otherwise, under any Environmental Law; (ii) violations or alleged violations of Environmental Laws; or (iii) personal injury or property damage claims relating to the release into the environment of Hazardous Substances.

(e) The Seller is not operating or required to be operating the Business or any of the Purchased Assets under any compliance or consent order, decree or agreement issued or entered into under Environmental Laws.

(f) To the Knowledge of the Seller, there is no asbestos or asbestos containing materials present at or in any of the Purchased Assets other than floor tile mastic.

(g) To the Knowledge of the Seller, no underground storage tanks or polychlorinated biphenyls have been introduced to the Owned Real Property by the Seller in connection with the Business except for trace amounts of polychlorinated biphenyls in scrap.

(h) To the Knowledge of the Seller and other than in the ordinary course of business, there are no liabilities under Environmental Laws arising from or related to the Purchased Assets or the Business with respect to which the Seller has assumed or otherwise agreed to be responsible for the liabilities of a Third Party, by contract or otherwise.

(i) To the Knowledge of the Seller, the Seller has provided the Buyer access to and copies as requested of (i) any Third Party environmental audits, evaluations, assessments and investigations pertaining to the Business or any of the Purchased Assets that are in the possession of or subject to the control of the Seller or any of its Affiliates and that were prepared or conducted since June 30, 1998, and (ii) all monitoring data of, and other environmental records pertaining to, the Business or any of the Purchased Assets that are in the possession of or subject to the control of the Seller or any of its Affiliates and that were prepared or conducted since June 30, 2002.

(j) The Seller is in material compliance with all Environmental Permits held by the Seller in connection with the Business and all Environmental Permits held by the Seller in connection with the Business are identified on Schedule 4.15. Each Environmental Permit listed on Schedule 4.15 is valid and in full force and effect. Except as set forth in Schedule 4.15, the Seller is not in violation of any of the requirements pertaining to those Environmental Permits. All Environmental Permits necessary to conduct the Business as currently conducted have been acquired and are in full force and effect.

(k) To the Knowledge of the Seller, all of the information set forth in Schedule 7.12 is complete and accurate.

Notwithstanding anything to the contrary in this Agreement, the representations and warranties contained in this Section 4.15 and Sections 4.5, 4.6(a), 4.6(b) (other than with respect to the use of engineered controls, isolation zones, use restrictions and limitations that do not materially impact the conduct of the Business as presently conducted), 4.21(a) and 4.25 (which, to the extent they relate to environmental matters, are incorporated herein) are the only representations and warranties of the Seller that pertain to Environmental Laws or Environmental Permits.

4.16 *Tangible Assets.* The Tangible Assets listed in Schedule 2.1(a) or subject to the equipment leases or other leases listed on Schedule 2.1(j) constitute all of the Tangible Assets material to the Business and constitute all of the Tangible Assets needed for the Buyer to conduct the Business. All Tangible Assets (whether owned or leased by the Seller) are in normal operating condition and repair, subject to ordinary wear and tear and maintenance.

4.17 *Sufficiency of Assets.* Except as set forth in Schedule 4.17, the Purchased Assets constitute all of the material assets used in the Business (taking into consideration the rights to use assets relating to the Business that are the subject of the Trademark License Agreement and the Licensed Intellectual Property Agreement) and are sufficient to operate the Business.

4.18 *Inventory.* Except as set forth in Schedule 4.18, (a) all Inventory as of the Effective Time will be reflected on the books and records of the Business; (b) all Inventory reflected on the books and records of the Business is valued at the lower of cost or market value, consistent with past accounting practices; (c) the Inventory as of the Effective Time will consist of items of Inventory useable or saleable in the ordinary course of the Business at a level that is reasonable under applicable conditions of the Business in light of past practices, except for customary amounts of raw materials that cannot be incorporated into finished products and items of obsolete materials and materials of below-standard quality that have been written off or written down to the Seller's best estimate of net realizable value; (d) the Inventory does not include any materials held by the Seller on consignment from any Third Parties; and (e) all Inventory disposed of since February 28, 2003, has been disposed of only in the ordinary course of the Business, consistent with the past practice of the Seller. The quantities of Inventory as of the Effective Time will be adequate to conduct the Business under the current circumstances of the Business. Except as set forth in Schedule 4.18, none of the Inventory is in the possession of others or held on consignment, except Inventory in transit or in the possession of processors in the ordinary course of the Business.

4.19 *Accounts Receivable.* The Accounts Receivable reflected on the Business Financial Statements are, and the Accounts Receivable that will be reflected on the Statement of Working Capital will be valid and collectible using commercially reasonable collection practices, subject to normal market write-offs for bad debt consistent with past practices of the Business. All of those Accounts Receivable arose in the ordinary course of the Business and none is subject to any Encumbrance (other than Permitted Encumbrances and claims, counterclaims, facts or defenses arising in the ordinary course). Since February 28, 2003, there has not been any material adverse change in the collectibility of the Accounts Receivable, taken as a whole.

4.20 *Books and Records.* To the Knowledge of the Seller, the Books and Records accurately and fairly reflect the transactions and the assets and liabilities of the Seller with respect to the Business.

4.21 *No Material Adverse Effect.* To the Knowledge of the Seller, since February 28, 2003, there has not occurred (a) any Material Adverse Effect, (b) any material damage, destruction or loss of any kind with respect to the Purchased Assets or the Business, (c) any material changes in terms of transactions between the Seller and the Seller's Affiliates, (d) any sale, assignment, transfer or acquisition (or Contract to do so) of any material operating asset of the Business, or a cancellation of,

or any agreement to cancel, any material debts or claims of the Business, except, in each case, in the ordinary course of business, (e) any increase in the rate of compensation or benefits payable or to become payable by the Seller or any of the Seller's Affiliates to any Affected Employee over the rate being paid to the Affected Employee at February 28, 2003, other than increases in the ordinary course of business in accordance with past practices, or any Contract to do so; or (f) any termination or material amendment of any Material Contract that has or is expected to result in a Material Adverse Effect.

4.22 *Major Customers, Distributors; Major Suppliers.*

(a) Schedule 4.22(a) sets forth (a) the names of the 10 largest customers of the Seller by dollar volume of sales that ordered goods and services from the Seller during the 12-month period ended February 28, 2003; and (b) the amount for which each such customer was invoiced during that period. As of the date of this Agreement, no such customer has notified the Seller that it (i) will materially reduce purchases of products from the Business; or (ii) has ceased, or will cease, to purchase products from the Business.

(b) Schedule 4.22(b) sets forth (a) the names of the 10 largest suppliers of the Seller by dollar volume of purchases from which the Business ordered raw materials, supplies, merchandise and other goods and services during the 12-month period ended February 28, 2003; and (b) the amount for which each such supplier invoiced the Business during such period. As of the date of this Agreement, no such supplier has notified the Seller that it (i) will materially reduce the amount of raw materials or equipment available for purchase by the Business, or (ii) has ceased, or will cease, to sell raw materials or equipment to the Business.

4.23 *Affiliate Transactions.*

(a) Except as set forth in Schedule 4.9 or 4.12(b) to the Knowledge of the Seller, no employee, officer or director of the Seller or its Affiliates (i) owns, directly or indirectly, in whole or in part, any Permits, real property, leasehold interests or other property, the use of which is necessary for the operation of the Business; (ii) has any claim or cause of action or any other action, suit or proceeding against, or owes any amount to, the Seller other than claims in the ordinary course of business that are immaterial to the conduct of the Business, or (iii) is a party to any Contract or participates in any arrangement, written or oral, pursuant to which the Business provides to, or receives services of any nature from, any such Person, except as to any such individual in his capacity as an employee of the Business.

(b) The Seller is not a party to any Contract that relates to the Business (i) between the Seller and any of its Affiliates or (ii) between the Seller on the one hand, and a Third Party, on the other hand, in which the terms or conditions of such Contract or transaction are materially more favorable to the Seller or the Third Party than the terms and conditions that could be achieved in an arm's length Contract or transaction with a Third Party.

4.24 *Backlog.* All outstanding customer or distributor purchase orders for products of the Business have been entered at prices and on terms and conditions consistent with the normal practices of the Business. As of the date of this Agreement, the Seller has not been informed by any customer or distributor that any material order included in the backlog of the Business is likely to be canceled or terminated before its completion.

4.25 *Other Information.* To the Knowledge of the Seller, no representation or warranty of the Seller contained in this Agreement and in the schedules to this Agreement contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements and facts contained in this Agreement and the schedules to this Agreement, in light of the circumstances under which they are made, not false or misleading.

4.26 *Disclaimer.*

(a) EXCEPT AS TO THOSE MATTERS EXPRESSLY COVERED BY THE REPRESENTATIONS AND WARRANTIES BY THE SELLER IN THIS AGREEMENT AND THE SELLER IN THE ANCILLARY AGREEMENTS, THE SELLER EXPRESSLY DISCLAIMS ALL REPRESENTATIONS AND WARRANTIES, WHETHER EXPRESS OR IMPLIED, INCLUDING ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE. In particular, the Seller disclaims any representation or warranty with respect to any information concerning the Business, the Seller or any of its Affiliates not expressly represented and warranted to in this Agreement or the Ancillary Agreements, including, (i) the information set forth in any information memoranda distributed by CIBC World Markets or Merrill Lynch & Co., Inc. with respect to the Seller and the Business; (ii) any financial projection or forecast relating to the Seller or the Business; (iii) the information included in the data room established by the Seller or otherwise delivered to the Buyer or its representatives; and (iv) all verbal or written communications by the Seller, employees thereof, or its representatives (including, without limitation, CIBC World Markets and Merrill Lynch & Co., Inc. The Buyer shall have no claim against the Seller, and the Seller shall have no liability to the Buying Parties, with respect to any such disclaimed information.

(b) EXCEPT AS TO THOSE MATTERS EXPRESSLY COVERED BY THE REPRESENTATIONS, WARRANTIES AND COVENANTS IN THIS AGREEMENT, THE BUYER IS ACQUIRING THE PURCHASED ASSETS ON AN "AS IS, WHERE IS" BASIS OTHER THAN FOR MANUFACTURERS' WARRANTIES, IF ANY, INCLUDED IN THE PURCHASED ASSETS.

ARTICLE 5

REPRESENTATIONS AND WARRANTIES OF THE BUYING PARTIES

Each of the Buying Parties represents and warrants as of the date hereof and as of the Closing Date:

5.1 *Existence and Good Standing.* Each of the Buying Parties is a corporation duly organized, validly existing and in good standing under the laws of Delaware.

5.2 *Due Authorization.* Each of the Buying Parties has all requisite corporate power and authority to execute, deliver and perform this Agreement and the Ancillary Agreements to which it is a party and to consummate the transactions described in this Agreement or the Ancillary Agreements. The execution, delivery and performance by each of the Buying Parties of this Agreement and the Ancillary Agreements to which it is a party and the consummation by each of the Buying Parties of the transactions described in this Agreement and the Ancillary Agreements have been duly and validly authorized by all necessary corporate action on the part of the Buying Parties, and no other corporate actions or proceedings on the part of the Buying Parties are necessary to authorize the execution, delivery and performance by the Buying Parties of this Agreement and by each of the Buying Parties of the Ancillary Agreements to which it is a party or the transactions described in this Agreement or the Ancillary Agreements. Each of the Buying Parties has duly and validly executed and delivered this Agreement and has duly and validly executed and delivered (or prior to or at the Closing shall duly and validly execute and deliver) the Ancillary Agreements to which it is a party. This Agreement constitutes, and upon execution and delivery (assuming due execution and delivery by all other parties) the Ancillary Agreements to which a Buying Party is a party shall constitute, legal, valid and binding obligations of each of the Buying Parties, enforceable against it in accordance with their respective terms, except as may be limited by (a) applicable bankruptcy, insolvency, moratorium, reorganization or similar laws in effect which affect creditors' rights generally; or (b) principles of equity including legal or equitable limitations on the availability of specific remedies.

5.3 *Consents.* Except as set forth on Schedule 5.3, (a) no Consent of any Person is required in connection with the execution, delivery and performance of this Agreement and the Ancillary Agreements by the Buying Parties, or the consummation of the transactions described in this Agreement or the Ancillary Agreements and (b) to the Knowledge of the Buying Parties, no material Consent of any Person is required for the Buyer to conduct the Business immediately after the Closing, in substantially the same manner presently conducted.

5.4 *Absence of Conflicts.* Neither the execution and delivery of this Agreement nor any of the Ancillary Agreements to which a Buying Party is a party, nor the consummation of any of the transactions described in this Agreement or the Ancillary Agreements will, with or without notice or lapse of time, violate, conflict with, or result in a breach of (a) the certificate of incorporation or by-laws of either Buying Party; (b) any judgment, decree or order of any Governmental Authority to which a Buying Party is subject or by which a Buying Party is bound; or (c) any requirements of Laws applicable to a Buying Party.

5.5 *Litigation.* There is no Litigation of any nature pending, asserted, or to the Knowledge of the Buying Parties, threatened against either of the Buying Parties by or before any Governmental Authority or by or on behalf of any Third Party which would (a) enjoin, restrict or prohibit the transfer of the Business or any of the Purchased Assets as described by this Agreement; (b) prevent either Buying Party from fulfilling all of its obligations set out in this Agreement or arising under this Agreement or any Ancillary Agreement; or (c) reasonably be expected to adversely affect the ability of either Buying Party to consummate the transactions described in this Agreement.

5.6 *Brokers.* Except for Credit Suisse First Boston, the Buying Parties have not used any broker or finder in connection with the transactions described in this Agreement, and neither the Seller nor any of its Affiliates has or shall have any liability or otherwise suffer or incur any Loss as a result of or in connection with any brokerage or finder's fee or other commission of any Person retained by a Buying Party in connection with any of the transactions described in this Agreement or any of the Ancillary Agreements.

5.7 *Sufficient Funds.* The Buyer has sufficient cash, lines of credit or other sources of available funds to enable it to pay the Purchase Price and all fees and expenses in connection with the consummation of the transactions described in this Agreement.

ARTICLE 6

COVENANTS OF THE SELLER

The Seller hereby covenants with the Buying Parties as follows:

6.1 *Conduct of Business.* Except as otherwise described in this Agreement, and except as otherwise consented to by the Buyer (which consent shall not be unreasonably withheld or delayed), from the date of this Agreement until the Closing Date, the Seller shall conduct the Business in the usual and ordinary course in accordance with past practice, including the maintenance of Inventory levels, the payment of Accounts Payable and compliance with the Seller's warranty policies and practices. The Seller shall use commercially reasonable efforts consistent with the Seller's current business practices, to preserve the goodwill of the Business, including to preserve its current relationships with customers, suppliers, agents and employees of the Business; provided, that nothing in this Section 6.1 shall require the Seller to make any capital expenditures, above and beyond routine maintenance and repair other than budgeted capital expenditures for which reserves have been established in the Business Financial Statements. The parties understand and acknowledge that the matters referred to in this Section 6.1 may be adversely affected by the public announcement of the transactions described in this Agreement, and any such adverse effect shall not be considered a breach of this covenant by the Seller.

6.2 *Negative Covenants Relating to Conduct of the Business.* Except as otherwise described in this Agreement, and except as consented to by the Buyer in writing (which consent shall not be unreasonably withheld or delayed), the Seller shall not, from the date of this Agreement until the Closing Date, with respect to the Business:

(a) Enter into, terminate or amend any Material Contract except for such amendments to the Material Contracts, the effect of which could reasonably be expected to be advantageous to the Business or enter into any new Contracts with customers that may extend beyond December 31, 2004;

(b) Other than pursuant to this Agreement, sell, transfer, lease or dispose of any of the Purchased Assets except Inventory in the ordinary course of the Business and assets that are not material to the Business and are sold, transferred, leased or disposed of in the ordinary course of the Business;

(c) Increase the rate of compensation of, or pay or agree to pay any benefit to the Affected Employees, except normal salary increases in the ordinary course of the Business or as may be required by the terms of any existing Employee Plan, agreement or arrangement;

(d) Enter into, adopt or amend any employee plan, collective bargaining agreement or employment or severance agreement affecting the Business or the Affected Employees, except as required by applicable Law;

(e) Incur any obligation or liability, absolute, accrued, contingent or otherwise, whether due or to become due, except current liabilities for trade or business obligations incurred in connection with the purchase of goods or services in the ordinary course of business consistent with past practice, none of which liabilities, in any case or in the aggregate, could have a Material Adverse Effect;

(f) Make any capital expenditures other than (i) for maintenance in the ordinary course of the Business; (ii) pursuant to any projects approved by the Seller before the date of this Agreement; and (iii) up to $100,000 for any one project (or series of related projects) approved after the date of this Agreement;

(g) Forgive, cancel or compromise any material debt or material claim, or intentionally waive or release any material right of substantial value;

(h) Make any material changes in policies or practices relating to selling practices, product returns, discounts or other terms of sale or accounting;

(i) Make any prepayment of any Accounts Payable, delay payment of any trade payables or other obligations other than in the ordinary course of business consistent with past practice, or make any other cash payments other than in the ordinary course of business;

(j) Fail to maintain all of the Tangible Assets in normal operating repair, working order and operating condition, in accordance with the seller's usual and customary maintenance schedule and practices, subject to ordinary wear and tear;

(k) Acquire any assets that would constitute Purchased Assets or assume any obligations or liabilities that would constitute Assumed Obligations, except, in each case, in the ordinary course of business;

(l) Change any accounting policies or principles applicable to the Business or the methods of applying those policies or principles;

(m) Allow any of the Transferred Intellectual Property to expire or become abandoned;

(n) Take any actions that could reasonably be expected to cause any labor strike or other material dispute, slowdown or stoppage involving the Affected Employees; or

(o) Agree, whether in writing or otherwise, to do any of the foregoing.

6.3 *Certain Notices.* The Seller shall promptly notify the Buying Parties (a) if any Litigation (other than the matters described in Schedule 4.9 or 4.12(b)) shall become pending or, to the Knowledge of the Seller, become threatened against the Seller; (b) of the occurrence of any labor strike or other material dispute, slowdown or stoppage involving the Affected Employees; (c) if any customer named in Schedule 4.22(a) shall notify the Seller that it (i) intends to materially reduce purchases of products from the Business or (ii) has ceased, or will cease, purchasing products from the Business; or (d) if any supplier named in

Schedule 4.22(b) shall notify the Seller that it (i) intends to materially reduce the amount of raw materials or equipment available for purchase by the Business or (ii) has ceased, or will cease, selling raw materials or equipment to the Business.

ARTICLE 7

COVENANTS OF THE BUYING PARTIES AND THE SELLER

7.1 *HSR Act Notification: Other Consents.*

(a) Each of the Buying Parties and the Seller shall cause to be filed as promptly as practicable following the execution of this Agreement, with the Federal Trade Commission and the Department of Justice the notification and report form required under the HSR Act for the transactions described in this Agreement and the Ancillary Agreements, and shall use commercially reasonable efforts to provide any supplemental information that may be reasonably requested in connection with those filings (it being understood that the filing fee shall be borne by the Buying Parties).

(b) The Seller shall make as promptly as practicable following the date of this Agreement the other notifications required in connection with this Agreement, and shall use commercially reasonable efforts to obtain the Consents of all Third Parties required in connection with the consummation of the transactions described in this Agreement. The Seller and the Buying Parties shall coordinate and cooperate with each other in exchanging information and assistance in connection with obtaining Consents of Third Parties and making all filings or notifications necessary to transfer any Permits to the Buyer, or in connection with any applications for new Permits relating to the Business.

7.2 *Access to Information, Inspections.*

(a) During the period from the date of this Agreement through the Closing Date, the Seller shall afford promptly to the Buying Parties and their authorized representatives, including environmental and real estate professionals, reasonable access during regular business hours and upon reasonable notice, to all plants, offices, warehouses, facilities, employees and Books and Records of the Seller relating to the Business as they may reasonably request. Notwithstanding and without limiting the foregoing, the Buying Parties shall not undertake any sampling or testing, including intrusive soil or groundwater testing without the Seller's approval. A Seller's representative shall be present at all site visits and inspections and the Buyer's representative shall, at all times while on the premises of the Seller, comply with all directions and requests relating to safety, security and confidentiality.

(b) The Buying Parties shall, at and after the Closing Date, afford promptly to the Seller and its respective agents reasonable access during regular business hours, and upon reasonable notice, to the properties, employees and Books and Records of the Business, to the extent reasonably necessary to permit the Seller to determine any matter relating to or arising during any period

ending on or before the Closing Date. If the Buying Parties propose to destroy or otherwise dispose of any Books and Records relating to the Business, on or before the 10th anniversary of the Closing Date, other than in the ordinary course of business, consistent with their written document retention policy, the Buying Parties shall first notify the Seller in writing, and afford the Seller the opportunity, for a period of at least 90 days following the date of the notice, to take custody of the records or make extracts from them or copies of them.

(c) After the Closing Date, the Seller shall cooperate with the Buyer with respect to any request by the Buyer for the Seller's consent (which consent will not be unreasonably withheld) to access, during regular business hours, to the employees and books and records of the Seller to the extent reasonably necessary to enable the Buyer to satisfy its obligations under this Agreement or to conduct the Business in the ordinary course.

7.3 *Title Commitment and Survey.*

(a) As evidence of title to the Owned Real Property, the Seller shall cause to be prepared and delivered to the Buyer, as soon as reasonably practicable, a current commitment from LandAmerica Lawyers Title Company together with copies of all exception documents, to issue to the Buyer at Closing, an ALTA Form B owner's title insurance. The title insurance policy delivered pursuant to the commitment described in this Section 7.3(a) shall (i) insure title to the Owned Real Property and all recorded easements benefiting the Owned Real Property; (ii) contain an "extended coverage endorsement" insuring over the general exceptions contained customarily in such policies; (iii) contain an ALTA Zoning Endorsement 3.1 (or equivalent); (iv) contain an endorsement insuring that the Owned Real Property described in the title insurance policy is the same real estate as shown on the survey to be provided by the Seller pursuant to Section 7.3(b); and (v) contain an endorsement insuring that each street adjacent to the Owned Real Property is a public street and that there is direct and unencumbered access to each street from the Owned Real Property. The cost of the title insurance (including premiums) shall be borne by the Buyer.

(b) The Seller shall deliver to the Buyer within 5 Business Days from the date of this Agreement, any survey with respect to the Owned Real Property currently in the possession of the Seller or its Affiliates and, as soon as practicable after the date of this Agreement, an updated survey of the Owned Real Property. The cost of the surveys and updates shall be borne by the Seller.

(c) If the title commitment, survey or other evidence of title discloses an Encumbrance, other than a Permitted Encumbrance, the Buying Parties shall notify the Seller within 10 Business Days of receiving all of the title evidence provided pursuant to this Section 7.3. The Seller shall use reasonable efforts to cure each title objection shown as an exception to the title commitment prior to Closing.

7.4 *Motor Vehicles.* The Seller shall take all actions and prepare all documents necessary to effect the transfer to the Buyer of all motor vehicle licenses and registrations pertaining to automobiles, trucks and other motor vehicles and rolling stock of whatever kind used primarily in the Business in compliance with the motor vehicle registration, licensing and other applicable Laws of any jurisdictions where such motor vehicles are registered or licensed. All transfer taxes related to the sale of motor vehicles in connection with the consummation of the transactions described in this Agreement shall be borne by the Buyer.

7.5 *Tax Matters.*

(a) With respect to ad valorem and similar Taxes relating to the Purchased Assets or any portion of them, the Seller shall pay and be responsible for (i) all such Taxes for the taxable years 2002 and earlier taxable periods and (ii) all payments of such Taxes for the taxable year 2003 (including installments) that become due and payable on or before the Effective Time. The Buyer

shall pay and be responsible for (i) all payments of such Taxes for the taxable year 2003 (including installments) that become due and payable after the Effective Time, and (ii) all such Taxes for taxable years after 2003.

(b) The Seller shall promptly deliver to the Buyer any and all notices, tax bills, tax statements, orders, or other similar documents or communications received by the Seller or any of its Affiliates and relating to ad valorem or similar Taxes affecting all or any portion of the Purchased Assets.

(c) The Buying Parties shall promptly notify the Seller in writing upon receipt by the Buying Parties or any Affiliates thereof, of notice of any pending or threatened Tax liabilities which relate to the Seller for the period prior to the Effective Time. The Seller shall have the sole right to control any Tax audit or administrative or court proceeding with respect to such Taxes liabilities and the Buying Parties agree that they will cooperate fully with the Seller and its counsel in the defense against or compromise of any claim in any said proceeding. After the Closing Date, the Buying Parties shall make available to the Seller such records as the Seller may reasonably require for the preparation of any Tax Returns, and the preparation and defense of any audit or administrative or court proceeding. All refunds of Taxes paid by the Seller that are attributable to periods prior to the Effective Time shall be for the account of the Seller. The Buying Parties shall take such actions as reasonably requested by the Seller to obtain such refunds and shall deliver to the Seller any such refunds promptly upon receipt thereof. All refunds of Taxes paid by the Buying Parties or their Affiliates attributable to the period from and after the Effective Time shall be for the account of the Buyer.

(d) The Buying Parties shall not revoke any Tax election previously made by the Seller nor make any new Tax election that changes the Seller's Tax results without securing the Seller's prior written consent, which consent shall not be unreasonably withheld.

(e) Notwithstanding anything contained herein to the contrary, except as reasonably necessary to comply with applicable securities laws, each of the Parties (and each employee, representative, or other agent of each Party) may (i) consult any tax advisor regarding the "tax treatment" or "tax structure" of the transaction (as such terms are defined in Treasury Regulation Section 1.6011-4(c)(8) and (9), respectively), and (ii) disclose to any and all Persons, without limitation of any kind, the tax treatment and tax structure of the transaction that is the subject of this Agreement and all materials of any kind (including opinions or other tax and analyses) that are provided to any Party relating to such tax treatment and tax structure.

7.6 *Bulk Sales Compliance.* The Buying Parties and the Seller waive compliance with the provisions of any applicable statutes relating to bulk transfers or bulk sales. The Buying Parties and the Seller mutually agree to cooperate in securing any available exemptions from any such provisions.

7.7 *Confidentiality.*

(a) Until Closing, Quanex shall continue to comply with and be subject to the terms of the Confidentiality Agreement; provided, however, that Section 7 of the Confidentiality Agreement is hereby amended to the extent necessary to permit the Buying Parties to fulfill their obligations under Section 10.1 of this Agreement and as otherwise agreed on by the Buyer and the Seller in writing. The Confidentiality Agreement, as so amended, shall terminate as of the Closing Date.

(b) For a period of 5 years after the Closing Date and except as otherwise required by Law, the Seller shall and shall cause its officers, directors, Affiliates, employees, agents and representatives to hold in confidence and not disclose or use (i) any proprietary or other confidential and non-public information regarding the Buying Parties disclosed to the Seller in connection with the negotiation or preparation of this Agreement; (ii) the nature or resolution of any disputes arising hereunder after the Closing; and (iii) any proprietary or other confidential

non-public information relating to the Purchased Assets or the Business, except for disclosures made pursuant to Section 7.7(e); and provided, however, the confidential and non-public information shall not include any information publicly known through no fault of the Seller or its Affiliates or disclosures made in connection with the consummation of this transaction, or the management and resolution of any Excluded Assets, Excluded Obligations, or Excluded Businesses.

(c) For a period of 5 years after the Closing Date and except as otherwise required by Law, each of the Buying Parties shall, and shall cause their respective officers, directors, Affiliates, employees, agents and representatives to hold in confidence and not disclose or use (i) any proprietary or other confidential and non-public information (excluding information relating to the Purchased Assets or the Business) regarding the Seller and any Affiliate of the Seller disclosed to any Buying Party in connection with the negotiation or preparation of this Agreement and (ii) the nature or resolution of any dispute arising under this Agreement after the Closing, except for disclosures made pursuant to this Section 7.7(e); provided, however, the confidential and non-public information shall not include any information publicly known through no fault of a Buyer Party or its Affiliates. The Seller acknowledges that Quanex is a publicly held company and will be required to disclose information about the transactions described in this Agreement, the Purchased Assets and the Business by Law, by the New York Stock Exchange or in connection with securities Laws, and will be required by Law to file a copy of this Agreement with the Securities and Exchange Commission and the New York Stock Exchange and to include such filings as part of Quanex' website; all such filings and disclosures may be made by Quanex notwithstanding the provisions of this Section 7.7, including Sections 7.1(a) and 7.7(c).

(d) For a period of 2 years after the Closing Date, the Buying Parties shall not solicit the employment of any Person who are employed in a management position with the Seller subsequent to the Closing Date (other than as otherwise agreed to by the Buyer and the Seller in writing), except that the foregoing shall not preclude a Buying Party from hiring any Person whose employment with the Seller has been terminated prior to any solicitation.

(e) No public announcement or other publicity regarding the transactions described in this Agreement shall be made by the Buying Parties or the Seller or any of their respective Affiliates, officers, directors, employees, representatives or agents, without the prior written agreement of the Seller and the Buying Parties, respectively. The Parties shall prepare and release public announcements or press releases regarding the execution and delivery of this

Agreement and the Closing. Any announcement shall be agreed to by the Parties as to form, content, timing and manner of distribution or publication, Nothing in this Section 7.7 shall prevent the Parties from discussing the transactions described in this Agreement with those Persons whose Consent is required for consummation of those transactions. The Parties shall exercise all reasonable efforts to assure that those Persons keep confidential any information relating to this Agreement.

7.8 *Payments Received.* After the Closing, the Seller and the Buying Parties shall hold and promptly transfer and deliver to the other, from time to time as and when received by either of them, any cash, checks with appropriate endorsements (using their commercially reasonable efforts not to convert checks into cash), or other property that either of them may receive on or after the Effective Time which properly belongs to the other Party, including any insurance proceeds, and shall account to the other Party for all such receipts.

7.9 *Satisfaction of Conditions and Further Assurances.* Without limiting the generality or effect of any provision of Articles VIII and IX, prior to the Closing, each of the Parties shall use commercially reasonable efforts and shall act in good faith to satisfy promptly all conditions required by this Agreement to be satisfied by it in order to expedite the consummation of the transactions described in this Agreement. The Parties shall execute and deliver such other documents, certificates, agreements and other writings and to take such other actions as may be reasonable, necessary or desirable in order to consummate or implement expeditiously the transactions described in this Agreement and any agreement, document or instrument described in this Agreement.

7.10 *Collective Bargaining Agreement.* Prior to the Closing Date, if the Buying Parties so request, the Seller shall assist and cooperate with the Buying Parties in arranging an initial meeting with collective bargaining representatives of the Affected Employees to facilitate negotiation of a collective bargaining agreement with the Affected Employees at the Seller's Monroe, Michigan facilities.

7.11 *Exclusivity Agreement.* For so long as this Agreement remains in effect, neither the Seller nor any Affiliate of the Seller, nor any of its directors, officers, employees, representatives or agents, nor anyone acting on its behalf shall, directly or indirectly solicit, encourage (including furnishing information to any Third Party), negotiate or assist in any manner any offers, bids or proposals involving, directly or indirectly, (a) the sale or other disposition of the Purchased Assets (other than sales of Inventory in the ordinary course of business) or (b) the sale or exchange (whether through a merger or otherwise) of all or any portion of the capital stock of the Seller if such sale or exchange would result in the Purchased Assets being owned, directly or indirectly, by a Person other than the Selling Parties (all such bids, offers and proposals being referred to as "Acquisition Proposals"). Seller shall not enter into any letter of intent, agreement in principle or other agreement with respect to any matter involving an Acquisition Proposal.

7.12 *Environmental Matters.*

(a) Schedule 7.12 sets forth a category "S" baseline environmental assessment (as defined in Part 201 of the Natural Resources and Environmental Protection Act, 1994 PA 451, as amended, and the regulations promulgated thereunder) of the Owned Real Property (the "BEA") and all supporting documents, including the necessary affidavits and a supporting Phase II Environmental Site Assessment.

(b) The Seller shall pay when due, any and all costs arising out of the preparation of the BEA and petitioning the Michigan Department of Environmental Quality ("DEQ") for an affirmation of the BEA pursuant to this Section 7.12, including any such costs of sampling, document preparation, and petitioning the DEQ.

(c) The Buyer has submitted to the DEQ the petition in Schedule 7.12 for a determination that the BEA is adequate for the purposes of the Buyer obtaining an exemption from liability under MCL 324.20126(1)(c) (hereinafter the petition as it may be amended from time to time is referred to as the "BEA Petition"). If the DEQ identifies any deficiency with the BEA Petition, the Seller, in cooperation with the Buying Parties, shall use commercially reasonable efforts to cause to be taken, whether before or after the Closing Date, reasonable steps necessary to cure any such deficiency so as to make a timely, complete and accurate response to the DEQ so that Buyer may obtain from the DEQ affirmation that the BEA is adequate for the purpose of the Buyer obtaining an exemption from liability under MCL 324.20126(1)(c) without being based on any stipulated condition other than the use of engineered controls, isolation zones, use restrictions or limitations or other measures that do not materially impact the conduct of the Business as presently conducted at the site (the "BEA Affirmation"). The Parties acknowledge that any BEA Affirmation will contain standard conditions, requirements and reservation of rights substantially the same as those contained in the sample BEA Affirmation contained in Schedule 7.12(c). Prior to the earlier to occur of any withdrawal of the BEA Petition or the Buyer's receipt of DEQ's final decision with respect to the BEA Affirmation, the Parties shall promptly notify each other of any communication from the DEQ relating to the BEA, including any such communications identifying deficiencies in the BEA Petition. The Seller shall have no obligation to incur any third party expenses under this provision after December 23, 2003; provided that, if the Seller elects not to do so, the Buyer in its sole discretion, shall have the right to incur such costs and assume control of the BEA Petition, in which case, the Seller agrees that the Buyer may retain any consultant, including Conestoga Rovers & Associates, to work at Buyer's direction in connection with the BEA Petition; that the Seller will not assert a conflict of interest in connection with the use of

Conestoga-Rovers & Associates for such purpose nor seek to disqualify such consultant based on any prior work for the Seller, or discourage such consultant from undertaking such work; and that the Seller will cooperate in such activity. Likewise, in the event of any future environmental claims by the Buyer against the Seller, the Buyer agrees that it will not seek to disqualify Conestoga Rovers & Associates or assert a conflict of interest, or discourage such consultant from undertaking such work on behalf of the Seller based solely on Buyer's retention of such consultant with respect to the BEA Petition.

(d) For ten years following the Closing Date, the Buyer shall (i) keep a written log of the amount of any slag produced by the electric arc furnace method of steelmaking that the Buyer applies each month to the exterior areas of the Owned Real Property together with a description of the general area where those amounts were used (e.g., roads, billet storage yard) and provide those logs to the Seller within 30 days of each anniversary of the Closing Date for the twelve months prior to the anniversary; (ii) implement dust control procedures at least as effective as those set forth in the Seller's Fugitive Dust Control Plan dated July 18, 2003; provided that, in selecting any alternative dust suppressant agent the Buyer shall employ commercially reasonable methods (consistent with Seller's past practices) to assure that use of the alternative agent does not increase the amount of metals leachate from slag produced by the electric arc furnace method of steelmaking; (iii) implement an environmental management system for the Business consistent with ISO 14001; (iv) implement procedures at least as effective as those set forth in Seller's Oil Pollution Spill Prevention Control and Countermeasure Plan and

Pollution Incident Prevention Plan dated January 1981, as revised through August 2003 (the "SPCC/PIPP"); (v) provide copies of the Buyer's SPCC/PIPP spill record forms and monthly inspection forms to the Seller within 30 days of each anniversary of the Closing Date for the twelve months prior to the anniversary; and (vi) provide such documents maintained in accordance with the environmental management system described in the foregoing clause (iii) as the Seller may reasonably request.

7.13 *Limitation on the Parties' Obligations With Respect to Product Warranties.* For each of the two years following the Closing Date, the Seller shall, on the Buyer's request and in lieu of any indemnity obligations set forth in Section 13.2 for Losses arising from Product Warranty Obligations, reimburse the Buyer for one-half of its out-of-pocket costs for any Product Warranty Obligations to the extent that those costs exceed $435,000 in either such year, up to a maximum of $935,000 for each such year.

7.14 *Seller's Option to Purchase Accounts Receivable.* To the extent, if any, that the Accounts Receivable reflected on the Statement of Working Capital are not collectible by the Buyer after the Closing Date, using reasonable collection practices, the Buyer shall, upon the Seller's written request, sell such uncollected Accounts Receivable to the Seller for a cash amount equal to the fact value thereof.

ARTICLE 8

CONDITIONS PRECEDENT TO OBLIGATIONS OF THE BUYING PARTIES

The obligations of the Buying Parties to consummate the transactions described in this Agreement are subject to the satisfaction or waiver (to the extent permitted by applicable Law) by the Buying Parties of the following conditions precedent on or before the Closing Date:

8.1 *Accuracy of Representations and Warranties.* The representations and warranties of the Seller contained in this Agreement and in any certificate or other writing delivered by the Seller pursuant to this Agreement or the Ancillary Agreements shall be true at and as of the Closing Date, as if made at and as of such date (unless any such representation or warranty refers specifically to a specified date, in which case such representation or warranty shall be true, accurate and correct on and as of such specified date), with only such exceptions (for this purpose disregarding any qualification as to

materiality or Material Adverse Effect) as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect. At Closing, the Buyer shall have received a certificate signed by an executive officer of the Seller to the foregoing effect.

8.2 *Compliance with Agreements and Covenants.* The Seller shall have performed and complied in all material respects with all of its covenants, obligations and agreements contained in this Agreement to be performed and complied with by it on or prior to the Closing Date.

8.3 *Hart-Scott-Rodino.* All applicable waiting periods under the HSR Act shall have expired or been terminated without action by the Justice Department or the Federal Trade Commission to prevent the consummation of the transaction described in this Agreement and the Ancillary Agreements.

8.4 *No Injunctions.* There shall not be in effect any temporary restraining order, preliminary injunction, injunction or other pending or threatened action by any Third Party or any order of any court or Governmental Authority restraining or prohibiting the Closing of the transaction described in this Agreement and the Ancillary Agreements.

8.5 *Title Insurance.* The Buyer shall have received a binding commitment to issue a policy of title insurance consistent with Section 7.3, dated the Closing Date, in an aggregate amount equal to the portion of the Purchase Price allocated to the Owned Real Property.

8.6 *Deliveries.* The Seller shall have made, or be prepared to make at Closing all of the Deliveries set forth in Section 11.2.

8.7 *Consents and Release of Encumbrances.* The Seller shall have received all Consents identified on Schedule 8.7 to the Buyer in form and substance reasonably satisfactory to the Buyer (unless the lack of any such Consents would not have, individually or in the aggregate, a Material Adverse Effect) and satisfactory evidence of releases of all Encumbrances on the Purchased Assets (other than Permitted Encumbrances).

8.8 *No Material Adverse Effect.* No event, occurrence, fact, condition, change, development or effect shall have occurred, exist or come to exist since the date of this Agreement that, individually or in the aggregate, has constituted or resulted in a Material Adverse Effect.

8.9 *Audited Financial Statements.* The Seller shall have delivered to the Buying Parties the Audited Financial Statements.

ARTICLE 9

CONDITIONS PRECEDENT TO OBLIGATIONS OF THE SELLER

The obligations of the Seller to consummate the transactions contemplated by this Agreement are subject to the satisfaction or waiver (to the extent permitted by applicable Law) by the Seller of the following conditions precedent on or before the Closing Date:

9.1 *Accuracy of Representations and Warranties.* The representations and warranties of the Buying Parties contained in this Agreement and in any certificate or other writing delivered by the Seller pursuant to this Agreement or the Ancillary Agreements shall be true at and as of the Closing Date, as if made at and as of such date (unless any such representation or warranty refers specifically to a specified date, in which case such representation or warranty shall be true, accurate and correct on and as of such specified date), with only such exceptions (for this purpose disregarding any qualification as to materiality or Material Adverse Effect) as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect. At Closing, the Seller shall have received a certificate signed by an executive officer of each of the Buying Parties to the foregoing effect.

9.2 *Compliance with Agreements and Covenants.* Each of the Buying Parties shall have performed and complied with all of its covenants, obligations and agreements contained in this Agreement to be performed and complied with by it on or prior to the Closing Date.

9.3 *Hart-Scott-Rodino.* All applicable waiting periods under the HSR Act shall have expired or been terminated without action by the Justice Department or the Federal Trade Commission to prevent the consummation of the transaction described in this Agreement and the Ancillary Agreements.

9.4 *No Injunctions.* There shall not be in effect any temporary restraining order, preliminary injunction, injunction or other pending or threatened action by any Third Party or any order of any court or Governmental Authority restraining or prohibiting the Closing of the transaction described in this Agreement and the Ancillary Agreements.

9.5 *Deliveries.* The Buying Parties shall have made, or be prepared to make at the Closing, the Purchase Price and all of the deliveries set forth in Section 11.3.

ARTICLE 10

EMPLOYEES AND BENEFIT PLANS

10.1 *Offer of Employment.* As of the Closing Date, the Seller shall terminate the employment of all of the Affected Employees (other than those who are on short-term disability leave). As soon as practicable after the date of this Agreement, the Buyer shall offer employment, effective as of the Effective Time, to all persons who are or will be Affected Employees on the day immediately preceding the Closing Date (other than those on short-term disability leave) and who complete the Buying Parties' standard application agreement. Each Affected Employee who accepts any such offer of employment shall be referred to herein as a "Transferred Employee". The offer of employment, including, without limitation, wages, salaries and benefits, shall be, in the aggregate, competitive with the terms and conditions as those under which the Transferred Employees were employed immediately prior to the Closing Date. Any Affected Employee who is on short-term disability leave as of the Closing Date shall remain employed by the Seller through such Affected Employee's short-term disability leave; provided, however, that if he or she recovers from his or her disability within the period of his or her short-term disability leave or the six-month period following the Closing Date (whichever is shorter), the Buyer shall at that time make or cause one of its Affiliates to make, an offer of employment to him or her on the same employment terms and conditions as are applicable to similarly situated Transferred Employees, and the Buyer shall reimburse the Seller for the full amount of any short-term disability leave cash compensation paid by the Seller to such Person with respect to periods beginning with the Effective Date until the date that such Person accepts employment with the Buyer; each such Person who accepts employment with the Buyer shall also be deemed a "Transferred Employee" as of the date of such acceptance.

10.2 *Severance Benefits.* In the event that, during the 90 day period immediately following the Closing Date (the "Severance Period"), the employment with the Buyer of a Transferred Employee is terminated (a) by the Buyer "without cause" in accordance with the terms of the Buyer's written policies, as applicable; provided that, for the purposes of this Agreement, reductions in force and job elimination shall not constitute a "for cause" termination; or (b) other than as a result of such Transferred Employee's death, disability or voluntary retirement; such Transferred Employee will be entitled to receive from the Buyer the amount of severance pay as calculated under the Buyer's severance policy or plan as in effect on the date of this Agreement. No Transferred Employee will be required to relocate outside of such Transferred Employee's primary work area during the Severance Period.

10.3 *Vacation.* The Seller shall be solely responsible and liable for all 2003 unused vacation for all Transferred Employees as of the Closing Date and shall provide a cash payment of such amounts to

such Transferred Employees as soon as practicable after the Closing. The Buyer shall be responsible for all 2004 vacation earned by all Transferred Employees on January 1, 2004 and shall provide a cash payment of such amounts to such Transferred Employees no later than February 28, 2004; provided, however, that the cash equivalent value of all such vacation with respect to the hourly Transferred Employees (the "Vacation Amount") shall not exceed $1,000,000. The Seller shall provide sufficient information about the 2004 vacation earned to enable the Buyer to make such cash payments. The Seller shall reimburse the Buyer for one-half of the Vacation Amount. The Buyer shall also be responsible for any vacation accruing after the Effective Time by any Transferred Employees.

10.4 *Salaries and Benefits.*

(a) The Seller shall be responsible for the payment of all wages and other remuneration due to Affected Employees up until the Effective Time.

(b) The Seller shall be liable for any claims made by Affected Employees and their beneficiaries under the Seller's Employee Plans. For purposes of the immediately preceding sentence, a charge will be deemed made, in the case of a hospital, medical or dental benefits, when the services that are the subject of the charge are performed.

(c) Welfare benefit plan coverage of the Seller for Transferred Employees shall cease as of the Effective Time and the welfare benefit plan coverage under the Buyer's plans for Transferred Employees shall immediately commence. The Seller shall be solely responsible for any continuation coverage required by COBRA for those Affected Employees of the Seller who are not Transferred Employees. The Buyer shall waive all pre-existing conditions, limitations or exclusions and waiting periods for the Transferred Employees under all pension, employee welfare plans and fringe benefits programs of the Buyer, including, without limitation, vacation, bonus and other incentive programs, except as to the waiting periods pursuant to the Buyer's 401(k) plan. As of the Effective Time, the welfare benefit plans of the Buyer shall be responsible for all coverage on the basis of when the services that are the subject of a claim are performed.

(d) The Seller shall retain all assets in the pension and retirement funds of the Seller, and shall distribute pension and retirement benefits that the Transferred Employees shall become entitled to receive from the Seller in accordance with the applicable plan document and the Transferred Employees' elections, as applicable.

(e) Effective as of the Closing Date (or as to employees on short-term disability leave on the Closing Date, as of the date of employment by Buyer), the Buyer shall give past service credit to all the Transferred Employees for purposes of determining vesting, eligibility and benefit accruals under all the Buyer's employee benefit programs, including pension, severance, vacation, bonus, incentive compensation and employee welfare benefit plans of the Buyer equal to that which such Transferred Employees were credited with by the Seller as of the Closing Date for service with the Seller or any predecessor employee, but excluding benefit accruals for Buyer's defined pension plans.

(f) The Seller will retain all incentive savings plan (401(k) plan) benefits held in the name of the Transferred Employees, if any, unless otherwise directed by a Transferred Employee or unless distribution is otherwise allowed or mandated pursuant to the plan document. The Buyer shall cause to be accepted qualified direct and indirect rollovers from the Seller's incentive savings plan, provided that the Buyer obtains such information as is satisfactory to the Buyer to assure itself that the Seller's incentive savings plan satisfies the qualification requirements of section 401(a) of the Code. The Buyer shall cause to be accepted all loans to Transferred Employees that are associated with any such rollovers from the Seller's incentive savings plan.

10.5 *No Transfer of Assets.* Except as provided in Section 10.4(f) no pension or other employee benefit plan assets held by the Seller shall be transferred to the Buyer.

10.6 *Termination/WARN Act Notification.* With respect to events following the Closing, the Buyer shall be responsible for sending timely and appropriate notices to all Transferred Employees required under all applicable Laws relating to plant or facility closings or otherwise regulating the termination of employees. To the extent that any liability is incurred under any such Laws based on the Buyer's failure to comply with Section 10.1 or the Buyer's actions after the Closing, the Buyer will be solely and exclusively responsible for all obligations and liabilities incurred under such Laws relating to this transaction.

10.7 *Employee Records.* The Seller shall make available to the Buyer records which provide information regarding employees' names, Social Security numbers, dates of hire by the Seller, date of birth, number of hours worked each calendar year, attendance and salary histories for all Transferred Employees. The Seller shall not provide records pertaining to performance ratings and evaluations, disciplinary records and medical records.

10.8 *General Employment Provisions.*

(a) The Seller and the Buyer shall give any notices required by Law and take whatever other actions with respect to the plans, programs and policies described in this Article X as may be necessary to carry out the agreements described in this Agreement.

(b) If any of the agreements described in this Article X are determined by any Governmental Authority to be prohibited by Law, the Seller and the Buyer shall modify those agreements to as closely as possible reflect their expressed intent and retain the allocation of economic benefits and burdens to the Parties described in this Agreement in a manner not otherwise prohibited by Law.

10.9 *Seller Retiree Benefits.* Transferred Employees who have attained sufficient age and service credit as of the Closing Date to retire and begin receiving retiree medical benefits under the Cargill, Incorporated and Associated Companies Retiree Health Care Plan and pension benefits under the Cargill, Incorporated and Associated Companies Salaried Employees Pension Plan and the North Star Steel Monroe, Michigan Hourly Employee Pension Plan may elect to retire and if they so elect begin receiving pension benefits from the Cargill, Incorporated and Associated Companies Salaried Employees Pension Plan and the North Star Steel Monroe, Michigan Hourly Employee Pension Plan effective as of the Closing Date, shall be treated as retirees for purposes of Seller retiree welfare benefit programs and shall be eligible to receive retiree benefits from such plans in accordance with their terms (as such may be amended from time to time), even if such individual continues employment with the Buyer or an Affiliate of the Buyer following the Closing Date. On or prior to the Closing Date, the Seller shall take such action as may be necessary or appropriate to conform the applicable Seller Benefit Plans to the provisions of this Section 10.9.

ARTICLE 11

CLOSING

11.1 *Closing.* The Closing shall take place at the Seller's offices in Minneapolis, Minnesota, at 9:00 a.m. on December 31, 2003 or, if all of the closing conditions set forth in Articles VIII and IX have not been satisfied or waived as of such date, on the first date on which such conditions have been satisfied or properly waived (to the extent permitted by applicable Laws) pursuant to the terms of this Agreement. The date on which the Closing occurs is referred to in this Agreement as the "Closing Date." The Closing shall be effective as of the Effective Time.

11.2 *Deliveries by the Seller.* At the Closing, the Seller shall be responsible for one-half of the Vacation Amount as described in Section 10.3, which shall be treated as a setoff to the Purchase Price as part of the closing adjustments to be made pursuant to this Agreement. Also at or before the

Closing, the Seller shall deliver to the Buying Parties the following, each dated the Closing Date and duly executed by the Seller:

(a) The Conveyance Documents;

(b) The Trademark License Agreement;

(c) Possession of the Purchased Assets;

(d) Certificates of title for all vehicles included in the Purchased Assets, duly endorsed for transfer to the Buying Parties and any related documents necessary to effect the transfer of the vehicles;

(e) Other instruments of transfer reasonably requested by the Buying Parties to evidence the transfer of the Purchased Assets to the Buying Parties and consummation of the transactions described in this Agreement, including assignments with respect to any Transferred Intellectual Property to be

registered, recorded or filed with any Governmental Authority, in a form suitable for registration, recordation or filing with such Governmental Authority, in each case duly executed by the Seller;

(f) A certificate, dated the Closing Date, of an appropriate officer of the Seller certifying as to the compliance by the Seller with Sections 8.1 and 8.2;

(g) A certificate of the Secretary of the Seller certifying resolutions of the board of directors of the Seller (or the executive committee of its board of directors) approving and authorizing the execution, delivery and performance by it of this Agreement by the Seller and the Ancillary Agreements to which the Seller is a party and the consummation by the Seller of the transactions described in this Agreement and the Ancillary Agreements (together with an incumbency and signature certificate regarding the officer signing on behalf of the Seller);

(h) The Consents identified on Schedule 4.3, each of which shall be in form and substance reasonably satisfactory to the Buying Parties;

(i) The documentation related to any unassignable Permits and Material Contracts described in Section 2.2, if applicable;

(j) A certificate, in the form prescribed by Treasury regulations under section 1445 of the Code, that the Seller is not a foreign Person within the meaning of section 1445 of the Code;

(k) The title insurance policy described in Section 7.3(a);

(l) The Escrow Agreement;

(m) The Licensed Intellectual Property Agreement;

(n) The Transition Services Agreement; and

(o) Such other documents and instruments as may be reasonably required to consummate the transactions described in this Agreement and the Ancillary Agreements.

11.3 *Deliveries by the Buying Parties.* At the Closing, the Buying Parties shall make the payments described in Section 3.1 and shall deliver to the Seller the following, each dated the Closing Date and duly executed by the Buying parties:

(a) The Assignment and Assumption Agreement;

(b) The Trademark License Agreement;

(c) A certificate, dated the Closing Date, of an appropriate officer of each of the Buying Parties, certifying as to compliance by the Buyer with Sections 9.1 and 9.2;

(d) A certificate of the Secretary of each of the Buying Parties certifying resolutions of its boards of directors approving and authorizing the execution delivery and performance of this Agreement by it and the Ancillary Agreements to which it is a party and the consummation by it of the transactions described in this Agreement (together with an incumbency and signature certificate regarding the officer signing on behalf of each of the Buying Parties);

(e) The Consents identified on Schedule 4.3, each of which shall be in form and substance reasonably satisfactory to the Seller;

(f) The Escrow Agreement;

(g) The Licensed Intellectual Property Agreement;

(h) The Transition Services Agreement; and

(i) Such other documents and instruments as may be reasonably required to consummate the transactions described in this Agreement and the Ancillary Agreements.

11.4 *Passage of Title and Risk of Loss.* Legal title, equitable title, and risk of loss in respect of the Purchased Assets will pass to the Buyer at the Closing, which transfer, once it has occurred, will be deemed effective for tax, accounting, and other computational purposes as of the Effective Time.

ARTICLE 12

TERMINATION

12.1 *Termination.* This Agreement may be terminated at any time on or prior to the Closing:

(a) By the mutual written agreement of the Seller and the Buyer;

(b) By the Seller or the Buying Parties if the Closing shall not have taken place on or before January 30, 2004; provided, however, that the terminating party shall not have failed to fulfill any obligation under this Agreement or be in breach of any representation, warranty or covenant under this Agreement, which failure or breach was the cause of or resulted in the failure of the Closing to occur on or before such date;

(c) By the Seller or the Buying Parties, if any court of competent jurisdiction or other Governmental Authority shall have issued a final and non-appealable order, decree or ruling or taken any other action permanently restraining, enjoining or otherwise prohibiting the consummation of the transactions described in this Agreement; or

(d) By the Seller or the Buying Parties, if prior to the Closing Date, the other Party is in default or breach in any material respect of any representation, warranty, covenant or agreement contained in this Agreement, and such default or breach shall not be cured within 15 Business Days after the date on which notice of such breach is delivered by the Party claiming such default or breach to the Party in default or breach.

In the event of any termination pursuant to this Section 12.1 (other than pursuant to clause (a)), written notice setting forth the reasons for the termination shall promptly be given by the terminating Party to the other Party.

12.2 *Effect of Termination.* If this Agreement is terminated pursuant to Section 12.1, all obligations of the parties under this Agreement shall terminate, except for the obligations set forth in Articles XIII, XIV and XV and Section 7.7, which shall survive the termination of this Agreement, and except that no such termination shall relieve any party from liability for any breach of this Agreement prior to such termination.

ARTICLE 13

INDEMNIFICATION

13.1 *Survival; Remedy for Breach.*

(a) The representations and warranties contained in this Agreement shall survive, for limitation purposes only, until the second-year anniversary of the Closing Date at which time they shall expire; provided, however, that:

(i) The representations and warranties contained in Section 4.15 (including any provision incorporated therein) shall, to the extent that they relate to Air Compliance Matters, survive until the fourth-year anniversary of the Closing Date;

(ii) The representations and warranties contained in Section 4.15 (including any provision incorporated therein) shall, to the extent that they relate to environmental matters other than Air Compliance Matters, survive until the third-year anniversary of the Closing Date; and

(iii) The representations and warranties contained in Section 4.8, 4.12 and 4.13 shall survive until the expiration of the applicable statute of limitations.

No claim regarding a breach of a representation or warranty contained in this Agreement shall be made after the expiration of the stated period of survival.

(b) The covenants contained in this Agreement shall survive until the second-year anniversary of the Closing Date unless the Agreement clearly specifies a longer duration. No claim regarding a breach of covenant contained in this Agreement shall be made after the expiration of the stated period of survival.

(c) The indemnity obligations contained in Section 13.2(a) shall survive until the second-year anniversary of the Closing Date at which time all indemnity obligations of the Seller shall expire; provided, however, that:

(i) The indemnity obligations contained in Sections 13.2(a)(i) and 13.2(a)(ii) shall survive so long as each underlying representation, warranty or covenant shall survive;

(ii) The indemnity obligations contained in Section 13.2(a)(iv) shall survive until the third-year anniversary of the Closing Date;

(iii) The indemnity obligations contained in Section 13.2(a)(vi) shall survive until the third-year anniversary of the Closing Date; except for Air Compliance Matters which shall survive until the fourth-year anniversary of the Closing Date; and

(iv) The indemnity obligations contained in Section 13.2(a)(viii) shall survive until the tenth-year anniversary of the Closing Date.

provided further, that any claim asserted in writing within the period of survival shall be timely made for purposes of this Agreement. No claim for indemnity shall be made after the expiration of the applicable survival period.

13.2 *Indemnification by the Seller.*

(a) Subject to Sections 13.1, 13.2(b) and 13.2(c), the Seller agrees to indemnify, defend and hold harmless the Buyer, its Affiliates and their respective stockholders, officers, directors, employees, agents, representatives, successors and assigns (the "Buyer Group") from and against

any and all Losses incurred or suffered by any of them arising out of or relating to any of the following:

(i) A breach of any representation or warranty made by the Seller in this Agreement or the Ancillary Agreements (other than any representation or warranty in Section 4.15 (including any provision incorporated therein) as to Existing Contamination);

(ii) Any breach of or failure by the Seller to perform any covenant or obligation set forth in this Agreement or the Ancillary Agreements;

(iii) The Seller's failure to comply with any applicable Law relating to bulk transfers or bulk sales;

(iv) The manufacture and sale of products prior to the Effective Time which give rise to Products Liability, and all costs incurred by the Buyer in connection with its obligations under Section 2.4(c) and 7.13, to the extent those costs exceed $935,000 in each of the first two years after the Closing Date;

(v) The ownership or operation of the Excluded Assets, and the ownership or the operation of the Excluded Businesses;

(vi) Any Scheduled Environmental Compliance Matters (other than any Scheduled Environmental Compliance Matter with respect to Existing Contamination Obligations);

(vii) Any Excluded Obligations (other than Existing Contamination Obligations);

(viii) Any Third Party Claim to the extent arising from Existing Contamination Obligations for which the Buyer has not received in accordance with Section 7.12 a BEA Affirmation that provides an exemption from liability, including (a) personal injury claims, (b) claims under any federal Environmental Law, (c) claims relating to the Seller's Type III landfill and any closure obligation in connection therewith, (d) claims arising from the Seller's failure or alleged failure to comply with the requirements of MCL 324.20107a, (e) claims relating to any Hazardous Substance found in slag produced by the electric arc furnace method of steelmaking; and (f) claims relating to any Hazardous Substance alleged to be at or from a portion of the Owned Real Property addressed in the BEA by a stipulation under Michigan Administrative Code R. 299.5909(2)(b)(ii); and

(ix) The operation of the Business by the Seller or the ownership of the Purchased Assets by the Seller before the Effective Time, other than (a) Environmental Losses and (b) Losses to the extent they are (A) based on specific matters identified on any schedules to this Agreement, (B) the subject of a representation, warranty, covenant or obligation made by the Seller in this Agreement or any Ancillary Agreement or (C) based on the matters described in Sections 13.2(a)(iii) through 13.2(a)(viii).

It is acknowledged that the Seller shall have no obligation under this Section 13.2(a) to the extent any claim (i) arises from or relates to a release or threatened release of a Hazardous Substance that first occurred after the Closing Date, (ii) is attributable to the operation (including any acts or omissions) of the Business by the Buyer or the use and operation (including any acts or omissions) of the Purchased Assets by the Buyer after the Closing Date, (iii) arises out of changes in Laws after the Closing Date, Laws issued or enacted after the Closing Date, or requirements of existing Laws that become effective or applicable after the Closing Date, or (iv) is for the removal, abatement, maintenance or management of any asbestos-containing building material at the Owned Real Property. It is further acknowledged that in the event the Buyer does not receive any BEA Affirmation in accordance with Section 7.12 (whether by any withdrawal of the BEA Petition or otherwise) then the Seller's obligations under Section 13.2(a)(viii) shall include any and all Third Party Claims to the extent arising from Existing Contamination Obligations.

(b) The obligations of the Seller to provide indemnification pursuant to Section 13.2(a) shall be limited as follows: the Seller shall not be liable with respect to (i) the Product Warranty Obligations described in Section 7.13, it being understood that the Buyer's sole remedy against the Seller for such Product Warranty Obligations shall be limited by the rights and obligations of the Parties set forth in Sections 2.4(c) and 7.13, to the extent the Buyer's costs for complying with Section 7.13 do not exceed $935,000 in either of the first two years after the Closing Date; or (ii) any matter referred to in Section 13.2(a) unless the Losses thereunder exceed an aggregate deductible of $3,000,000 (the "Seller's Basket") in which event the Selling Party shall be liable for all claims under Section 13.2(a) to the extent such Losses exceed the Seller's Basket; provided, however, that the Seller's Basket shall not apply to any Losses based on Product Liability, Air Compliance Matters, the claims described in Section 13.2(a)(viii) or the Excluded Obligations, in which cases the obligations of the Seller to provide indemnification pursuant to Section 13.2(a) shall be subject only to the Seller's Maximum Indemnity Amount. The Seller's combined aggregate liability for all Losses shall in no event exceed an amount equal to $33,000,000 (the "Seller's Maximum Indemnity Amount").

(c) The amount for which the Seller shall be liable with respect to any Loss pursuant to Section 13.2(a) shall be reduced to the extent that the Buyer or any other member of the Buyer Group shall have realized any net proceeds recovered from Third Parties (other than Buyer Group insurers) with respect to the Loss. If the Buyer or any other Person entitled to indemnity under Section 13.2(a) shall have received or shall have had paid on its behalf an indemnity payment with respect to a Loss and shall subsequently receive, directly or indirectly, any proceeds, then the Buyer shall promptly pay to the Seller the net amount of those proceeds or, if less, the amount of the indemnity payment. The Buyer shall have no obligation to take any action to file claims under applicable policies to recover insurance proceeds that may be due to the Buyer or any other Person in order to mitigate the Seller's obligations under this Agreement.

(d) For purposes of determining whether any condition or event constitutes a breach of any Seller environmental representation or warranty under Section 4.15 for which indemnification is to be provided under this Section 13.2, and whether Losses arising out of such breach exceed Seller's Basket, any qualifier in said representation or warranty as to knowledge or materiality shall be disregarded.

(e) For purposes of Section 13.2(a)(viii), a Third Party Claim alleging any release of a Hazardous Substance at or from the Owned Real Property shall be presumed to arise out of Existing Contamination unless, and only to the extent that, the Seller establishes by a preponderance of the evidence that such Hazardous Substance is the result of the Buyer's or the Buyer's Group's steelmaking operations at the Owned Real Property or other use of the Owned Real Property after the Closing Date.

(f) The Buying Parties shall use their commercially reasonable efforts to mitigate any direct fixed overhead costs (including labor costs) associated with any facility shut-down for which indemnification is sought under this Section 13.2.

13.3 *Indemnification by the Buyer.*

(a) Subject to Sections 13.1, 13.3(b) and 13.3(c), each of the Buying Parties shall, on a joint and several basis, indemnify, defend and hold harmless the Seller, its Affiliates and its respective stockholders, officers, directors, employees, agents, representatives, successors and assigns (the "Seller Group"), from and against any and all Losses incurred or suffered by them arising out of any of the following:

(i) Any breach of any representation or warranty made by the Buying Parties in this Agreement or the Ancillary Agreements;

(ii) Any breach of or failure by the Buying Parties to perform any covenant or obligation set forth in this Agreement or the Ancillary Agreements; and

(iii) Any of the Assumed Obligations (to the extent a member of the Buyer's Group is not entitled to indemnification under Section 13.2).

(b) The Buying Parties shall not be liable with respect to any matter referred to in Section 13.3(a) unless the Losses thereunder exceed an aggregate deductible of $3,000,000 (the "Buyer's Basket") in which event the Buying Parties shall be liable for all claims under Section 13.3(a) to the extent such Losses exceed the Buyer's Basket; provided, however, that the Buying Parties' combined aggregate liability for Losses that exceed the Buyer's Basket shall in no event exceed an amount equal to $33,000,000 (the "Buyer's Maximum Indemnity Amount').

(c) The amount for which the Buyer shall be liable with respect to any Loss pursuant to Section 13.3(a) shall be reduced to the extent that the Seller or any other member of the Seller Group shall have realized any net proceeds recovered from Third Parties (other than Seller Group insurers) with respect to the Loss. If the Seller or any other Person entitled to indemnity under Section 13.3(a) shall have received or shall have had paid on its behalf an indemnity payment with respect to a Loss and shall subsequently receive, directly or indirectly, any proceeds, then the Seller shall promptly pay to the Buyer the net amount of any proceeds or, if less, the amount of the indemnity payment. The Seller shall have no obligation to take any action to file claims under applicable policies to recover insurance proceeds that may be due to the Seller or any other Person in order to mitigate the Buying Parties' obligations hereunder.

13.4 *Claims.* As soon as is reasonably practicable after becoming aware of a Third Party Claim with respect to which indemnity may be claimed pursuant to the terms of this Agreement, the Indemnified Person shall promptly give notice to the Indemnifying Person of the claim or the commencement of the Third Party Claim and a good faith estimate of the amount the Indemnified Person will be entitled to receive under this Agreement from the Indemnifying Person; provided, however, that the failure of the Indemnified Person to give notice shall not relieve the Indemnifying Person of its obligations under this Article XIII except to the extent (if any) that the Indemnifying Person shall have been actually prejudiced by that failure. A claim for indemnification for any matter not involving a Third Party Claim may be asserted by notice to the Indemnifying Person without the need to comply with Sections 13.5 through 13.7.

13.5 *Assumption of Defense.* The Indemnifying Person may, at its own expense participate in the defense of any Third Party Claim and upon written acknowledgement to the Indemnified Person that the Indemnified Person is entitled to indemnification pursuant to Section 13.2 or 13.3, as applicable, for all Losses arising out of the Third Party Claim, at any time during the course of any Third Party Claim assume the defense of the Third Party Claim; provided, however, that (a) the Indemnifying Person's counsel is reasonably satisfactory to the Indemnified Person; (b) after assuming the defense, the Indemnifying Person shall consult with and update the Indemnified Person upon the Indemnified Person's reasonable request for consultation or update from time to time with respect to the Third Party; and (c) the Third Party Claim involves only monetary damages and does not seek an injunction or other equitable relief or does not, in the good faith judgment of the Indemnified Person, involve a conflict of interest. If the Indemnifying Person assumes the defense, the Indemnified Person shall have the right (but not the obligation) to participate in the defense and to employ counsel, at its own expense, separate from the counsel employed by the Indemnifying Person; provided, however, that if (i) the Indemnified Party determines that a conflict of interest exists or (ii) the Indemnifying Party fails to actively and diligently conduct the defense of a Third Party Claim, then in either event, the Indemnified Person may hire separate counsel, at the Indemnifying Person's expense. Whether or not the Indemnifying Person chooses to defend or prosecute any Third Party Claim, all of the Parties shall reasonably cooperate in the defense or prosecution of the Claim.

13.6 *Settlement or Compromise.* Any settlement or compromise made or caused to be made by the Indemnified Person or the Indemnifying Person, as the case may be, of a Third Party Claim shall also be binding on the Indemnifying Person or the Indemnified Person, as the case may be, in the same manner as if a final judgment or decree had been entered by a court of competent jurisdiction in the amount of the settlement or compromise; provided, however, that (a) subject to Section 13.7, no obligation, restriction, course of conduct or Loss shall be imposed on the Indemnified Person or the Business, as the case may be, as a result of the settlement or compromise without the prior written consent of such Indemnified Person; and (b) the Indemnifying Person shall not enter into any settlement or compromise without obtaining a duly executed unconditional release of the Indemnified Person from all liability in respect of the Third Party Claim. The Indemnified Person or the Indemnifying Person, as the case may be, shall give the other Person at least 10 days' prior written notice of any proposed settlement or compromise of any Third Party Claim it is defending, during which time the other Person may reject the proposed settlement or compromise. If the Indemnified Person is the rejecting party, it shall be obligated to assume the defense of, and full and complete liability and responsibility for, the Third Party Claim and any and all Losses in connection with it in excess of the amount of Losses which the Indemnified Person would have incurred under the proposed settlement or compromise. If the Indemnifying Person is the rejecting party, the Indemnifying Person shall be obligated to assume the defense of, and full and complete liability for, the Third Party Claim and any and all Losses in connection with it.

13.7 *Failure of Indemnifying Person to Act.* If the Indemnifying Person does not elect to assume the defense of any Third Party Claim, then (a) the Indemnified Person shall (upon further notice to the Indemnifying Person) have the right to undertake the defense, compromise or settlement of such Third Party Claim on behalf of and for the account and risk of the Indemnifying Party, subject to the Indemnifying Party's election to assume the defense of such Third Party Claim at any time prior to settlement, compromise or final determination of the Claim; and (b) any failure of the Indemnified Person to defend or to participate in the defense of a Third Party Claim or to cause the same to be done, shall not relieve the Indemnifying Person of its obligations under this Agreement.

13.8 *Direct Claims.* The Indemnifying Person will have a period of 30 calendar days within which to respond in writing to any claim made in writing by an Indemnified Person on account of any Loss that does not result from a Third Party Claim (a "Direct Claim"). If the Indemnifying Person does not so respond within that 30 day period, the Indemnifying Person will be deemed to have rejected the Direct Claim, in which event the Indemnified Person will be entitled to pursue such remedies as may be available to the Indemnified Person.

13.9 *Exclusive Remedy.* Except as provided in Section 15.16, or otherwise expressly provided by the Ancillary Agreements or any other agreement with any Affiliate of the Seller expressly referring to this Agreement, the rights and remedies set forth in this Article XIII shall, from and after the Closing constitute the sole and exclusive rights and remedies of (a) any member of the Seller Group against a Buying Party; and (b) any member of the Buyer's Group against the Seller, in each case with respect to the Purchased Assets, the Assumed Obligations, the Excluded Assets, the Excluded Obligations, the Existing Contamination Obligations, the Business, this Agreement or the Ancillary Agreements. Each member of the Seller Group, on the one hand, and each member of the Buyer Group, on the other hand, hereby waives, releases and agrees not to assert any other right, whether arising by statute, common law, equity or otherwise, including

contribution or cost recovery claims under Environmental Laws, against any member of the other group, in connection with or otherwise relating to the Purchased Assets, the Assumed Obligations, the Excluded Obligations, the Existing Contamination Obligations, the Business, this Agreement or the Ancillary Agreements.

13.10 *Procedures and Limitations with respect to the Seller's Environmental Indemnification.* Notwithstanding anything in this Agreement to the contrary, the Seller's obligation to indemnify and defend the Buyer Group pursuant to Section 13.2(a) with respect to any Loss in excess of the Seller's

Basket but less than the Seller's Maximum Indemnity Amount that arises out of or relates to Section 13.2(a)(i) as it pertains to breach under Section 4.15 (including any provision incorporated therein), 13.2(a)(vi) or 13.2(a)(viii) ("collectively, Environmental Losses") is subject to the following terms, limitations and conditions:

(a) The Seller's indemnification obligation to the Buyer Group with respect to environmental response, remedy, or corrective action selected and implemented by the Seller or the Buyer that constitutes Environmental Losses under this Agreement shall be limited to compliance with the minimum standards and requirements of applicable Environmental Laws in effect as of the Closing Date (including engineering controls or institutional controls) (the "Standard").

(b) Environmental Losses that are the subject of Third Party Claims shall be subject to the Claims and Assumption of Defense provisions in Sections 13.4, 13.5, 13.6 and 13.7 of this Article XIII with the following modifications: If the Seller, after providing written acknowledgement to the Buyer that the Buyer Group is entitled to indemnification pursuant to Section 13.2 for all Environmental Losses arising out of the Third Party Claim, assumes the defense of the Third Party Claim pursuant to Section 13.5, the Seller shall have the right to control, direct, defend, and implement any environmental response, remedy, or corrective action required under or pursuant to Environmental Laws for which the Seller acknowledges that it has an indemnification obligation under this Agreement. This right shall include the selection of consultants (in addition to counsel) reasonably satisfactory to the Buyer Group. In exercising the right to control, direct, defend, and implement any environmental response, remedy, or corrective action, the Seller shall not unreasonably interfere with the Buyer's operation of the Business and the Buyer shall cooperate with the Seller in providing reasonable access to its employees, the Owned Real Property and any applicable books and records of the Business to enable the Seller to carry out its indemnification obligations which are the subject of the Third Party Claim. The Seller may exercise the right to control, direct, defend, and implement any environmental response, remedy, or corrective action notwithstanding the limitation in Section 13.5(c) regarding injunctions or equitable relief; provided however, that settlement of an environmental matter that includes injunctive or equitable relief affecting the operation of the Business by the Buyer Group shall be subject to the express written consent of the Buyer, which consent shall not be unreasonably withheld.

(c) In the event the Seller fails to assume the defense of a Third Party Claim for Environmental Loss pursuant to Section 13.5, or the Buyer has a Direct Claim for Environmental Loss pursuant to Section 13.8 which the Seller rejects, the Buyer Group shall have the right to control, direct, defend and implement the related environmental response, remedy, or corrective action required under or pursuant to Environmental Laws; provided however, that prior to agreeing upon or implementing such a response, remedy or corrective action, the Buyer shall submit to the Seller a written statement setting forth the proposed response, remedy or corrective action, the scope of the proposed work, an explanation as to why the proposal meets the Standard, and the expected cost thereof (hereinafter referred to as the Scope of Work or ("SOW"); provided, however, that the Buyer Group may begin any environmental response, remedy, or corrective action necessary to address an imminent and substantial endangerment to human health or the environment or as directed by a Governmental Authority without first submitting the SOW to the Seller, in which case the Buyer Group shall provide the SOW to the Seller as soon thereafter as practicable.

(d) In the event that the Seller asserts that the SOW as provided for in subsection (c) hereof does not satisfy the Standard, the Seller shall notify the Buyer Group in writing as to why the proposal does not meet the Standard within 30 days of receipt of the SOW. Upon delivery of a notice of dispute, the Parties shall attempt to resolve the dispute through informal discussions lasting no longer than fourteen (14) days. If the Seller does not accept the Buyer Group's position

with respect to the SOW at the end of the fourteen (14)-day period, the Seller shall send written notice to the Buyer Group within seven (7) days thereof that sets forth in detail the nature of any remaining objection and invoking the Mutual Dispute Resolution provisions of Article XIV. Failure to give timely notice shall be deemed acceptance of Buyer's position.

(e) The provisions of Article XIV shall apply to any dispute regarding the SOW except that in lieu of any judicial remedies, the Parties shall submit the matter to arbitration. The sole issue to be submitted to arbitration shall be whether the SOW satisfies the Standard. The Party invoking arbitration shall do so by serving notice on the other Party within ten (10) days following the failure of the Chief Executive Officers to resolve the dispute. The dispute shall be resolved by an independent arbitrator selected by the Parties who has substantive expertise in the area of dispute with no prior involvement with the Business or economic interest in the outcome of the dispute ("Arbitrator"). If the Parties are unable to agree on an Arbitrator within ten (10) days following the notice date, each Party shall nominate its own expert who together shall select the Arbitrator within seven (7) days.

(f) Within fourteen (14) days of the selection of the Arbitrator the Parties shall submit any written materials they desire the Arbitrator to consider (the "Initial Submittals"). The Parties shall not engage in formal discovery but shall provide each other with such non-privileged information in its possession reasonably required to determine whether the SOW satisfies the Standard. Within forty-five (45) days of the selection of the Arbitrator, the Parties shall meet jointly with the Arbitrator, at which time each may present any documentation to rebut the positions of the other Party's Initial Submittal (the "Rebuttal Submittals"). Neither party may present witnesses at that meeting but may be accompanied by experts to answer any questions posed by the Arbitrator in the Arbitrator's discretion. The decision of the Arbitrator shall be based on the Initial Submittals, the Rebuttal Submittals, and the joint meeting of the Parties without regard to the legal rules of evidence. The time and location of the meeting shall be determined by the Arbitrator but shall be reasonably convenient to the Parties and shall not cause one Party to incur a disproportionate amount of travel or other costs. Within thirty (30) days of the joint meeting, the Arbitrator shall provide the Parties with a written decision specifying whether the SOW satisfies the Standard, and if not, specifying any measures appropriate to bring the SOW into conformance with that Standard. This agreement to arbitrate shall be specifically enforceable and the determination of the Arbitrator shall be final.

(g) In no event shall any determination of a Governmental Authority be subject to arbitration hereunder.

(h) Each Party shall bear its own fees and expenses in any arbitration proceedings pursuant to this Section 13.10. The costs and fees of the Arbitrator shall be shared equally by the Parties.

(i) If any Governmental Authority notifies the Buyer that any environmental response, remedy or corrective action selected pursuant to this Section 13.10 does not actually attain compliance with the minimum standards and requirements of applicable Environmental Laws, then the indemnification provisions contained in Section 13.2 shall apply to such compliance matters and the Buying Parties may make a new claim under, and subject to the limitations contained in, such provisions.

ARTICLE 14

DISPUTE RESOLUTION

14.1 *Mutual Dispute Resolution.* Except as provided for in Section 3.2 (regarding Working Capital adjustments to the Purchase Price) or in Section 13.10(f) (regarding the SOW in connection with environmental response actions), any dispute or difference arising subsequent to the Closing Date,

out of or in connection with this Agreement or the formation of this Agreement (including any contested claim for indemnification pursuant to Article XIII), shall be first submitted for resolution pursuant to the following procedure. First, a senior executive officer for each Party will meet in person to resolve the dispute within ten (10) days after written notice of such dispute is provided by a Party to the other Parties. If the executive officers are unable to resolve the dispute within five (5) days after their meeting, the Chief Executive Officers of each Party shall promptly attempt to resolve the dispute. If the Chief Executive Officers are unable to resolve the dispute within thirty (30) days following the original notice of the claim or dispute, then any Party may seek any remedy available under Law, including bringing an action for relief in any court having appropriate jurisdiction.

ARTICLE 15

MISCELLANEOUS

15.1 *Disclosure Schedules.* The inclusion of any matter on any schedule to this Agreement shall not constitute an admission by the Seller that the matter is material or would reasonably be expected to have a Material Adverse Effect. Any matters disclosed by the Seller to the Buyer pursuant to any section of this Agreement shall be deemed to be disclosed with respect to all sections of this Agreement. The schedules to this Agreement are being delivered to the Parties separate from this Agreement, and are incorporated in this Agreement by reference.

15.2 *Expenses.* Except as otherwise provided in this Agreement, each Party hereto shall bear its own expenses with respect to the transactions described in this Agreement.

15.3 *Amendment.* This Agreement may be amended, modified or supplemented only by a writing signed by the Parties.

15.4 *Interpretation.* The headings preceding the text of articles and sections included in this Agreement and the headings to schedules and exhibits attached to this Agreement are for convenience only and shall not be deemed part of this Agreement or be given any effect in interpreting this Agreement. The terms as set forth in this Agreement have been arrived at after mutual negotiation with the advice of counsel representing all Parties and, therefore, it is the intention of the Parties that its terms may not be construed against any of the Parties by reason of the fact that it was prepared by one of the Parties. Unless the context otherwise requires, (a) the gender (or lack of gender) of all pronouns used in this Agreement includes the masculine, feminine and neuter; (b) references to articles, sections, exhibits and schedules refer to articles and sections of, or exhibits and schedules to this Agreement; and (c) "including" means "including without limitation".

15.5 *Notices.* Any notice, request, instruction or other document to be given under this Agreement by a Party shall be in writing and shall be deemed to have been given (a) when received if given in person or by courier or a courier service; (b) on the date of transmission if sent by telex, facsimile or other wire transmission (receipt confirmed); or (c) 5 Business Days after being deposited in the mail, certified or registered, postage prepaid:

If to the Seller, addressed as follows:

North Star Steel Company
7650 Edinborough Way, Suite 600
Edina, Minnesota 55435
Attention: President
Telephone No.: (952) 367-3000
Facsimile No.: (952) 367-3082

With a copy to:

General Counsel
Cargill Law Department
P.O. Box 5624
Minneapolis, Minnesota 55440-5624
15615 McGinty Road West
Wayzata, Minnesota 55391-2399

Telephone No.: (952) 742-6372
Facsimile No.: (952) 742-4671

If to a Buying Party, addressed as follows:

Quanex Corporation
1900 West Loop South, Suite 1500
Houston, Texas 77027
Telephone No.: 713 961-4600
Facsimile No.: 713 877-5333
Attention: Mr. Terry M. Murphy

With a copy to:

Ms. Harva R. Dockery
Fulbright & Jaworski, L.L.P.
1301 McKinney Street, Suite 1500
Houston, TX 77010-3095
Telephone No.: 713 651-5196
Facsimile No.: 713 651-5246

or to such other individual or address or facsimile number as a Party hereto may designate for itself by notice given as herein provided.

15.6 *Waivers.* The failure of a Party at any time or times to require performance of any provision of this Agreement shall in no manner affect its right at a later time to enforce the same provision. No waiver by a Party of any condition or of any breach of any term, covenant, representation or warranty contained in this Agreement shall be effective unless in writing, and no waiver in any one or more instances shall be deemed to be a further or continuing waiver of any such condition or breach in other instances or a waiver of any other condition or breach of any other term, covenant, representation or warranty.

15.7 *Successors and Assigns.* This Agreement shall be binding on and shall inure to the benefit of the Parties and their respective permitted successors and assigns; provided, however, that neither this Agreement, nor any Ancillary Agreements (except as may be expressly provided otherwise in any Ancillary Agreement) nor any right or obligation under this Agreement or any Ancillary Agreement may be assigned by any Party hereto other than to an Affiliate of that Party without the prior written consent of the other Parties; provided further, that no such assignment shall relieve a Party from its obligations under this Agreement or any Ancillary Agreement.

15.8 *No Third Party Beneficiaries.* Except as otherwise expressly provided in Article XIII, this Agreement is solely for the benefit of the Parties and no provision of this Agreement shall be deemed to confer upon any other Person any remedy, claim, liability, reimbursement, cause of action or other right, including the rights of any Affected Employee.

15.9 *Severability and Reform.* If any provision of this Agreement shall be held invalid, illegal or unenforceable, the validity, legality or enforceability of the other provisions of this Agreement shall not

be affected by that holding, and there shall be deemed substituted for the provision at issue a valid, legal and enforceable provision as similar as possible to the provision at issue.

15.10 *Entire Understanding.* This Agreement, and the Ancillary Agreements and the Confidentiality Agreement (including schedules and exhibits to any of the foregoing), set forth the entire agreement and understanding of the Parties with respect to the transactions described in this Agreement and the Ancillary Agreements and supersede any and all prior agreements, arrangements and understandings among such parties relating to the subject matter of this Agreement.

15.11 *Applicable Law.* This Agreement shall be governed by and construed and enforced in accordance with the internal laws of the State of Delaware without giving effect to the principles of conflicts of law.

15.12 *Submission to Jurisdiction.*

(a) Each Party irrevocably agrees that the courts of the State of Delaware or the United States of America for the District of Delaware shall have exclusive jurisdiction to settle any claims, differences or disputes which may arise out of or in connection with this Agreement.

(b) Each Party hereto irrevocably waives any objection it may now or hereafter have to the laying of the venue of any proceedings in any court referred to in Section 15.12(a) and any claim that any proceedings brought in any such court have been brought in an inconvenient forum and further irrevocably agrees that a judgment in any proceedings brought in a court of the State of Delaware or of the United States of America for the District of Delaware shall be conclusive and binding on the Parties and may be enforced in the courts of any other jurisdiction.

15.13 *Waiver of Jury Trial.* The Parties waive any right to trial by jury in any proceeding arising out of or relating to this Agreement or any Ancillary Agreement, whether now existing or hereafter arising, and whether grounded in contract, tort, strict liability or otherwise. The Parties agree that any of them may file a copy of this Section 15.13 with any court as written evidence of the knowing, voluntary and bargained for agreement among the parties irrevocably to waive trial by jury and that any proceeding whatsoever between or among them relating to this Agreement or any of the transactions described in this Agreement shall instead be tried in a court of competent jurisdiction by a judge sitting without a jury.

15.14 *Counterparts.* This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same original instrument.

15.15 *Specific Performance.* The Parties recognize that if the Seller refuses to perform under the provisions of this Agreement, monetary damages alone will not be adequate to compensate the Buyer for its injuries. The Buyer shall therefore be entitled, in addition to any other remedies that may be available, to obtain specific performance of the terms of this Agreement.

IN WITNESS WHEREOF, the Parties hereto have executed and delivered this Agreement on the date first above written.

SELLER:

NORTH STAR STEEL COMPANY

By: _____

Name: _____

Title: _____

BUYING PARTIES:

MACSTEEL MONROE, INC.

By: _____

Name: _____

Title: _____

QUANEX CORPORATION

By: _____

Name: _____

Title: _____

EXHIBIT A

ASSIGNMENT AND ASSUMPTION AGREEMENT

This Assignment and Assumption Agreement (the "Agreement") is entered into and made effective as of the day of , 2003 (the "Effective Date") by and between North Star Steel Company, a Minnesota corporation ("Assignor"), and Quanex Two, Inc., a Delaware corporation ("Assignee").

WHEREAS, Assignor, Assignee and Quanex Corporation, a Delaware corporation, are parties to that certain Asset Purchase and Sale Agreement dated September 30, 2003 (the "Sale Agreement"), pursuant to which Assignor agreed to transfer to the Assignee and the Assignee agreed to assume all the Assumed Obligations;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants contained herein, and for other good and valuable consideration, the receipt, adequacy and legal sufficiency of which are hereby acknowledged, the parties do hereby agree as follows:

1. *Capitalized Terms*. Capitalized terms used but not defined herein shall have the meaning for such terms that are set forth in the Sale Agreement.

2. *Assignment and Assumption*. Assignor hereby sells, assigns, conveys, transfers and delivers (collectively the "Assignment") to Assignee each of the Assumed Obligations and Assignee hereby assumes and agrees to discharge, pursuant to the terms of the Sale Agreement, each of the Assumed Obligations.

3. *Terms of the Sale Agreement*. This Agreement is entered into pursuant to the Agreement and is subject to the terms of the Sale Agreement. In the event of any conflict or inconsistency between the terms of the Sale Agreement and the terms hereof, the terms of the Sale Agreement shall govern.

IN WITNESS WHEREOF, Assignor and Assignee executed this Agreement as of the date first above written.

NORTH STAR STEEL COMPANY

By:

QUANEX TWO, INC.

By:

Name: _____ Name: _____

Its: _____ Its: _____

EXHIBIT B

BILL OF SALE

THIS BILL OF SALE is made as of , 2003, by and between NORTH STAR STEEL COMPANY, a Minnesota corporation, whose address is 7650 Edinborough Way, Suite 600, Edina, Minnesota 55345 ("Seller"), and QUANEX TWO, INC., a Delaware corporation, whose address is 1900 West Loop South, Suite 1500, Houston, Texas 77027 ("Buyer"). This Bill of Sale is made pursuant to and in accordance with the Asset Purchase and Sale Agreement between Buyer, Seller and Quanex Corporation, a Delaware corporation, dated as of September 30, 2003 (the "Agreement"). All capitalized terms used herein without definition have the respective meanings given to them in the Agreement.

FOR AND IN CONSIDERATION of the sum of Ten Dollars ($10.00) and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged by Seller, Seller has granted, bargained, sold, transferred, assigned and delivered and by these presents does hereby grant, bargain, sell, transfer, assign and deliver to Buyer and its successors and assigns the Purchased Assets, free and clear of all Encumbrances, other than those Encumbrances described in Schedule 4.6(a) to the Agreement, TO HAVE AND TO HOLD the Purchased Assets unto Buyer, its successors and assigns forever.

This Bill of Sale is entered into pursuant to the Agreement and is subject to the terms of the Agreement. In the event of any conflict between the provisions and warranties contained herein and the provisions and warranties contained in the Agreement, the provisions and warranties set forth in the Agreement shall govern and control.

IN WITNESS WHEREOF, Seller has hereunto set its hand as of the date first set forth above.

NORTH STAR STEEL COMPANY

By: _____

Print name: _____

Title: _____

QUANEX TWO, INC.

By: _____

Print name: _____

Title: _____

EXHIBIT C

ESCROW AGREEMENT

This Escrow Agreement (the "Agreement"), dated as of December , 2003, among Quanex corporation, a Delaware corporation ("Quanex"), MACSTEEL Monroe, Inc., a Delaware corporation and wholly owned subsidiary of Quanex (the "Buyer"), North Star Steel Company, a Minnesota corporation (the "Seller"), and Wells Fargo Bank, National Association. (the "Escrow Agent");

W I T N E S S E T H:

WHEREAS, Quanex, the Buyer and the Seller have entered into an Amended and Restated Asset Purchase Agreement dated December 22, 2003 (the "Asset Purchase Agreement"), pursuant to which the Buyer is purchasing certain assets of the Seller;

WHEREAS, the Asset Purchase Agreement provides that the Buyer will pay $2,000,000 of the Purchase Price, as that term is defined in the Asset Purchase Agreement, into an escrow account pursuant to the terms of this Agreement;

WHEREAS, Quanex, the Buyer and the Seller wish to enter into this Agreement pursuant to the Asset Purchase Agreement; and

WHEREAS, Quanex, the Buyer and the Seller have requested the Escrow Agent to act as the escrow agent under this Agreement, and the Escrow Agent has agreed to do so.

NOW, THEREFORE, in consideration of the premises and for other good and valuable consideration, Quanex, the Buyer and the Seller agree as follows:

1. ***Effective Time.*** This Agreement shall be effective as of the Effective Time.

2. ***Appointment of Escrow Agent.*** Quanex, the Buyer and the Seller appoint Wells Fargo Bank, National Association. as the Escrow Agent for the purposes set forth in this Agreement, and the Escrow Agent accepts the appointment under the terms of this Agreement.

3. ***Deposit of Escrow Fund.*** For the purposes set forth in this Agreement, the Buyer is depositing or has deposited with the Escrow Agent $2,000,000 in cash or immediately available funds (together with income on such amounts as described in Section 5, the "Escrow Fund"). The Escrow Agent shall hold, invest, reinvest and disburse the Escrow Fund in accordance with the terms of this Agreement. The Escrow Fund shall be under the sole and exclusive dominion and control of the Escrow Agent, and none of Quanex, the Buyer nor the Seller shall have any right with respect to the Escrow Fund except as set forth in this Agreement.

4. ***Satisfaction of Claims with Escrow Fund.***

(a) **Distributions to Pay Claims.** At all times during the term of this Agreement, the Escrow Fund will be retained by the Escrow Agent and shall be distributed at any time, or from time to time, for the purpose of paying any and all Claims (as defined below) pursuant to the terms of this Escrow Agreement. It is anticipated that following the date hereof, Quanex and the Buyer (collectively, the "Buying Parties") will finalize a new collective bargaining agreement (the "Labor Agreement") with the unionized employees associated with the Business. During the term hereof the Escrow Fund shall be distributed at any time, or from time to time, for the purpose of paying (i) any and all signing bonuses, anticipated aggregate increases, if any, in hourly wages and benefits for such employees for the first twelve months following the effectiveness of the Labor Agreement and all other costs that the Buying Parties incur in connection with the negotiation, execution and delivery of the Labor Agreement, (ii) all severance benefits pursuant to Section 10.2 of the Asset Purchase Agreement, (iii) all retention bonuses, if any, paid by Buyer to employees of Seller who Buyer agrees to employ and who are not, at the Effective Time, located at Seller's

facility in Monroe, Michigan and (iv) one-half of the Vacation Amount paid by Quanex or Buyer to hourly Transferred Employees pursuant to Section 10.3 of the Asset Purchase Agreement (collectively, "Claims").

(b) **Notice and Payment of Claims.** From time to time in accordance with the terms of this Escrow Agreement, the Buying Parties shall provide written notice (the "Notice"), including a description of the nature and amount of the Claim or Claims for which payment is requested, to Seller. A copy of the Notice shall be contemporaneously provided to Escrow Agent. Seller shall have a period of ten (10) days from the date of the Notice in which Seller may make Buyer aware of, and attempt to settle, any dispute Seller may have regarding the Claim. The Buying Parties agree to furnish such other information and documents (including, with respect to Claims described in Section 4(a)(i) above, a copy of the Labor Agreement) in connection with the Claims as the Seller may reasonably request. If Seller does not provide written notice of a dispute regarding the Notice within such ten day period, then Escrow Agent shall immediately disburse the amount of such Claims, together with any Escrow Income accrued on that portion of the Escrow Funds since its initial deposit, to the Buying Parties. Escrow Agent's duty to pay amounts pursuant to this Section 4(b) shall be unconditional and shall not require Seller's consent.

(c) **Disputed Claims.** If a Claim is disputed pursuant to Section 4(b) above, the Escrow Agent shall not pay any amounts to the Buying Parties with respect to such Claim until the matter in dispute is resolved pursuant to Section 14.1 of the Asset Purchase Agreement. Once a disputed Claim is resolved as described above, the Buying Parties shall provide the Escrow Agent with a copy of the written settlement, order, judgment or other documentation as soon as practicable and the Escrow Agent shall distribute (or retain in the Escrow Fund, as the case may be) all or any portion of the Escrow Fund as set forth in such written order, judgment or other documentation.

5. ***Investment of Escrow Fund.***

The Escrow Fund shall be invested by the Escrow Agent in such investments as the Buying Parties and the Seller shall jointly direct from time to time. The foregoing notwithstanding, such investments shall be in Wells Fargo Money Market Funds, savings deposits, certificates of deposit or government obligations. All income earned on the Escrow Fund shall be deemed part of the Escrow Fund and shall be paid in accordance with the provisions of Sections 4 and 6 hereof.

6. ***Payment of Remaining Escrow Fund Amounts; Taxation.***

(a) This Escrow Agreement shall terminate on the second anniversary of the Closing Date (the "Termination Date"). On the Termination Date, Escrow Agent shall pay and distribute the balance of the Escrow Fund as of such date to Seller unless any Claims are then pending (including any Claim of which the Escrow Agent has notice and which has not been resolved either through payment to the Buying Parties or through final resolution of a matter in dispute), in which case an amount equal to the aggregate dollar amount of all such Claims (as shown in the Notices of such Claims) shall be retained by the Escrow Agent in the Escrow Fund (and the balance paid to Seller as hereinafter provided). Amounts retained in the Escrow Fund under this section shall not be distributed until Escrow Agent receives either (i) joint written instructions of the Buying Parties and the Selling Parties, or (ii) a written court order, judgment or other documentation as set forth in Section 4(c) herein and the Escrow Agent shall distribute such amounts accordingly. Any of the Escrow Fund remaining after the resolution of all Claims described in this section shall be promptly distributed by Escrow Agent to Seller.

(b) All income earned on the Escrow Fund shall be reported annually as accrued by the Seller for federal, state and local income tax purposes.

7. ***Rights and Duties of the Escrow Agent.***

(a) **General Scope and Limitations.** The duties of the Escrow Agent under this Agreement shall be limited to the observance of the provisions of this Agreement. The Escrow Agent will not be subject to, or be obliged to recognize, any other agreement between the Buyer and the Selling Parties. The Escrow Agent shall not make any payment or disbursement from or out of the Escrow Fund that is not authorized pursuant to this Agreement. The Escrow Agent may rely on and act based on any instrument received by it pursuant to the provisions of this Agreement that it reasonably believes to be genuine and in conformity with the requirements of this Agreement. The Escrow Agent will not be liable for any error of judgment for any act done or any step taken by it in good faith in compliance with the provisions of this Agreement, for any mistake of fact or law or for anything that it might do or refrain

from doing in complying with this Agreement, except to the extent those actions shall be proved to constitute gross negligence or willful misconduct on the part of the Escrow Agent.

(b) **Indemnification of the Escrow Agent.** The Buying Parties and the Seller shall jointly and severally indemnify and hold harmless the Escrow Agent from and against any and all losses, costs, damages and expenses (including reasonable attorneys' fees) it may sustain by reason of its services as Escrow Agent under this Agreement, except those losses, costs, damages and expenses (including reasonable attorneys' fees) incurred by reason of those acts or omissions for which the Escrow Agent is liable or responsible under the last sentence of Section 7(a). Any costs of the Buying Parties and the Seller associated with the indemnification of the Escrow Agent pursuant to this Section 7(b) shall be borne one-half by the Buying Parties and one-half by Seller.

(c) **Resignation of Escrow Agent.** The Escrow Agent may resign from its duties under this Agreement by giving the Buying Parties and the Seller not less than 30 days' prior written notice of the effective date of its resignation (which effective date shall be at least 30 days after the date the notice is given). If on or before the effective date of the resignation, the Escrow Agent has not received written instructions from the Buying Parties and the Seller regarding the transfer of the Escrow Fund to a substitute escrow agent, it may institute a bill of interpleader and deposit the Escrow Fund with the registry of a court of competent jurisdiction. The parties intend that a substitute escrow agent will be appointed to fulfill the duties of the Escrow Agent under this Agreement for the remaining term of this Agreement if the Escrow Agent resigns.

(d) **Consultation with Legal Counsel.** The Escrow Agent may consult with its counsel or other counsel satisfactory to it in respect of any question relating to its duties or responsibilities under this Agreement and shall not be liable for any action taken, suffered or omitted by the Escrow Agent in good faith on the advice of that counsel. The Escrow Agent may act through its officers, employees, agents and attorneys.

8. ***Fees and Expenses of the Escrow Agent.*** The Buyer shall be solely responsible for all of the fees of the Escrow Agent for its services under this Agreement in accordance with the standard fee schedule of the Escrow Agent which is attached hereto, together with any expenses reasonably incurred by the Escrow Agent in connection with this Agreement.

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9. ***Notices.*** All notices, requests, demands and other communications made in connection with this Agreement shall be in writing and shall be deemed to have been duly given on the date delivered, if delivered personally or sent by facsimile to the persons identified below, or three days after mailing in the United States mail if mailed by certified or registered mail, postage prepaid, return receipt requested, addressed as follows:

(a) if to the Buying Parties:

Quanex Corporation
1900 West Loop South, Suite 1500
Houston, Texas 77027
Attention: Mr. Terry M. Murphy
Fax No. (713) 877-5333

with a copy to:

Fulbright & Jaworski L.L.P.
2200 Ross Avenue, Suite 2800
Dallas, Texas 75201
Attention: Ms. Harva R. Dockery
Fax No. (214) 855-8200

(b) if to the Seller:

North Star Steel Company
7650 Edinborough Way, Suite 600
Edina, Minnesota 55435
Attention: President
Telephone No.: (952) 367-3011
Facsimile No.: (952) 367-3082

with a copy to:

General Counsel
Cargill Law Department
P.O. Box 5624
Minneapolis, Minnesota 55440-5624
15615 McGinty Road West
Wayzata, Minnesota 55391-2399
Telephone No.: (952) 742-6334
Facsimile No.: (952) 742-6349

(c) If to the Escrow Agent:

Wells Fargo Bank N.A.
MAC T5001-0611000 Louisiana Street Suite 640
Houston, Texas 77002
Telephone No. 713-319-1658
Fax No. (713) 650-0579

Each party shall have the right to change its address for notice to any other location by giving written notice to the other parties in the manner set forth above.

10. ***Binding Effect.*** This Agreement shall be binding on and shall inure to the benefit of each party to this Agreement and its successors and permitted assigns.

11. ***Amendment and Termination.*** This Agreement contains the entire agreement among the parties relating to the subject matter of this Agreement. This Agreement may be amended only by a written instrument executed by the parties to this Agreement. This Agreement will terminate when all of the Escrow Fund and the Escrow Income have been disbursed in accordance with the terms of this Agreement.

12. ***Applicable Law.*** This Agreement will be governed by and construed in accordance with the laws of the State of Delaware, without giving effect to conflicts of law principles.

13. ***Counterparts.*** This Agreement may be executed in two or more counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

14. ***Captions and Paragraph Headings.*** Captions and paragraph headings used in this Agreement are for convenience only, are not part of this Agreement and shall not be used in construing it.

15. ***Defined Terms and Construction.*** Capitalized terms used in this Agreement shall have the meanings ascribed to them in the Asset Purchase Agreement unless the context requires otherwise. All references to "Section" or "Sections" refer to the corresponding Section or Sections of this Agreement unless otherwise specified. All words used in this Agreement will be construed to be of such gender or number as the circumstances require. Unless otherwise expressly provided, the word "including" does limit the preceding words or terms.

* * *

IN WITNESS WHEREOF, Quanex, the Buyer, the Seller and the Escrow Agent have caused this Agreement to be executed, effective as of the date first above written.

QUANEX CORPORATION

By: _____

Name: _____

Title: _____

MACSTEEL MONROE, INC.

By: _____

Name: _____

Title: _____

NORTH STAR STEEL COMPANY

By: _____

Name: _____

Title: _____

WELLS FARGO BANK N.A.

By: _____

Name: _____

Title: _____

EXHIBIT D

LICENSED INTELLECTUAL PROPERTY AGREEMENT

THIS LICENSED INTELLECTUAL PROPERTY AGREEMENT ("Agreement") is made and is effective as of the day of , 2003, by and between NORTH STAR STEEL COMPANY, a Minnesota corporation (hereinafter "North Star") and QUANEX TWO, INC., a Delaware corporation ("Quanex").

W I T N E S S E T H:

WHEREAS, North Star, Quanex and Quanex Corporation, a Delaware corporation, have entered into an Asset Purchase and Sale Agreement dated as of September 30, 2003, with respect to the sale of the Business to Quanex (the "Purchase Agreement"); and

WHEREAS, North Star and Quanex wish to describe herein the terms under which Quanex will be authorized to use certain Intellectual Property of North Star.

NOW, THEREFORE, in consideration of the premises and the mutual covenants and agreements set forth herein and included in the Purchase Agreement, the parties hereto hereby covenant and agree as follows:

ARTICLE I
Definitions

1.1. Terms used but not otherwise defined in this Agreement shall have the meaning ascribed to such terms in the Purchase Agreement.

ARTICLE II
Grants and Delivery

2.1. North Star hereby grants to Quanex, and Quanex hereby accepts, a non-exclusive, world-wide, royalty free, fully paid up, irrevocable, perpetual right and license to use the Licensed Intellectual Property.

2.2. North Star shall disclose the Licensed Intellectual Property to Quanex through the physical transfer of the assets of the Business. After the Effective Time, North Star shall have no continuing obligation to provide information of any kind in order to deliver the Licensed Intellectual Property.

ARTICLE III
North Star Warranties, Representations and Obligations

3.1 North Star warrants that it has the legal power and right to extend the rights granted to Quanex in this Agreement and that it has not and shall not make any commitments to others inconsistent with or in derogation of such rights.

3.2 North Star warrants that to its Knowledge, no unlicensed Third Party is operating under any of the Licensed Intellectual Property.

3.3 North Star represents and warrants that to its Knowledge, its license of the Licensed Intellectual Property hereunder and Quanex's use thereof shall not infringe the Intellectual Property or other rights of any Third Party.

3.4 Except as set forth above and in the Purchase Agreement, North Star hereby specifically disclaims all other Intellectual Property representations and warranties.

ARTICLE IV
Quanex Obligations

4.1 Licensed Intellectual Property disclosed by North Star to Quanex shall be treated as confidential information by Quanex pursuant to the provisions of Section 7.7(b) of the Purchase Agreement.

ARTICLE V
Term

5.1 The term of this Agreement shall commence as of the Effective Time and continue indefinitely.

ARTICLE VI
Transfer of Agreement or Licensed Intellectual Property

6.1 Quanex shall not assign or transfer this Agreement or any of the Licensed Intellectual Property to any Third Party without the prior written consent of North Star; provided, however, that Quanex shall be permitted, without the prior written consent of North Star, to assign or transfer this Agreement and the Licensed Intellectual Property to (a) any of its Affiliates or (b) any Third Party who purchases all of the outstanding capital stock or assets of Quanex or all or substantially all of the assets of the Business.

6.2 North Star shall not assign or transfer any of the Licensed Intellectual Property to any Third Party or permit any Third Party to license or otherwise use the Licensed Intellectual Property without the prior written consent of Quanex; provided, however, that North Star shall be permitted, without the prior written consent of Quanex, to (a) assign or transfer the Licensed Intellectual Property to (i) any of its Affiliates or (ii) any Third Party who purchases all of the outstanding capital stock of North Star or all or substantially all of the assets of North Star or (b) license or otherwise allow a Third Party who acquires a division or other significant part of the business of North Star to use the Licensed Intellectual Property.

ARTICLE VII
Miscellaneous

The provisions of Articles XIII, XIV and XV of the Asset Purchase Agreement are incorporated by reference herein and shall be made a part of this Agreement; provided, however, that if the terms of this Agreement and the Asset Purchase Agreement conflict or are inconsistent, the terms of this Agreement shall control.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day, month and year first above written.

NORTH STAR STEEL COMPANY

By: _____

Name: _____

Title: _____

QUANEX TWO, INC.

By: _____

Name: _____

Title: _____

Prepared by:

Mark J. Isaacson, Esq.
Cargill, Incorporated
P.O. Box 5624
Minneapolis, MN 55440-5624

EXHIBIT E

SPECIAL WARRANTY DEED

THIS SPECIAL WARRANTY DEED, made the day of , 2003, by NORTH STAR STEEL COMPANY, a Minnesota corporation, whose post office address is 7650 Edinborough Way, Suite 600, Edina, Minnesota 55435-5992 ("Grantor"), to QUANEX TWO, INC., a Delaware corporation, whose post office address is 1900 West Loop South, Suite 1500, Houston, Texas 77027 ("Grantee").

WITNESSETH:

That Grantor, for and in consideration of the sum of $10.00 and other good and valuable considerations, the receipt of which is hereby acknowledged, does hereby grant, bargain, sell and convey unto Grantee and Grantee's heirs, successors and assigns the following described land in Monroe County, Michigan:

See Exhibit A attached hereto and incorporated herein by reference for the description of the land conveyed herein.

TOGETHER with all the tenements, hereditaments and appurtenances thereto.

TO HAVE AND TO HOLD the same unto Grantee and Grantee's heirs, successors and assigns in fee simple forever.

And Grantor does hereby covenant with Grantee that title to the premises is free from all encumbrances made by Grantor, and that Grantor will warrant and defend the same against the lawful claims and demands of all persons claiming by, through or under Grantor (except for matters set forth in Exhibit B attached hereto and incorporated herein by reference), but against none other.

IN WITNESS WHEREOF, Grantor has executed this deed the day and year first above written.

WITNESSES:

NORTH STAR STEEL COMPANY
a Minnesota corporation

_____

Print name: _____

By:

Print name:

Print name:

Title:

STATE OF MINNESOTA)
) ss.
COUNTY OF HENNEPIN)

The foregoing instrument was acknowledged before me this day of , 2003 by as of North Star Steel Company, a Minnesota corporation, on behalf of said corporation.

Print name:

Notary Public

My commission expires

(AFFIX NOTARY SEAL)

EXHIBIT A

Owned Real Property

Land in the City of Monroe, Monroe County, Michigan described as:

A parcel of land lying in the Southeast quarter of Section 9, the Southwest quarter of Section 10, the Northwest quarter of Section 15 and the Northeast quarter of Section 16, Town 7 South, Range 9 East, and Private Claim 349 and more particularly described as follows: Beginning at a point located from the Southeast corner of Private Claim 349 North 37°37'00" East 599.20 feet along the East line of Private Claim 349 to a point on a line common to Section 9 and 16, said point being West 1844.63 feet from a section corner common to Section 9, 10, 15 and 16; thence continuing along the East line of Private Claim 349 from said point North 37°37'00" East 205.50 feet to the True Point of Beginning;

thence North 80°26'56" West 925.62 feet;

thence North 51°26'01" West 409.25 feet;

thence North 22°27'57" East 1642.05 feet;

thence North 44°19'30" East 542.61 feet to a point on a curve, said point being on the Southerly line of a 60 foot wide railroad easement, which centerline of said easement is described in Liber 624, Page 560, Monroe County Records;

thence Southeasterly along the line of said 60 foot wide railroad easement and on the arc of a curve to the right, 320.40 feet to a point of tangent, said curve having a radius of 686.78 feet, central angle 26°43'46" and chord bearing distance South 66°17'28" East 317.50 feet;

thence continuing along the line of said 60 foot wide railroad easement South 52°55'35" East 191.11 feet;

thence Northeasterly along the line of said 60 foot wide railroad easement North 42°49'45" East 7.47 feet to a point on a curve and the Southerly line of a 42 foot wide railroad right-of-way lying on the Southerly side of Front Street (100 feet wide);

thence Easterly along the Southerly line of said 42 foot wide railroad right-of-way and on the arc of a curve to the left 794.87 feet to a point of tangent, said curve having a radius of 5804.65 feet, central angle 07°50'45" and chord bearing and distance South 51°05'37" East 794.25 feet;

thence South 55°01'00" East 1072.33 feet along the Southerly line of a 42 foot wide railroad right-of-way;

thence South 55°10'30" East 2023.48 feet along the Southerly line of a 42 foot wide railroad right-of-way;

thence South 23°32'00" West 1295.07 feet;

thence North 55°10'30" West 1393.01 feet to a point on a line common the Sections 15 and 16, said point being South 421.31 feet from the section corner common to Sections 9, 10, 15 and 16;

thence continuing North 55°10'30" West 680.98 feet;

thence North 80°26'56" West 1176.49 feet to the True Point of Beginning,

EXHIBIT B

Permitted Encumbrances

1. Easement(s) and rights relating thereto granted to The Detroit Edison Company, recorded March 4, 1970 in Liber 578, Page 548, Monroe County Records.

2. Easement(s) and rights relating thereto granted to The Detroit Edison Company, recorded March 4, 1970 in Liber 578, Page 550, Monroe County Records.

3. Terms, conditions and provisions which are recited in Warranty Deed recorded April 19, 1978 in Liber 761, Page 279, Monroe County Records.

4. Easement(s) and rights relating thereto granted to Michigan Gas Utilities Company, recorded October 18, 1979 in Liber 806, Page 406, Monroe County Records.

5. Easement(s) and rights relating thereto granted to Utilicorp United Inc. DBA Michigan Gas Utilities, recorded March 28, 1995 in Liber 1431, Page 572, Monroe County Records.

6. Taxes and assessments that become a lien against the property after the date of closing. The title company assumes no liability for tax increases occasioned by retroactive revaluation, changes in the land usage or loss of any homestead exemption status for the insured premises.

7. Rights of the public and of any governmental unit in any part of subject property taken, used or deeded for street, road or highway purposes.

EXHIBIT F

TRADEMARK LICENSE AGREEMENT

THIS TRADEMARK LICENSE AGREEMENT ("Agreement") is made and is effective as of , 2003, by and between NORTH STAR STEEL COMPANY, a Minnesota corporation ("Licensor") and QUANEX TWO, INC., a Delaware corporation ("Licensee").

WHEREAS, Licensor is the owner of the trade names and trademarks "NORTH STAR STEEL" and its corporate symbol registered and used in the United States in connection with the Business and as shown on Attachment I hereto (such marks and derivations therefrom as currently used by Licensor in connection with the Business are hereinafter referred to collectively as the "Trademarks"); and

WHEREAS, Licensor and Licensee have entered into an Asset Purchase and Sale Agreement with respect to the Business dated as of September 30, 2003 (which, together with the exhibits and schedules thereto, is hereinafter referred to as the "Purchase and Sale Agreement"); and

WHEREAS, Licensor utilizes the Trademarks in marking its Inventory, Equipment and Fixed Assets and upon purchase orders, invoices, and other business documents (such use of the Trademarks are referred to herein as the "Current Use"); and

WHEREAS, the sale of the Business to Licensee contemplates the licensing of the Trademarks within their Current Use to Licensee on an interim basis to facilitate the transition of the Business from Licensor to Licensee.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereby agree as follows:

1. *Definitions.*

Any capitalized terms used but not defined in this Agreement, shall have the meaning given those terms in the Purchase and Sale Agreement.

2. *Grant of License.*

Subject to existing licenses, if any, in the Assigned Contracts, Licensor hereby grants a non-exclusive, non-transferable, royalty-free license (the "License") to use the Trademarks within their Current Use in connection with the Business, in the United States, for the term of this Agreement in order to facilitate Licensee to sell, distribute and otherwise dispose of the Inventory bearing the Trademarks and to utilize the Trademarks within their Current Use.

3. *Limitations on Use of the Trademarks.*

3.1 Title to and ownership of the Trademarks is and shall always be vested solely in Licensor. It is understood that the present license will not in any way affect the ownership by Licensor of the Trademarks, which shall continue to be the exclusive property of the Licensor and Licensee shall not represent that it has any right, title or interest in the Trademarks other than the rights expressly granted by this Agreement.

4. *Covenants by Licensor.*

4.1 Licensor need not maintain the registrations, if any, of the Trademarks if, in Licensor's sole discretion, Licensor determines not to do so.

4.2 Should it become necessary to record Licensee as a registered user of the Trademarks in any country, Licensor shall prepare and file the appropriate documents to effectuate such recording. Licensee shall cooperate in the completion of such documentation. Expenses incurred by Licensor, or the Licensee in the process of documentation and completion of said recording shall be for the account of Licensee.

4.3 Licensor makes no representation or warranty with respect to the Trademarks and the use thereof other than those expressly set forth in the Purchase and Sale Agreement.

5. *Term and Termination.*

5.1 Unless such rights are otherwise terminated in accordance with this Section 5, the Licensee's rights to use the Trademarks under this Agreement shall terminate with respect to Inventory upon the earlier of (i) one (1) year anniversary of the Closing Date or (ii) the sale or other disposal of all Inventory, and shall terminate with respect to other items bearing the Trademarks upon the earlier of (i) the six (6) month anniversary of the Closing Date, or (ii) the sale disposal or remarking of other items bearing the Trademarks. Licensee agrees to remove the Trademarks from all Equipment and Fixed Assets and to utilize or replace other consumable items which bear the Trademarks with items which do not bear the Trademarks as expeditiously as reasonably possible after the Closing Date.

5.2 In the event that the Licensee is, in Licensor's sole judgment, in material breach of any provision of this Agreement, or in the event, in Licensor's sole judgment, the use by the Licensee of the Trademarks, does not comply in all material respects with the terms of this Agreement, Licensee shall have thirty (30) days after receipt of written notice from Licensor to fully cure, to Licensor's satisfaction, such breach, failure or deficiency. If Licensee does not so cure, Licensor shall notify Licensee in writing that the License has been terminated.

5.3 This Agreement shall also be terminated in the following events: (i) dissolution or liquidation of the Licensee; (ii) mutual written agreement of the parties or (iii) Licensee makes an assignment for the benefit of creditors, experiences bankruptcy or any proceeding under the law pertaining to the relief of debtors.

5.4 Upon the termination of this Agreement, Licensee agrees that it will immediately cease using the Trademarks, make no further shipments of Inventory bearing the Trademarks, destroy all unsold Inventory bearing any of the Trademarks and have no further rights, interest or claims to any of the Trademarks. Licensee shall thereafter not use any of the Trademarks (or any trademarks confusingly similar to the Trademarks) for any purpose whatsoever.

6. *Assignment.*

The Licensee shall not have any right to assign this Agreement or to sublicense any of its rights hereunder (other than assignment or sublicense to an Affiliate) without the express written consent of Licensor, which consent may be withheld for any reason.

7. *Infringement Actions.*

In the event that the Trademarks and/or the Trademarks registration shall be infringed by any third party, Licensor shall have the sole right to bring any action for infringement, at Licensor's cost and expense, and to recover and retain any and all damages. The Licensee shall give Licensor prompt notice of any such infringement that comes to its attention and provide all reasonable cooperation and documentation requested by Licensor.

8. *Goodwill.*

Licensee recognizes and acknowledges that the Trademarks and all rights therein and goodwill pertaining thereto belong exclusively to Licensor and Licensor's Affiliates, and that the use by Licensee pursuant to this Agreement shall inure to the benefit of Licensor and its Affiliates.

9. *Miscellaneous.*

9.1 *Indemnification.* Licensee shall indemnify and hold Licensor and its Affiliates harmless from and against all Losses that Licensor and any of its Affiliates incur arising out of the Licensee's breach of this Trademark License Agreement and all use by Licensee of the Trademarks in violation of this Agreement.

9.2 *Provisions of the Purchase and Sale Agreement.* The provisions of Articles XIII, XIV and XV of the Purchase and Sale Agreement are incorporated by reference herein and shall be made a part of this Agreement; provided, however, that if the terms of this Agreement and the Purchase and Sale Agreement conflict or are inconsistent, the terms of this Agreement shall control.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective duly authorized representatives.

NORTH STAR STEEL COMPANY

By: _____

Name: _____

Title: _____

QUANEX TWO, INC.

By: _____

Name: _____

Title: _____

ATTACHMENT I

COUNTRY	TRADEMARK	REGN NO.
United States	NORTH STAR STEEL	2206654
United States	NORTH STAR STEEL CORPORATE SYMBOL	2222258

EXHIBIT G

TRANSITION SERVICES AGREEMENT

This Transition Services Agreement ("Agreement") is made and is effective as of , 2003 by and between QUANEX TWO, INC, a Delaware corporation ("Buyer"); CARGILL, INCORPORATED, a Delaware corporation ("Cargill"), and NORTH STAR STEEL COMPANY, a Minnesota corporation ("North Star") (Cargill and North Star individually and collectively referred to herein as "Seller").

WITNESSETH:

WHEREAS, pursuant to the terms of an Asset Purchase and Sale Agreement dated as of September 30, 2003, to which Buyer and North Star are parties (the "Purchase and Sale Agreement"), Buyer will, contemporaneously with the effectiveness of this Agreement, acquire the Business (the "Acquisition"); and

WHEREAS, Buyer has requested that Seller provide Buyer with those certain transition services described on Schedule A (or the individual Addendums thereto) attached hereto and made a part hereof (the "Transition Services", and each a "Transition Service"), for a period of time after the Closing Date.

NOW, THEREFORE, and in consideration of the premises and the mutual covenants herein contained and intending to be legally bound hereby, the parties hereto agree as follows:

1. *Definitions.* Capitalized terms used but not defined in this Agreement shall have the meanings given those terms in the Purchase and Sale Agreement.

2. *Transition Services; Limitations.*

A. Subject to the terms and provisions of this Agreement, Seller shall provide to Buyer the Transition Services as described on Schedule A or the Addendums thereto. Detailed costs and precise services (including additional services as may be agreed to by the parties) are reflected to the extent presently possible on Schedule A or the Addendums thereto, or shall be negotiated in good faith subsequent to the Closing by the Parties.

B. The provider of a Transition Service hereunder (Seller or a particular Affiliate of Seller, as the case may be) shall be referred to as "Service Provider" and the recipient of a Transition Service hereunder (Buyer or an Affiliate of Buyer, as the case may be) shall be referred to as "Service User". The Service Provider shall provide the Transition Services to Buyer in good faith, in substantially the same manner, at substantially the same quality, and with substantially the same degree of care the Service Provider has provided such Transition Services to the Business during the twelve (12) month period immediately prior to the execution of the Purchase and Sale Agreement. Service Provider shall have no obligation to supply Transition Services hereunder (i) that are not of the type presently being supplied by Seller to the Business and (ii) if a third party's consent is necessary for Service Provider to provide such Transition Services and such third party's consent has not been obtained after Service Provider has notified Service User of the failure to obtain such consent within ten (10) days prior to the Closing, and the reasons therefor, if known to Service Provider, and shall have used commercially reasonable efforts (to the extent legally possible) to obtain such consent.

C. In providing the Transition Services, Service Provider, as deemed necessary or appropriate in its reasonable discretion, may (i) use its own personnel, or (ii) employ the services of third parties (at the market rates charged by such third parties, and without further markup by Service Provider) to the extent such third party services are routinely utilized to provide similar services to Service Provider's own businesses or are reasonably necessary for the efficient performance of any Transition Service. Prior to entering into any new agreement with any third party service provider for the provision of Transition Services, Service Provider shall give not less than ten (10) business days written notice to Service User.

D. As needed from time to time during the term of this Agreement, and upon termination of any Transition Service or this Agreement, the Service Provider will provide Buyer all records, whether such are in written electronic or other format, related to the provision of the Transition Services hereunder in such format, whether written, electronic or other, as may be reasonably requested by Buyer. Upon termination of this Agreement, each party hereto shall, at the request of the other party, promptly return to such requesting party or its designated representatives or otherwise dispose of as the requesting party may instruct all materials that contain confidential or proprietary information in written, recorded, or other tangible form that such party may have in its possession, custody, or under its direct or indirect control.

E. Buyer and Seller shall designate a representative to act as their primary contact person with respect to the provision of all Transition Services (each such person being a "Responsible Person"). The initial Responsible Person for Buyer shall be and for Seller shall be Terry Forrest.

3. *Term of Agreement/Transition Services.* The obligation of Service Provider to provide each Transition Service will commence on the Closing Date and, unless otherwise specified in Schedule A or a particular Addendum thereto, will terminate on the "Service Termination Date" for such Transition Service, which shall be the earliest to occur of (i) the date specified on the applicable Addendum, which shall in no event be a date later than six (6) months after the Closing

Date, or (ii) the date on which Service User, by notice to Service Provider at any time prior to the termination of such Transition Service set forth on the applicable addendum, terminates such Transition Service. Notwithstanding the foregoing, (i) either Buyer or Seller may, by giving written notice, terminate this Agreement if the other party is in material breach of its obligations hereunder and has failed to cure said breach within thirty (30) days after receipt of written notice of such breach from the other party. Each Service User shall use reasonable commercial efforts to transition and terminate the Transition Services as soon as possible after the Closing Date.

4. *Costs.* In consideration for the performance of each Transition Service, Service User agrees to pay to Service Provider the amounts set forth Schedule A or the Addendums thereto ("Costs"). Any Taxes (other than income Taxes of Seller) assessed on the provision of Transition Services hereunder, shall be paid by Service User.

5. *Invoice.* Service Provider shall invoice Service User monthly for Transition Services provided during the preceding month and all invoices shall reflect in reasonable detail the nature and quantity of the Transition Services rendered during the previous month and the charges therefor. Service User agrees to pay to the invoicing entity each invoice within thirty (30) days after Service User's receipt of each such invoice.

6. *Cooperation.* The parties will use good faith efforts to cooperate with each other in all matters relating to the provision and receipt of Transition Services. Each party will provide such facilities, information, books, records, files, supplies, etc., as may be necessary or desirable for Service Provider to provide the Transition Services and Service User shall provide, from time to time, timely decisions on such matters as required for the performance of the Transition Services by Service Provider.

7. *Confidentiality.* The parties each acknowledge and agree that the confidentiality provisions of Section 7.7 of the Purchase and Sale Agreement apply with respect hereto.

8. *Compliance with Laws and Regulations.* Service User will use the Transition Services and Service Provider shall perform or provide the Transition Services only in accordance with all applicable Laws. Each party reserves the right to take all actions, including termination of any particular Transition Service, upon not less than twenty (20) days written notice to the other party, without penalty or liability to the other party, that is reasonably believed, based upon the advice of counsel, to

be necessary to assure compliance with applicable Laws or to avoid being subjected to regulation as a common carrier or utility. No such termination or refusal to perform shall be deemed a breach hereunder.

9. *No Warranties; Indemnification.*

A. **SERVICE PROVIDER MAKES NO REPRESENTATIONS OR WARRANTIES WHATSOEVER, EXPRESS OR IMPLIED, AS TO THE MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, OR ANY OTHER MATTER WITH RESPECT TO ANY TRANSITION SERVICE OR THE PERFORMANCE THEREOF; PROVIDED, HOWEVER, THAT NOTHING CONTAINED IN THIS SECTION 9(A) SHALL RELEASE SERVICE PROVIDER FROM THE OBLIGATIONS SET FORTH IN SECTION 2(B) OF THIS AGREEMENT.**

B. Service User shall indemnify and hold harmless Service Provider and its Affiliates and their respective directors, officers, employees and agents (collectively, "DOEAs") from and against any and all Losses incurred by Service Provider, its Affiliates or their respective DOEAs as a result of the performance of the Transition Services; provided, however, the foregoing indemnity shall not apply to any such Losses to the extent caused by acts or omissions of Service Provider, its Affiliates or their respective DOEA's constituting gross negligence or willful misconduct or breach by Service Provider or its Affiliates of their obligations under this Agreement. However, in no event shall Service User be liable to Service Provider for special, consequential, punitive or exemplary damages. The above indemnity includes, but is not limited to, (a) any injury to or death of any persons or damage to or loss or destruction of any property, (b) any contamination of or injury or damage to or adverse effect upon persons, vegetation, air, land, water or the environment, and (c) any governmental agency related claims, losses, liabilities, damages and expenses. Service User and its Affiliates shall have no liability to Service Provider or any of its Affiliates or any of their respective DOEA's for any Losses arising out of this Agreement except as expressly provided in this Section 9(B).

C. Service Provider shall indemnify and hold harmless Service User, its Affiliates and their respective DOEA's from and against any and all Losses incurred by Service User, its Affiliates or their respective DOEA's to the extent but only to the extent arising out of any acts or omissions of Service Provider or its Affiliates constituting gross negligence or willful misconduct or breach by Service Provider or its Affiliates of their obligations under this Agreement. However, in no event shall Service Provider be liable to Service User for special, consequential, punitive or exemplary damages. The above indemnity includes, but is not limited to, (a) any injury to or death of any persons or damage to or loss or destruction of any property, (b) any contamination of or injury or damage to or adverse effect upon persons, vegetation, air, land, water or the environment, and (c) any governmental agency related claims, losses, liabilities, damages and expenses. Service Provider and its Affiliates shall have no liability to Service User or any of its Affiliates or any of their respective DOEA's for any Losses arising out of this Agreement except as expressly provided in this Section 9(C).

D. Notwithstanding anything to the contrary contained herein, to the extent that Service Provider utilizes third parties to provide Transition Services hereunder, Service Provider shall not have any liability to Service User or their respective DOEAs for the acts and omissions of such Third Party Suppliers; provided, however, if Service User, any of its Affiliates or any of their respective DOEAs suffer Losses, due to an act or omission of a Third Party Supplier which constitutes gross negligence or willful misconduct, Service Provider will first present a claim to the Third Party Supplier on behalf of Service User to the extent permitted under Service Provider's agreement with the Third Party Supplier and will pursue the claim in the same manner as Service Provider would pursue a claim with respect to its other businesses and any recovery shall be remitted to the affected indemnitee(s). Nothing contained herein shall require Service Provider to

institute any litigation or other proceeding against such Third Party Supplier. Service Provider will use commercially reasonable efforts to cause Service User to be a third party beneficiary under any contracts with third party service providers providing Transition Services.

E. Notwithstanding anything to the contrary herein, Service User hereby waives for itself and its Affiliates any and all rights of recovery, claims, actions or causes of action for any and all Losses to the extent it receives insurance proceeds with respect thereto.

F. The provisions of this Section 9 shall survive the termination of this Agreement.

10. *Force Majeure.* Service Provider shall not be liable for any failure to perform or delay in performing its obligations pursuant to this Agreement to the extent its failure to do so is caused by or results from any act of God; war, riot, fire; explosion; accident; flood; sabotage, lack of (despite reasonable efforts of such party to obtain) adequate fuel, power, raw materials, labor, containers or transportation facilities; compliance with Laws, national defense requirements; or any other cause or circumstances beyond the reasonable control of the affected party. The Service Provider which is rendered unable to perform its obligations as a result of the foregoing shall notify the Service User as soon as reasonably possible to discuss the circumstances and potential solutions of such force majeure event, including reasonable efforts as to mitigation of such force majeure event and provision of substitute Transition Services by a Third Party Supplier at Service User's sole cost and expense and the parties shall reasonably cooperate in respect thereto.

11. *Third Party Suppliers.*

A. Service User understands that the provision of some Transition Services may involve services historically provided by a third party (a "Third Party Supplier") to Service Provider or the lease or license of property (including, without limitation, computer software) to Service Provider by a Third Party Supplier. If permitted by the agreement governing the provision of such services or property by a Third Party Supplier (a "Third Party Agreement"), Service Provider will provide, or arrange for such Third Party Supplier to provide, such Transition Service for Service User in accordance with the terms of this Agreement; provided, however, if the provision of such Transition Service would result in the breach of the terms of such Third Party Agreement, then Service Provider shall be relieved of its obligation to provide such Transition Service and shall instead use its commercially reasonable best efforts to assist Service User in obtaining an amendment to such Third Party Agreement or such other authorization from such Third Party Supplier which would allow Service Provider to provide such Transition Service in accordance with the terms of this Agreement. In the event that Service Provider is unable to obtain an amendment of such Third Party Agreement or an authorization from such Third Party Supplier that would allow Service Provider to provide such Transition Service to Service User, Service Provider shall use its commercially reasonable efforts to assist Service User in obtaining a similar service (in both quality and quantity) from another Third Party Supplier. Service User shall be solely responsible for the cost of any such Third Party Supplier Transition Services.

B. At its option and upon reasonable notice to Service User, Service Provider may terminate or fail to renew any Third Party Agreement and contract with another Third Party Supplier to provide the affected Transition Service or, alternatively, perform such Transition Service itself.

12. *Amendment; Additional Services.* This Agreement may be amended, modified or supplemented only by a writing signed by the parties. The parties agree to amend this Agreement to add additional services as Transition Services hereunder so long as the parties agree such services would have been included as Transition Services hereunder had the parties given consideration to such services as of the date hereof.

13. *Provisions of the Asset Purchase Agreement.* The provisions of Articles XIII, XIV and XV of the Asset Purchase Agreement are incorporated by reference herein and shall be made a part of this Agreement; provided, however, that if the terms of this Agreement and the Asset Purchase Agreement conflict or are inconsistent, the terms of this Agreement shall control.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective duly authorized representatives.

QUANEX TWO, INC.

By: _____

Name: _____

Title: _____

CARGILL, INCORPORATED

By: _____

Name: _____

Title: _____

NORTH STAR STEEL COMPANY

By: _____

Name: _____

Title: _____

SCHEDULE A TO TRANSITION SERVICES AGREEMENT

List of services to be performed

The following services will be provided to Quanex upon closing the purchase of the North Star Steel Michigan facility. A one-time charge for setting up ledgers, transferring files, and related tasks will be assessed in the amount not to exceed $300,000 payable at the time the services are rendered. Further, the monthly charges for providing the services listed below will not exceed $150,000. Each service will be detailed prior to Closing based on Quanex's requirements and priced accordingly. Any additional services outside of Seller's interpretations of the following services will be priced and billed.

1. ***Financial Reporting***—Balance Sheet, Profit and Loss Statements through JDE package

2. ***Accounts Payable***—Process and issue payments to vendors

    a. Scrap vendors twice per week

    b. All other suppliers on the 10th and 25th of the month

3. ***Accounts Receivable***—Process invoices, collections, cash applications, accounts receivable file maintenance

4. ***Sales Order Entry***—Provide quotes and process customer orders to only those customers that Quanex provides credit approval. Quanex will be responsible for all outside contacts with the customer

5. ***Transportation/Logistics***—Scheduling freight and administering contracts

6. ***Purchasing /Storeroom***—MP2 will be provided and supported however, Quanex will have to acquire the necessary licenses to operate at the conclusion of the transition services

7. ***Phone Services***—Provide wide area network to support IT functions, does not include local or long distance voice services

8. ***IT Support***—Help desk, technical support, software support. Any changes to legacy systems will be billed on an hourly rate to be determined at the time of the request

Note:
None of the above services will extend beyond six months from the date of closing.

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ATTACHMENT I
EXHIBIT G TRANSITION SERVICES AGREEMENT
SCHEDULE A TO TRANSITION SERVICES AGREEMENT List of services to be performed

Exhibit 4.5

CONSENT AND FIRST AMENDMENT TO REVOLVING CREDIT AGREEMENT

This Consent and First Amendment to Revolving Credit Agreement (this "First Amendment") is made as of this 20th day of November, 2003 by and among Quanex Corporation, a Delaware corporation (the "Company"), Comerica Bank and the other banks signatory hereto and Comerica Bank, as agent for the Banks (in such capacity, "Agent").

RECITALS

A. Company, Agent and the Banks entered into that certain Quanex Corporation Revolving Credit Agreement dated as of November 26, 2002 (the "Credit Agreement") under which the Banks extended (or committed to extend) credit to the Company, as set forth therein.

B. Company has requested that Agent and the Banks (i) consent to the TruSeal Acquisition (as defined below), (ii) increase the amount of the Revolving Credit facility concurrently with this First Amendment, and (iii) make certain other amendments to the Credit Agreement, and Agent and the Banks are willing to do so, but only on the terms and conditions set forth in this First Amendment.

NOW, THEREFORE, Company, Agent and Banks agree:

1. The undersigned Banks hereby consent and agree to (i) the acquisition of all of the stock or substantially all of the assets of TruSeal Technologies, Inc. (such acquisition, the "TruSeal Acquisition") by the Company, either directly or by a Domestic Subsidiary (if a stock purchase, TruSeal Technologies, Inc. shall be deemed a Significant Domestic Subsidiary, and if an asset acquisition, the entity holding the TruSeal Technologies, Inc. assets shall be deemed a Significant Domestic Subsidiary following the TruSeal Acquisition), subject to the following conditions: (a) that the Company consummate the TruSeal Acquisition on or before January 31, 2004, (b) the TruSeal Acquisition complies with the requirements set forth in clauses (a), (e) and (f) and clauses (b) or (c) of the definition of "Permitted Acquisitions", (c) the Company delivers to Banks copies of the documents, instruments and agreements relating to the TruSeal Acquisition (the "Acquisition Documents"), including a certificate of representations and warranties regarding the TruSeal Acquisition and the Acquisition Documents, and such other documents as Banks may reasonably request, all in form and substance acceptable to Banks, and (d) satisfaction of the conditions of effectiveness of this First Amendment set forth in Section 6 hereof; and (ii) extend the time period during which the Company or a Domestic Subsidiary of the Company may acquire the assets of North Star Steel Company's Monroe, Michigan operations (which acquisition was previously consented and agreed to by the requisite Banks pursuant to those certain Consent Letters dated as of May 5, 2003 and September 26, 2003 (collectively, the "Consent Letters")) may occur to January 31, 2004, *provided, however*, that the Company must satisfy all other requirements specified in the Consent Letters in connection with such acquisition.

2. Section 1 of the Credit Agreement is hereby amended as follows:

(a) the definition of "Revolving Credit Aggregate Commitment" in the Credit Agreement is deleted in its entirety, and the following is inserted in its place:

""Revolving Credit Aggregate Commitment" shall mean Three Hundred Ten Million Dollars ($310,000,000) subject to any reduction or termination under Section 2.13, 2.14 or 8.2 hereof."

(b) the following definition of "Net Income Adjustment" is inserted in Section 1 of the Credit Agreement in its appropriate alphabetical order:

""Net Income Adjustment" shall mean that amount to be added to the minimum Consolidated Tangible Net Worth required to be maintained under Section 6.10 hereof for any fiscal quarter, consisting of an amount equal to fifty percent (50%) of the Consolidated Net Income of the Company and its Subsidiaries (but only if a positive number) for any fiscal

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quarter without any deductions or adjustments for losses, commencing with the fiscal quarter ending April 30, 2004."

(c) the following definition of "Asset Adjustment" is inserted in Section 1 of the Credit Agreement in its appropriate alphabetical order:

""Asset Adjustment" shall mean that amount to be added to the minimum Consolidated Tangible Net Worth required to be maintained under Section 6.10 hereof for any fiscal quarter, consisting of an amount equal to the aggregate write ups of any assets during such fiscal quarter (with respect to assets acquired solely pursuant to a Permitted Acquisition or any other acquisition of all or substantially all of the assets or equity interests of any Person consented to by the requisite Banks) above the amounts set forth in the pro-forma balance sheet for such fiscal quarter submitted to the Agent and delivered by Agent to the Banks in compliance with the requirements for such acquisition under this Agreement or any consent or amendment hereto."

3. Section 6.10 of the Credit Agreement is hereby deleted in its entirety, and the following is inserted in its place:

"6.10 *Maintain Consolidated Tangible Net Worth.* Maintain as of the end of each fiscal quarter of Company (commencing with the quarter ending October 31, 2003), Consolidated Tangible Net Worth of not less than the following amounts during the periods specified below, plus in each case, the Equity Offering Adjustment, the Subordinated Debt Adjustment, the Asset Adjustment, if any, and the Net Income Adjustment:

Period	Amount
October 31, 2003	$ 320,000,000
January 31, 2004 and each quarter thereafter	$ 217,500,000

4. Existing *Schedule 1.1* to the Credit Agreement is deleted in its entirety and a replacement *Schedule 1.1* in the form of *Attachment I* to this First Amendment is inserted in its place.

5. Existing *Schedule 1.2* to the Credit Agreement is deleted in its entirety and a replacement *Schedule 1.2* in the form of *Attachment II* to this First Amendment is inserted in its place.

6. This First Amendment shall become effective according to the terms hereof and as of such date (the "First Amendment Effective Date") that the Company shall have satisfied the following conditions:

(a) Agent shall have received:

(i) counterpart originals of this First Amendment, in each case duly executed and delivered by Company and the requisite Banks, in form satisfactory to Agent and the Banks and counterpart originals of a Reaffirmation of Guaranty, duly executed and delivered by the Guarantors, in form satisfactory to Agent and Banks;

(ii) renewal and replacement Revolving Credit Notes (the "New Notes") substantially in the form of *Exhibit B* to the Credit Agreement, payable to the order of each of the Revolving Credit Banks previously having requested Revolving Credit Notes in the face amount of each such Bank's Percentage of the Revolving Credit as set forth in replacement *Schedule 1.2* attached as *Attachment II* hereto

(iii) certified copies of resolutions of the Board of Directors of each of the Company and the Guarantors authorizing, as applicable, the execution and delivery of this First Amendment, the New Notes and the other Loan Documents required under this clause (a) and the

performance by the Company and the undersigned Guarantors of each of their respective obligations under the Credit Agreement, as amended by this First Amendment; and

(iii) such other documents as Agent may reasonably request, in form and substance acceptable to Banks.

(b) Company shall have paid to Agent, for distribution to the Banks as applicable, (i) all interest, Fees and other amounts, if any, owed to the Agent and the Banks and accrued to the First Amendment Effective Date, (ii) a closing fee of $5,000 for each existing Bank which executes this First Amendment by the date stated in subparagraph (d) below, (iii) for each Revolving Credit Bank whose stated dollar commitment amount is increasing and each new Bank who has entered into a commitment to lend, an amendment fee of twenty (20) basis points on the amount of either the incremental increase in commitment, or the new commitment, as applicable and (iv) a special letter of credit fee to each new Bank and each existing Bank who has increased its commitment on the Letters of Credit outstanding on the effective date of such increase or new commitment, calculated on the basis of the Letter of Credit Fees which would be applicable to such Letters of Credit if issued on the date of such increase or new commitment, for the period from the effective date of such increase or new commitment to the expiration date of such Letters of Credit based upon each such Bank's new commitment or applicable incremental increase.

(c) No Default or Event of Default shall have occurred and be continuing.

(d) If the First Amendment Effective Date shall not have occurred on or before December 19, 2003, this First Amendment shall not become effective and the offer by the Agent and the Banks to amend the Credit Agreement on the terms set forth herein shall be deemed withdrawn.

7. The Company for itself and each of the Guarantors hereby represents and warrants that, after giving effect to the amendments contained herein, (a) execution and delivery of this First Amendment, the New Notes and the other Loan Documents required to be delivered hereunder, and the performance by the Company of its obligations under the Credit Agreement as amended hereby are within such undersigned's corporate powers, have been duly authorized, are not in contravention of law or the terms of its articles of incorporation, bylaws or any other organizational documents of the parties thereto, as applicable, and except as have been previously obtained, do not require the consent or approval, material to the amendment contemplated in this First Amendment or Credit Agreement, as amended, of any governmental body, agency or authority, and this First Amendment, the Credit Agreement, as amended, the New Notes and the other Loan Documents required to be delivered hereunder, will constitute the valid and binding obligations of such undersigned parties, enforceable in accordance with its terms, except as enforcement thereof may be limited by applicable bankruptcy, reorganization, insolvency, moratorium, ERISA or similar laws affecting the enforcement of creditors' rights generally and by general principles of equity (whether enforcement is sought in a proceeding in equity or at law), (b) the representations and warranties contained in Section 5 of the Credit Agreement, as amended are true and correct on and as of the date hereof, except to the extent such representations and warranties speak only as of certain date, and (c) there has been no material change to the Pro Forma Projected Financial Information most recently provided to the Agent and the Banks with respect to the TruSeal Acquisition.

8. Except as specifically set forth above, this First Amendment shall not be deemed to amend or alter in any respect the terms and conditions of the Credit Agreement, any of the Notes issued thereunder or any of the Loan Documents, or to constitute a waiver by the Banks or Agent of any right or remedy under or a consent to any transaction not meeting the terms and conditions of the Credit Agreement, any of the Notes issued thereunder or any of the other Loan Documents.

9. Concurrently with the First Amendment Effective Date pursuant to Section 6 hereof, each Bank shall have (i) a Percentage equal to the percentage set forth in replacement *Schedule 1.2* attached as *Attachment II* hereto, and (ii) Advances under the Revolving Credit (and participations in Letters of Credit) in its Percentage of all Advances under the Revolving Credit (and undrawn Letters of Credit) outstanding on the First Amendment Effective Date. To facilitate the foregoing, each Bank which as a result of the adjustments to Percentages evidenced by replacement *Schedule 1.2* attached as *Attachment II* is to have a greater principal amount of Advances under the Revolving Credit outstanding than such Bank had outstanding under the Credit Agreement immediately prior to the First Amendment Effective Date shall deliver to the Agent immediately available funds to cover such Advances under the Revolving Credit (and the Agent shall, to the extent of the funds so received, disburse funds to each Bank which, as a result of the adjustment of the Percentages, is to have a lesser principal amount of Advances under the Revolving Credit outstanding than such Bank had under the Credit Agreement immediately prior to the First Amendment Effective Date). Each Bank, upon receipt of its New Note(s) (which Notes are to be in exchange for and not in payment of the predecessor Revolving Credit Notes) issued by the Company to such Bank, shall return its predecessor Revolving Credit Notes, and if applicable, its Swing Line Note, to the Agent which shall stamp such Notes

"exchanged" and deliver said Notes to the Company. Each Person which did not previously execute and deliver the Credit Agreement shall, upon its execution of this First Amendment, be deemed a "Bank" under the Credit Agreement, and shall hold the Percentage set forth opposite its name in *Schedule 1.2* attached as *Attachment II* hereto.

10. Unless otherwise defined to the contrary herein, all capitalized terms used in this First Amendment shall have the meaning set forth in the Credit Agreement, as amended.

11. This First Amendment shall be construed in accordance with and governed by the laws of the State of Michigan.

12. Any references in the Loan Documents to the Credit Agreement shall be deemed a reference to the Credit Agreement as amended by this First Amendment.

[signatures follow on succeeding pages]

WITNESS the due execution hereof as of the day and year first above written.

COMERICA BANK,
as Agent

By: _____

Its: _____

QUANEX CORPORATION

By: _____

Its: _____

SWING LINE BANK AND ISSUING BANK:

COMERICA BANK

By: _____

Its: _____

BANKS:

COMERICA BANK

By: _____

Its: _____

HARRIS TRUST & SAVINGS BANK

By: _____

Its: _____

U.S. BANK NATIONAL ASSOCIATION

By: _____

Its: _____

BANK OF AMERICA, N.A.

By: _____

Its: _____

WELLS FARGO BANK TEXAS, N.A.

By: _____

Its: _____

BNP PARIBAS

By: _____

Its: _____

UNION BANK OF CALIFORNIA, N.A.

By: _____

Its: _____

THE NORTHERN TRUST COMPANY

By: _____

Its: _____

SOUTHWEST BANK OF TEXAS, N.A.

By: _____

Its: _____

CREDIT LYONNAIS

By: _____

Its: _____

GUARANTY BANK

By: _____

Its: _____

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Exhibit 21

SUBSIDIARIES OF QUANEX CORPORATION	STATE OF INCORPORATION
Piper Impact, Inc.	Delaware
Quanex Bar, Inc.	Delaware
Quanex Steel, Inc.	Delaware
Quanex Health Management Company, Inc.	Delaware
Quanex Manufacturing, Inc.	Delaware
Quanex Solutions, Inc.	Delaware
Quanex Technologies, Inc.	Delaware
Nichols Aluminum-Alabama, Inc.	Delaware
Colonial Craft, Inc.	Delaware
MACSTEEL Monroe, Inc.	Delaware
Nichols Aluminum-Golden, Inc.	Delaware
Quanex Four, Inc.	Delaware
Quanex Six, Inc.	Delaware
Imperial Products, Inc.	Delaware
Temroc Metals, Inc.	Minnesota

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Exhibit 21

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Exhibit No. 23

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statements No. 33-23474, No. 33-29585, No. 33-22550, No. 33-35128, No. 33-38702, No. 33-46824, No. 33-57235, No. 33-54081, No. 33-54085, No. 33-54087, No. 333-18267, No. 333-22977, No. 333-36635, No. 333-89853, No. 333-66777, No. 333-45624 and No. 333-108687 of Quanex Corporation of our report dated December 15, 2003 appearing in this Annual Report on Form 10-K of Quanex Corporation for the year ended October 31, 2003.

/s/ Deloitte & Touche LLP

Houston, Texas
December 29, 2002

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INDEPENDENT AUDITORS' CONSENT

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Exhibit 31.1

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Raymond A. Jean, certify that:

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

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

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

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

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

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

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

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of 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.

December 22, 2003

/s/ RAYMOND A. JEAN

RAYMOND A. JEAN
Chairman of the Board, President and
Chief Executive Officer
(Principal Executive Officer)

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CHIEF EXECUTIVE OFFICER CERTIFICATION

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Exhibit 31.2

CHIEF FINANCIAL OFFICER CERTIFICATION

I, Terry M. Murphy, certify that:

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

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

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

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

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

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

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

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of 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.

December 22, 2003

/s/ TERRY M. MURPHY

TERRY M. MURPHY
Vice President—Finance and
Chief Financial Officer
(Principal Financial Officer)

QuickLinks

CHIEF FINANCIAL OFFICER CERTIFICATION

QuickLinks -- Click here to rapidly navigate through this document

Exhibit 32.1

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

We hereby certify that the accompanying Report of Quanex Corporation on Form 10-K for the year ended October 31, 2003 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.

December 22, 2003

/s/ RAYMOND A. JEAN	/s/ TERRY M. MURPHY
Raymond A. Jean *Chairman of the Board, President and Chief Executive Officer*	Terry M. Murphy *Vice President—Finance and Chief Financial Officer*

QuickLinks

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