

ESSAR STEEL ALGOMA INC.
Consolidated Financial Statements
For the Year ended March 31, 2011

Independent Auditor's Report

To the Shareholder of
Essar Steel Algoma Inc.

We have audited the accompanying consolidated financial statements of Essar Steel Algoma Inc., which comprise the consolidated balance sheet as at March 31, 2011, and the consolidated statement of loss, comprehensive loss and deficit, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Essar Steel Algoma Inc. as at March 31, 2011 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Other Matters

The consolidated financial statements of Essar Steel Algoma Inc. for the year ended March 31, 2010 were audited by another auditor who issued an unmodified opinion on May 31, 2010.

As part of our audit of the consolidated financial statements for the year ended March 31, 2011, we also audited the reclassifications described in Note 3 that were applied to amend the consolidated financial statements for the year ended March 31, 2010. In our opinion, such reclassifications are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the consolidated financial statements for the year ended March 31, 2010 of Essar Steel Algoma Inc. other than with respect to the reclassifications and, accordingly, we do not express an opinion or any other form of assurance on the consolidated financial statements for the year ended March 31, 2010 taken as a whole.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants
June 8, 2011

ESSAR Steel Algoma Inc.
Consolidated Statements of Loss

Expressed in millions of Canadian dollars

Years ended March 31,	<u>2011</u>	<u>2010</u>
Sales	\$ 1,768.3	\$ 1,409.4
Operating expenses		
Cost of sales excluding amortization (note 4)	1,755.4	1,362.8
Amortization	178.4	190.3
	<u>1,933.8</u>	<u>1,553.1</u>
Administrative and selling	64.2	50.5
Amortization of intangible assets and non-production assets	22.9	24.2
	<u>2,020.9</u>	<u>1,627.8</u>
Loss from operations	(252.6)	(218.4)
Financial expense (income)		
Interest on long-term liabilities	79.2	77.9
Change in the fair value of embedded derivatives (note 9)	0.1	0.2
Interest on short-term liabilities, net	6.4	1.7
Foreign exchange loss	36.6	187.1
Other (income) loss	(1.7)	1.9
	<u>120.6</u>	<u>268.8</u>
Loss before income taxes	(373.2)	(487.2)
Income taxes		
Current recovery (note 12)	-	(61.8)
Future recovery (note 12)	(87.3)	(29.5)
	<u>(87.3)</u>	<u>(91.3)</u>
Net loss	\$ (285.9)	\$ (395.9)
Attributable to:		
Equity owners	(285.9)	(398.9)
Non-controlling interests	-	3.0
	<u>\$ (285.9)</u>	<u>\$ (395.9)</u>
 Consolidated Statements of Comprehensive Loss and (Deficit) Retained Earnings		
Net loss	\$ (285.9)	\$ (395.9)
Unrealized loss on foreign exchange translation	(8.5)	(159.4)
Comprehensive loss for the periods	\$ (294.4)	\$ (555.3)
Attributable to:		
Equity owners	(294.4)	(558.3)
Non-controlling interests	-	3.0
	<u>\$ (294.4)</u>	<u>\$ (555.3)</u>
(Deficit) retained earnings		
Balance, beginning of periods	\$ (193.0)	\$ 205.9
Net loss for the periods	(285.9)	(398.9)
Balance, end of periods	<u>\$ (478.9)</u>	<u>\$ (193.0)</u>

See accompanying notes to the consolidated financial statements

ESSAR Steel Algoma Inc.
Consolidated Balance Sheets

Expressed in millions of Canadian dollars

As at March 31,

	<u>2011</u>	<u>2010</u>
		(Note 3)
Assets		
Current		
Cash	\$ 5.7	\$ 40.2
Accounts receivable (note 23)	160.4	203.5
Income taxes receivable (note 12)	2.5	21.4
Loan receivable from related party (note 23)	11.0	-
Inventories (note 4)	278.2	289.3
Prepaid expenses	4.5	7.4
Future income tax assets (note 12)	1.5	1.5
Total current assets	<u>463.8</u>	<u>563.3</u>
Property, plant and equipment, net (note 5)	1,363.0	1,552.8
Intangible assets, net (note 6)	95.0	116.5
Other assets	1.4	2.5
	<u>\$ 1,923.2</u>	<u>\$ 2,235.1</u>
Liabilities and shareholder's equity		
Current		
Bank indebtedness (note 8)	\$ 184.5	\$ 92.2
Accounts payable and accrued liabilities (notes 7 and 23)	181.4	194.1
Income taxes payable (note 12)	-	0.3
Accrued post-employment benefit obligation (note 11)	20.5	18.2
Current portion of other long-term liabilities (note 22)	2.0	2.2
Future income tax liabilities (note 12)	2.2	3.5
Total current liabilities	<u>390.6</u>	<u>310.5</u>
Long-term debt (note 9)	742.8	776.5
Accrued pension liability (note 10)	144.6	135.5
Accrued post-employment benefit obligation (note 11)	418.6	405.0
Other long-term liabilities (note 22)	8.6	9.2
Future income tax liabilities (note 12)	122.5	208.5
	<u>1,827.7</u>	<u>1,845.2</u>
Commitments and contingencies (note 13)		
Shareholder's equity		
Accumulated other comprehensive income (note 18)	25.8	34.3
Deficit	(478.9)	(193.0)
	<u>(453.1)</u>	<u>(158.7)</u>
Capital stock (note 14)	490.4	490.4
Contributed surplus (note 17)	58.2	58.2
	<u>95.5</u>	<u>389.9</u>
Total liabilities and shareholder's equity	<u>\$ 1,923.2</u>	<u>\$ 2,235.1</u>

See accompanying notes to the consolidated financial statements

ESSAR Steel Algoma Inc.
Consolidated Statements of Cash Flows

Expressed in millions of Canadian dollars

Years ended March 31,	<u>2011</u>	<u>2010</u> (Note 3)
Operating activities		
Net loss	\$ (285.9)	\$ (395.9)
Adjustments and items not affecting cash:		
Amortization of property, plant and equipment and intangible assets	201.3	214.5
Future income tax recovery	(87.8)	(29.5)
Pension expense in excess of current funding	9.1	2.0
Unrealized foreign exchange loss on accrued pension liability	6.5	29.1
Post-employment benefit expense in excess of payments	15.9	7.5
Unrealized foreign exchange loss on accrued post-employment benefit obligation	20.3	90.9
Change in the fair value of embedded derivatives	(0.2)	(0.1)
Loss on disposal of property, plant and equipment	1.9	1.5
Unrealized foreign exchange loss on future income taxes	6.8	51.9
Other	(0.6)	6.8
	<u>(112.7)</u>	<u>(21.3)</u>
Changes in non-cash operating working capital (note 21)	<u>48.0</u>	<u>(145.0)</u>
	<u>(64.7)</u>	<u>(166.3)</u>
Investing activities		
Acquisition of property, plant and equipment	(54.9)	(91.7)
Proceeds on sale of assets held for sale	-	136.0
Acquisition of intangible asset	(2.0)	(0.6)
Restricted cash	-	1.8
Loan/receivable from related party	(11.3)	14.2
	<u>(68.2)</u>	<u>59.7</u>
Financing activities		
Bank indebtedness, net	98.6	25.6
Proceeds of Secured Notes	-	402.1
Repayment of term loan	-	(331.9)
Advances from related parties, net	-	(4.1)
Other	(0.8)	(0.2)
	<u>97.8</u>	<u>91.5</u>
Effect of exchange rate changes on cash	0.6	(5.6)
Cash		
Change during periods	(34.5)	(20.7)
Balance, beginning of periods	40.2	60.9
Balance, end of periods	<u>\$ 5.7</u>	<u>\$ 40.2</u>
Supplemental cash flow information		
Income taxes (refunded) paid	\$ (15.6)	\$ 7.5
Interest paid	<u>\$ 62.3</u>	<u>\$ 67.9</u>

See accompanying notes to the consolidated financial statements

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

1. BASIS OF PRESENTATION

ESSAR Steel Algoma Inc. (the "Company") is an integrated steel producer with its active operations located entirely in Canada. The Company produces sheet and plate products that are sold primarily in Canada and the United States. The Company had a 50.1% interest in a subsidiary which generated and sold electricity from commencement of operations on June 13, 2009 until November 17, 2009 at which time the Company sold its interest to a related company.

The Company's functional currency is the United States dollar ("U.S. \$") which reflects the Company's exposure to the U.S. dollar. The Company uses the Canadian dollar ("Cdn. \$") as its reporting currency. In accordance with Canadian generally accepted accounting principles ("GAAP"), all amounts presented in these consolidated financial statements are translated into Canadian dollars using the current rate method whereby all revenues, expenses and cash flows are translated at the average rate that was in effect during the year and all assets and liabilities are translated at the prevailing closing rate in effect at the end of the year (Cdn. \$0.9696 per U.S. \$1.00 as at March 31, 2011; Cdn. \$1.0158 per U.S. \$1.00 as at March 31, 2010). Equity transactions have been translated at historical rates. The resulting net translation adjustment has been recorded in comprehensive income (loss) for the year.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared by the Company in accordance with Canadian GAAP. These principles are also in conformity, in all material respects, with United States generally accepted accounting principles ("U.S. GAAP"), except as described in note 24 to these consolidated financial statements.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned and controlled subsidiaries. Until November 17, 2009 the Company held a 50.1% interest in Algoma Energy Limited Partnership ("AELP"). The outside equity holders' interests were shown as 'Non-controlling Interest'. Subsequent to the sale of AELP, the Company's interest in all its subsidiaries is 100%. All significant intercompany balances and transactions have been eliminated.

Cash and restricted cash

Restricted cash represents cash in an escrow account in order to secure and fund a future obligation that was eliminated in the year ended March 31, 2009.

Inventories

Raw materials, work in process and finished products inventories are measured at the lower of average cost and net realizable value. Supplies inventories are measured at the lower of average cost and replacement cost. Average cost for finished goods and work in process is comprised of direct costs and an allocation of production overheads, including amortization expense.

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Property, plant and equipment

Property, plant and equipment are recorded at cost. The amortization of property, plant and equipment begins when assets are ready for their intended use.

Amortization is calculated generally by the straight-line method based on estimated remaining useful lives as follows:

Buildings	5 to 40 years
Machinery and equipment	5 to 20 years
Computer hardware	5 years
Mill rolls	1 to 15 years

Capital costs related to extending the useful life of the blast furnace are amortized over its remaining estimated useful life on a unit of production basis.

The Company incurs maintenance costs on all of its major equipment. Costs that extend the life of the asset or increase the utility of the asset are capitalized as property, plant and equipment and are amortized over its estimated useful life. All other repairs and maintenance costs are expensed as incurred.

On an annual basis, the Company reviews whether there are any indicators of impairment of property, plant and equipment. If such indicators are present, the Company assesses the recoverability of the group of assets by determining whether the carrying value of such assets can be recovered through undiscounted future cash flows. If the sum of undiscounted future cash flows is less than the carrying amount, the excess of the carrying amount over the estimated fair value, based on discounted future cash flows, is recorded as a charge to income.

Intangible assets

Finite life intangible assets are amortized on a straight-line basis over their estimated remaining useful lives, as follows:

Customer relationships	Over expected life, ranging from 12 to 14 years
Technology	Over expected useful life, ranging from 5 to 10 years
In-process research and development	Over expected useful life, ranging from 5 to 10 years
Supply agreements	Over terms of specific agreements, ranging from 5 to 15 years
Essar Centre naming rights	Over term of specific agreement, 10 years
Computer software	Over expected life, 5 years

Finite life intangible assets which are subject to amortization are evaluated for impairment when events or conditions indicate that the carrying value may be impaired by comparing the carrying value to future undiscounted cash flows. If impairment is determined to have occurred, an impairment loss is recognized for the excess of the carrying amount of the intangible asset over its fair value.

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income taxes

The Company follows the liability method of income tax allocation. Future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using enacted or substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are provided to the extent that it is more likely than not that the future income tax assets will not be realized. Investment tax credits related to research and development are recognized in income as a reduction of such expenses when the Company has made the qualifying expenditures and to the extent that there is reasonable assurance that the credits will be realized. Income tax benefits relating to uncertain tax positions are recognized when they are considered by management more likely than not to be realized and are measured at management's best estimate of the amount to be realized. Such tax benefits are derecognized and related tax liabilities are recorded when management considers realization to no longer be more likely than not.

Pensions and other post-employment benefits

The Company measures its accrued benefit obligation and the fair value of plan assets for accounting purposes at March 31 (the measurement date) each year. The expected return on plan assets is based on the fair value of plan assets. The accrued benefit obligations and the benefit costs are actuarially determined using the projected benefit method pro-rated on services. Future salary levels affect the amount of future pensions. The past service costs resulting from negotiated benefit changes are amortized over the term of the collective bargaining agreements which are three and four years. In the event that a single transaction gave rise to both a curtailment and a settlement, the curtailment would be accounted for first.

Cumulative actuarial gains and losses (such as adjustments arising from experience gains and losses and changes in assumptions) in excess of 10% of the greater of the accrued benefit obligation and the market value of plan assets are amortized over the expected average remaining service period of active members expected to receive the benefits under the plans and over the average remaining life expectancy of 15 years for plans where all, or almost all, of the employees are no longer active. The expected average remaining service period of active members of the pension plans at the measurement date of March 31, 2011 was 9 to 10 years.

The Company also provides for other post-employment benefits upon retirement for employees and their dependents. The cost of these benefits is accrued over the service lives of the employees based on actuarial estimates. The expected average remaining service period of active members related to the other post-employment benefits at the measurement date of March 31, 2011 was 10 to 13 years.

Asset retirement obligations

The Company recognizes the fair value of a future asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of property, plant and equipment that results from the acquisition, construction, development, and/or normal use of the assets. The Company concurrently recognizes a corresponding increase in the carrying amount of the related property, plant and equipment that is amortized over the life of the asset. The fair value of the asset retirement obligation is estimated using the expected cash flow approach that reflects a range of possible outcomes discounted at a credit-adjusted risk-free interest rate. Subsequent to the initial measurement, the asset retirement obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. Changes in the obligation due to the passage of time are recognized in income as an operating expense. Changes in the obligation due to changes in estimated cash flows are

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

recognized as an adjustment of the carrying amount of the related property, plant and equipment that is amortized over the remaining life of the asset.

Comprehensive income (loss)

Other comprehensive income (loss) includes unrealized gain (loss) on foreign exchange translation from the U.S. functional currency to the Canadian reporting currency. Other comprehensive income (loss) is presented below net income (loss) on the consolidated statements of income (loss) and comprehensive income (loss). Comprehensive income (loss) is composed of net income (loss) and other comprehensive income (loss).

Accumulated other comprehensive income is a separate component of shareholder's equity which includes the accumulated balances of all components of other comprehensive income (loss) which are recognized in comprehensive income (loss) but excluded from net income (loss).

Revenue recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable, and collection is reasonably assured. Revenues are recorded net of provisions for returns, customer claims and other adjustments. Amounts billed to customers in a sale transaction related to shipping and handling are recorded as revenue. The Company reflects freight costs associated with shipping its products to customers as a component of cost of sales. Until November 17, 2009 the Company owned 50.1% of AELP (note 23). Revenue generated by AELP from the sale of electricity was recorded at the time the power was provided based upon output delivered at rates specified under contract terms.

Research and development

Research costs are charged to operations as incurred, due to the nature of the projects. Where government incentives in the form of investment tax credits and grants are received for research and development projects initiated by the Company for its own purposes, these incentives are deducted from the applicable category of expenditures, that is, either cost of sales or property, plant and equipment.

Financial instruments

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. Financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables or other financial liabilities. Held-for-trading financial instruments are subsequently measured at fair value and changes in fair value are recognized in net income in the period in which they occur. Available-for-sale financial instruments are subsequently measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired, at which time the amounts would be recognized in net income. Held-to-maturity investments, loans and receivables and other financial liabilities are subsequently measured at amortized cost using the effective interest rate method.

The Company has designated its cash and derivatives as held-for-trading and its accounts receivable and loans receivable as loans and receivables. Bank indebtedness, accounts payable and accrued liabilities, and long-term debt are designated as other financial liabilities.

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

To manage risks associated with future variability in cash flows attributable to certain commodity purchases, the Company uses natural gas swap contracts with maturities of 12 months or less. To manage its interest rate risks, the Company may utilize interest rate swaps for portions of its outstanding long-term debt. The Company does not utilize derivative financial instruments for trading or speculative purposes. An embedded derivative is a component of a financial instrument or another contract of which the characteristics are similar to a derivative. All derivative instruments including embedded derivatives are measured at fair value with changes in fair value recognized in income.

The Company categorizes its financial assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs used in the measurement. Level one includes unadjusted quoted prices in active markets for identical assets and liabilities. Level two includes inputs that are observable other than quoted prices included in level one. Level three includes inputs that are not based on observable market data.

Financing costs

Financing costs associated with the Revolving Facility are amortized using the straight-line basis over 5 years as a component of interest expense. Financing costs related to the Senior Secured Notes and the Senior Notes are recorded as a component of the carrying amount of the related debt and are amortized to income using the effective interest rate method.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. In addition to items discussed elsewhere, significant items subject to such estimates and assumptions include the carrying amount and useful lives of property, plant and equipment and intangible assets; measurement of inventories; expected future tax benefits; valuation allowances for receivables and future income taxes; intangibles; the fair value of derivative instruments; asset retirement obligations; treatment of uncertain tax positions and assets and obligations related to employee future benefits. Actual results could differ from those estimates.

3. ACCOUNTING AND REPORTING CHANGES

In February 2008, the Canadian Accounting Standards Board announced the adoption of International Financial Reporting Standards (“IFRS”) for publicly accountable enterprises. These standards are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company plans to report its consolidated financial statements in accordance with IFRS commencing April 1, 2011. The Company has assessed the impact of these new standards and is prepared to disclose the impact as required in the first quarter of 2012 interim financial statements.

In October 2008, the Canadian Institute of Chartered Accountants (“CICA”) issued Handbook Sections 1582, “Business Combinations”, 1601, “Consolidated Financial Statements”, and 1602, “Non-controlling Interests”. CICA 1582 establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed, CICA 1601 carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition other than non-controlling interests, and CICA 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

3. ACCOUNTING AND REPORTING CHANGES *(continued)*

were effective for the Company on April 1, 2010. The adoption did not have a material impact on the Company's consolidated financial statements other than the reclassification of prior year non-controlling interests in the Consolidated Statements of Loss and Comprehensive Loss and (Deficit) Retained Earnings.

The CICA Handbook Section 3064, "Goodwill and Intangible Assets", was revised in February 2008 and replaced Section 3062, "Goodwill and Intangible Assets", and Section 3450, "Research and Development Costs". The new section established standards for the recognition, measurement and disclosure of goodwill and intangible assets and was effective for the period commencing April 1, 2009. The Company corrected the balance sheet classification of software costs from property, plant and equipment to intangibles during the year along with the comparative figures at March 31, 2010 to conform to the requirements of the section. The net book value of software costs reclassified was \$13.5 million at March 31, 2011 (March 31, 2010 - \$20.0 million). The adoption of the section did not have an impact on the Company's interim and year-end consolidated financial statements other than the reclassification described previously.

The Company has reclassified the pension liability included in current liabilities to long term to conform to the presentation adopted in the current year consolidated financial statements. This reclassification of the balance sheet for the year ended March 31, 2010 resulted in a reduction in current liabilities of \$52.8 million and a corresponding increase in long term liabilities.

4. INVENTORIES

	<u>2011</u>	<u>2010</u>
Raw materials and supplies	\$ 180.8	\$ 160.4
Work in process	51.4	62.5
Finished products	<u>46.0</u>	<u>66.4</u>
	<u>\$ 278.2</u>	<u>\$ 289.3</u>

During the year ended March 31, 2011 the cost of inventory sold was \$1,807.1 million (2010 - \$1,403.0 million).

The Company received \$18.6 million in the year ended March 31, 2011 (2010 - \$30.0 million) from insurers in final settlement of the claim for the Company's blast furnace #7 damage suffered on September 24, 2009 as a result of a failure in the bustle main. This amount was recorded in cost of sales. There are no amounts outstanding at March 31, 2011.

Inventory write-downs for the year ended March 31, 2011 of \$17.0 million (2010 - \$12.9 million) were recorded to adjust inventories to net realizable value and recognized as an expense in cost of sales during the year. There have been no reversals during 2011 of any previously recorded inventory write-downs.

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

5. PROPERTY, PLANT AND EQUIPMENT

	2011			2010		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Land	\$ 18.4	\$ -	\$ 18.4	\$ 19.3	\$ -	\$ 19.3
Buildings	188.5	73.6	114.9	193.7	58.2	135.5
Machinery and equipment	1,680.2	519.4	1,160.8	1,725.8	397.3	1,328.5
Computer hardware	8.6	4.1	4.5	9.0	3.0	6.0
Mill rolls	30.5	9.8	20.7	29.6	11.2	18.4
Assets under capital lease	4.8	3.5	1.3	5.0	2.6	2.4
Construction in progress	42.4	-	42.4	42.7	-	42.7
	\$ 1,973.4	\$ 610.4	\$ 1,363.0	\$ 2,025.1	\$ 472.3	\$ 1,552.8

Amortization of property, plant and equipment for the year ended March 31, 2011 was \$178.3 million (2010 - \$191.3 million). Amortization included in inventories at March 31, 2011 amounted to \$8.5 million (2010 - \$12.5 million).

6. INTANGIBLE ASSETS

	2011			2010		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Customer relationships	\$ 94.1	\$ 27.2	\$ 66.9	\$ 98.6	\$ 20.9	\$ 77.7
Technology	9.8	4.1	5.7	10.3	3.2	7.1
In-process research and development	4.3	2.1	2.2	4.4	1.6	2.8
Supply agreements	11.8	6.1	5.7	19.9	12.2	7.7
Essar Centre naming rights	1.4	0.4	1.0	1.5	0.3	1.2
Software	37.5	27.6	9.9	39.5	21.0	18.5
Software in development	3.6	-	3.6	1.5	-	1.5
	\$ 162.5	\$ 67.5	\$ 95.0	\$ 175.7	\$ 59.2	\$ 116.5

Amortization of intangible assets for the year ended March 31, 2011 was \$19.0 million (2010 - \$20.5 million).

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	<u>2011</u>	<u>2010</u>
Trade payables	\$ 75.8	\$ 77.4
Accrued liabilities	56.5	69.1
Wages and employee deductions payable	14.0	13.3
Accrued vacation pay	30.0	31.3
Other taxes payable	5.1	3.0
	<u>\$ 181.4</u>	<u>\$ 194.1</u>

8. BANKING FACILITIES

On June 20, 2007, the Company entered into a five-year Revolving Credit Agreement. The agreement provides the Company with a revolving credit facility ("Revolving Facility") equal to the lesser of a maximum lender commitment and a calculated borrowing base determined by the levels of the Company's accounts receivable and inventories, less certain reserves. The Revolving Facility is secured by substantially all of the Company's assets. Under the General Security Agreement, the Revolving Facility has priority claim on the accounts receivable and inventories of the Company and a secondary claim on the rest of the Company's assets. In addition to satisfying the borrowing base requirements in order to make borrowings under the Revolving Facility, the Company is required to either meet a fixed charge coverage ratio test or maintain a minimum excess availability of 10% of the Revolving Facility commitment. At March 31, 2011, the Company is required to maintain a minimum excess availability equal to U.S. \$35 million.

There were no amendments to the facility in fiscal 2011; however, during fiscal year 2010, the Revolving Facility lenders approved two amendments to the Revolving Facility. On November 10, 2009, the lenders approved a Second Amendment which amended the definition of 'Permitted CoGen Sale' to allow the sale of the 50.1% balance of the Equity Interest in AELP as a 'Permitted CoGen Sale'. In conjunction with the issuance of the 9.375% Senior Secured Notes, the Revolving Facility lenders approved a Third Amendment to the Revolving Facility which reduced the maximum lender commitment from U.S. \$425 million to U.S. \$350 million as of December 4, 2009.

The Revolving Facility permits borrowings of Canadian or U.S. dollars. Canadian borrowings bear interest at either the Canadian bankers' acceptance rate plus a margin of 1.25% - 2.0% or Canadian prime rate plus a margin of 0.25% - 1.0%. U.S. borrowings bear interest at either the London Inter-Bank Overnight Rate ("LIBOR") plus a margin of 1.25% - 2.0% or the lender's corporate base rate plus a margin of 0.25% - 1.0%. The applicable margin is dependent on the average excess availability under the Revolving Facility for the preceding fiscal quarter.

The Revolving Facility also provides for payment to the lenders of an unused line fee on the average daily excess availability of 0.25% per annum and a letter of credit fee ranging from 1.25% to 2.00%, depending on the average excess availability under the Revolving Facility. A commitment fee of 0.25% of the full amount of the Revolving Facility and a funding fee of 0.75% of the full amount of the Revolving Facility were incurred to establish the Revolving Facility and are being amortized to expenses using a straight-line method over 5 years. The unamortized balance of the Revolving Facility fees at March 31, 2011 is \$1.2 million (2010 - \$2.2 million).

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

8. BANKING FACILITIES *(continued)*

At March 31, 2011, there was \$184.5 million (includes U.S. borrowings of U.S. \$185.0 million) and \$92.2 million at March 31, 2010 (includes U.S. borrowings of U.S. \$nil million) outstanding under the Revolving Facility and \$71.0 million (2010 - \$163.9 million) of unused availability after taking into account \$16.8 million (2010 - \$16.6 million) of outstanding letters of credit and the U.S. \$35 million minimum excess availability requirement. In addition, the Company had \$5.7 million of unrestricted cash at March 31, 2011 (2010 - \$40.2 million)

Under the terms of the Revolving Facility, the Company is required to be in compliance with various restrictive covenants which, among other things, limit the incurrence of additional indebtedness, limit investments, capital expenditures and dividends and restrict transactions with affiliates, permitted acquisitions, asset sales, liens and encumbrances and other matters customarily restricted in such agreements. The Company was in compliance with the financial covenant requirements of the Revolving Facility at March 31, 2011.

9. LONG-TERM DEBT

	<u>2011</u>	<u>2010</u>
9.375% Senior Secured Notes denominated in U.S. dollars, due March 15, 2015	\$ 387.8	\$ 406.1
9 7/8% Senior Notes denominated in U.S. dollars, due June 15, 2015	<u>373.0</u>	<u>390.8</u>
	760.8	796.9
Less unamortized financing costs, premiums, and/or discounts	<u>18.0</u>	<u>20.4</u>
	<u>\$ 742.8</u>	<u>\$ 776.5</u>

The aggregate amount of principal repayments in each of the next five years and thereafter at current exchange rates is as follows:

2012	\$ -
2013	-
2014	-
2015	387.8
2016	<u>373.0</u>
	<u>\$ 760.8</u>

On June 20, 2007, the Company entered into a U.S. \$450 million Term Loan. The Term Loan was secured by substantially all of the Company's assets and contained various restrictive covenants including limits on leverage and interest coverage ratios. The term loan was settled during the year ended March 31, 2010. At the time of the settlement \$8.8 million of unamortized financing costs were expensed to interest on long-term liabilities.

On December 14, 2009, the Company issued U.S. \$400 million of 9.375% Senior Secured Notes ("Secured Notes"). The Secured Notes bear interest at 9.375% per annum which is payable on March 15 and September 15 of each year and will mature on March 15, 2015. Under an Intercreditor Agreement, the Secured Notes have priority claim on all of the Company's assets except for accounts receivable and inventories. In addition, the Secured Notes have a secondary claim on accounts receivable and inventories. The Company applied the net proceeds from the sale of the Secured Notes to repay all amounts outstanding on the Term Loan facility, reduce the balance of the Revolving Facility and for general corporate purposes.

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

9. LONG TERM DEBT (continued)

Subject to certain conditions, at any time prior to March 15, 2013, the Company may redeem up to 35% of the principal amount of the Secured Notes at a redemption price of 109.375% of the principal amount plus accrued and unpaid interest with the proceeds of a public equity offering. At any time prior to March 15, 2013, the Company may also redeem all or a part of the Secured Notes at a redemption price equal to 100% of the principal amount of the Secured Notes redeemed plus accrued and unpaid interest and a specified premium. On or after March 15, 2013, the Company may redeem all or a part of the Secured Notes at the following redemption prices, plus accrued and unpaid interest:

	<u>%</u>
2013	104.6875
2014 and thereafter	<u>100.0000</u>

The prepayment options in the Secured Notes are required to be accounted for as embedded call option derivative instruments, which require bifurcation and are accounted for at fair value. The embedded call options were included in other assets and have an estimated fair value of nil at March 31, 2011 (\$0.1 million at March 31, 2010).

The Company also has U.S. \$384.7 million of 9 7/8% Senior Notes ("Senior Notes") outstanding. The Senior Notes were issued on June 20, 2007. The Senior Notes bear interest of 9 7/8% per annum which is payable on June 15 and December 15 each year. The Senior Notes are unsecured and are subordinated in right of payment to all existing and future secured indebtedness of the Company to the extent of the assets securing such indebtedness. The total Senior Notes outstanding on the issue date was \$450 million. During fiscal 2009, the Company purchased and cancelled U.S. \$65.3 million of Senior Notes, leaving a remaining balance of U.S. \$384.7 million.

Subject to certain conditions, at any time prior to June 15, 2010, the Company may redeem up to 35% of the principal amount of the Senior Notes at a redemption price of 109.875% of the principal amount plus accrued and unpaid interest with the proceeds of a public equity offering. At any time prior to June 15, 2011, the Company may also redeem all or a part of the Senior Notes at a redemption price equal to 100% of the principal amount of the Senior Notes redeemed plus accrued and unpaid interest and a specified premium. On or after June 15, 2011, the Company may redeem all or a part of the Senior Notes at the following redemption prices, plus accrued and unpaid interest:

	<u>%</u>
2011	104.938
2012	102.469
2013 and thereafter	<u>100.000</u>

The prepayment options in the Senior Notes are required to be accounted for as embedded call option derivative instruments, which require bifurcation and are accounted for at fair value. The embedded call options were included in other assets and have an estimated fair value of nil at March 31, 2011 (2010 – \$0.1 million).

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

9. LONG TERM DEBT *(continued)*

Total transaction costs and discounts related to the Secured Notes and Senior Notes issued during the prior year amounted to \$30.3 million. Unamortized financing costs and discounts or premiums related to the Secured Notes or the Senior Notes totalling \$18.0 million at March 31, 2011 (2010 - 20.4 million) are recorded as a component of the carrying amount of the related debt and are amortized to income using the effective interest rate method.

Under the terms of the Secured Notes and the Senior Notes, the Company is required to be in compliance with various restrictive covenants which, among other things, limit the incurrence of additional indebtedness, limit investments and dividends and restrict transactions with affiliates, permitted acquisitions, asset sales, liens and encumbrances and other matters customarily restricted in such agreements. The Company was in compliance with these requirements at March 31, 2011.

10. PENSION BENEFITS

Defined contribution pension plan

The Company initiated a defined contribution pension plan in 2004 for non-unionized employees joining the Company after January 1, 2003. As part of the contract negotiations with the Company and its locals which concluded on July 31, 2010, the locals and the Company agreed to include in this plan all unionized employees hired subsequent to August 1, 2010 and to offer to all the current employees the option to move to the Defined Contribution Pension Plan. The plan was revised during the year, these revisions went into effect March 1, 2011. Prior to March 1, 2011 the Company provided a base contribution of 3% of salary and also matched employee contributions to a maximum of 4%, depending on years of service. After March 1, 2011, the company provides a base contribution of 5% of salary and also matches employee contributions to a maximum of 2%, depending on years of service for non-unionized employees. Additionally, the Company provides a contribution for unionized employees equal to two dollars and fifty cents per qualified hour. The pension expense under this plan is equal to the Company's contribution. The 2011 pension expense was \$0.6 million (2010 - \$0.3 million).

Defined benefit pension plans

The Company maintains non-contributory defined benefit pension plans that cover all employees not covered under the Defined Contribution Pension Plan (including pensioners retiring after January 1, 2002, which is the date that the Ontario Pension Benefit Guarantee Fund assumed some of the assets and obligations of the pension plans). The benefits are based on years of service and average earnings for a defined period prior to retirement.

The Company also maintains a closed plan for pensioners who retired prior to January 1, 2002. This plan provides the pensioners with a pension benefit in excess of the limits provided by the Ontario Pension Benefit Guarantee Fund.

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

10. PENSION BENEFITS *(continued)***Components of net periodic pension cost**

	<u>2011</u>	<u>2010</u>
Current service cost	\$ 22.3	\$ 15.0
Interest cost	57.2	57.6
Actual return on plan assets	(59.3)	(86.3)
Actuarial loss on benefit obligation	24.0	191.5
Plan amendments	44.6	-
Costs arising in the period	<u>88.8</u>	<u>177.8</u>
Differences between costs arising in the period and costs recognized in the period in respect of:		
Return on plan assets	15.6	45.8
Actuarial gain	(20.5)	(191.8)
Plan amendments/prior service costs	<u>(27.6)</u>	<u>21.4</u>
Net periodic pension cost	<u>\$ 56.3</u>	<u>\$ 53.2</u>

Changes in accrued benefit obligation

	<u>2011</u>	<u>2010</u>
Accrued benefit obligation at beginning of measurement year	\$ 944.1	\$ 721.9
Current service cost	22.3	15.0
Interest cost	57.2	57.6
Actuarial loss	24.0	191.5
Benefits paid	(45.7)	(41.9)
Plan amendments	44.6	-
Accrued benefit obligation at end of measurement year	<u>\$ 1,046.5</u>	<u>\$ 944.1</u>

On August 1, 2010, the Company completed the negotiation of new three and four-year collective bargaining agreements with its trade unions. Under the new agreements the Company agreed to pension plan amendments which resulted in an increase of \$44.6 million in actuarially estimated pension obligations related to past service. These costs are being amortized over the applicable three or four-year collective agreement term.

Change in defined benefit pension plan assets

	<u>2011</u>	<u>2010</u>
Market value at beginning of measurement year	\$ 681.9	\$ 586.2
Actual return on plan assets	59.3	86.3
Employer contributions	47.2	51.3
Benefits paid	(45.7)	(41.9)
Market value at end of measurement year	<u>\$ 742.7</u>	<u>\$ 681.9</u>

The assets of the pension plans are held by an independent trustee. Based on their fair value at March 31, 2011, the plan assets were comprised of approximately 45% equity, 54% bonds and 1% other.

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

10. PENSION BENEFITS (continued)**Reconciliation of funded status:**

	<u>2011</u>	<u>2010</u>
Deficit at measurement date	\$ (303.8)	\$ (262.2)
Unamortized actuarial loss	124.5	119.6
Unamortized past service costs	34.7	7.1
Accrued pension liability	\$ (144.6)	\$ (135.5)

The significant weighted-average assumptions are as follows:

	<u>2011</u>	<u>2010</u>
Accrued benefit obligation:		
Discount rate	5.86%	5.85%
Rate of compensation increase	3.50%	2.70%
Net periodic pension costs:		
Discount rate	5.60%	8.03%
Expected long-term rate of return on plan assets	6.34%	6.84%
Rate of compensation increase	2.74%	2.65%

Cash flow information

Total pension funding for the year ended March 31, 2011 was \$47.2 million (2010 - \$51.3 million). Contributions in fiscal 2011 were based on actuarial valuations at August 1, 2007.

The actuarially estimated funding contributions expected for the year ended March 31, 2012 are \$69.4 million based on actuarial valuations at August 1, 2010.

The actuarially estimated future pension benefit payments to retirees for the next 10 years based on the August 1, 2010 valuation are as follows:

2012	\$ 59.9
2013	64.6
2014	67.1
2015	68.3
2016	69.7
2017 – 2021	374.4

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

11. OTHER POST-EMPLOYMENT BENEFITS

The Company offers post-employment life insurance, health care and dental care to some of its retirees. These obligations are not pre-funded.

Components of net periodic post-employment benefit cost

	<u>2011</u>	<u>2010</u>
Current service cost	\$ 4.4	\$ 2.7
Interest cost	24.3	25.0
Actuarial loss	21.0	77.5
Plan amendments	3.7	-
Costs arising in the year	<u>53.4</u>	<u>105.2</u>
Differences between costs arising in the year and costs recognized in the year in respect of:		
Actuarial gain	(21.0)	(84.5)
Plan amendments	(2.2)	2.0
Net periodic post-employment benefit cost	<u>\$ 30.2</u>	<u>\$ 22.7</u>

Change in post-employment benefit obligation

	<u>2011</u>	<u>2010</u>
Benefit obligation at beginning of year	\$ 404.8	\$ 314.8
Current service cost	4.4	2.7
Interest cost	24.3	25.0
Actuarial loss	18.0	77.5
Benefits paid	(14.3)	(15.2)
Plan amendments	3.7	-
Benefit obligation at end of year	<u>\$ 440.9</u>	<u>\$ 404.8</u>

On August 1, 2010, the Company completed the negotiation of new three and four-year collective bargaining agreements with its trade unions. Under the new agreements the Company agreed to post-employment benefit plan amendments which resulted in an increase of \$3.7 million in actuarially estimated other post-employment benefit obligations related to past service. These costs are being amortized over the applicable three or four-year collective agreement term.

Reconciliation of funded status:

	<u>2011</u>	<u>2010</u>
Deficit at measurement date	\$ (440.9)	\$ (404.8)
Unamortized actuarial gain	(1.0)	(19.0)
Unamortized past service costs	2.8	0.6
Accrued post-employment benefit obligation	<u>\$ (439.1)</u>	<u>\$ (423.2)</u>

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

11. OTHER POST EMPLOYMENT BENEFITS (continued)**Allocation of accrued post-employment benefit obligation on consolidated balance sheet:**

	<u>2011</u>	<u>2010</u>
Current portion	\$ (20.5)	\$ (18.2)
Accrued post-employment benefit obligation	(418.6)	(405.0)
	<u>\$ (439.1)</u>	<u>\$ (423.2)</u>

The significant weighted-average assumptions are as follows:

	<u>2011</u>	<u>2010</u>
Accrued benefit obligation:		
Discount rate	5.65%	5.90%
Rate of compensation increase	3.00%	3.00%
Initial health care rate	7.41%	7.54%
Ultimate health care rate	4.50%	4.50%
Year ultimate rate reached	2030	2030
Net periodic benefit costs:		
Discount rate	5.90%	8.10%
Rate of compensation increase	3.00%	3.00%
Initial health care rate	7.54%	7.28%
Ultimate health care rate	4.50%	4.50%
Year ultimate rate reached	2030	2027

Increasing the health care trend by 1% would change the accrued benefit obligation at March 31, 2011 by approximately \$64.3 million (2010 - \$55.7 million) and the post-employment benefit cost for the period from April 1, 2010 to March 31, 2011 by approximately \$4.6 million (2010 - \$4.1 million). Decreasing the trend by 1% would change the accrued benefit obligation at March 31, 2011 by approximately \$52.6 million (2010 - \$45.8 million) and the post-employment benefit cost for the period from April 1, 2010 to March 31, 2011 by approximately \$3.7 million (2010 - \$3.4 million).

Supplemental cash flow information

Payments made for other post-employment benefits were \$14.3 million for the year ended March 31, 2011 (2010 - \$15.2 million), and are on a pay-as-you-go basis.

The actuarially estimated future benefit payments for the next 10 years are as follows:

2012	\$ 20.5
2013	21.9
2014	22.8
2015	24.1
2016	25.3
2017 – 2021	143.9

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

12. INCOME TAXES

The composition of the future income tax recovery is as follows:

	<u>2011</u>	<u>2010</u>
Initiating and reversing temporary differences:		
Accounting reserves and inventory book-tax basis differences	\$ (1.3)	\$ 3.9
Pension and post-employment benefit expense	(6.2)	(8.1)
Tax depreciation less than book amortization	(35.8)	(28.3)
Unrealized foreign exchange gain on U.S. dollar debt	4.5	26.3
Tax loss carry-forward	(49.9)	(8.4)
Financing expenses	1.7	(1.3)
Other	(0.3)	2.4
Benefit of future tax rate reductions enacted during the year	-	(16.0)
	<u>\$ (87.3)</u>	<u>\$ (29.5)</u>

Effective income tax rate

The following table explains the variation between the Company's provision for income taxes and the statutory income tax rate:

	<u>2011</u>	<u>2010</u>
Income tax provision (recovery) at the statutory manufacturing and processing rate of 28.4% (2010 - 30.8%)	\$ (106.0)	\$ (150.7)
Add (deduct):		
Non-deductible portion of exchange loss on U.S. dollar currency	12.1	75.7
Initiating future tax asset recognized at tax rates lower than statutory rate	6.9	-
Impact of future tax rate reductions enacted during the year	-	(16.0)
Other	(0.3)	(0.3)
Recovery of income taxes	<u>\$ (87.3)</u>	<u>\$ (91.3)</u>

Components of future income tax assets and liabilities are summarized as follows:

	<u>2011</u>	<u>2010</u>
Future income tax assets – current Canadian taxes		
Accounting reserves not currently deductible for tax purposes	\$ 1.5	\$ 1.5
Total current assets	<u>\$ 1.5</u>	<u>\$ 1.5</u>
Future income tax liabilities – current Canadian taxes		
Book value of inventory in excess of tax basis	\$ (2.2)	\$ (3.5)
Total current liabilities	<u>\$ (2.2)</u>	<u>\$ (3.5)</u>

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

12. INCOME TAXES (continued)

	<u>2011</u>	<u>2010</u>
Future income tax assets – non-current Canadian taxes		
Post-employment benefit obligation	\$ 109.7	\$ 105.8
Pension benefit obligation	36.2	33.9
Tax loss carryforward	58.3	8.4
Other	7.4	7.9
	<u>211.6</u>	<u>156.0</u>
Valuation allowances	-	-
Canadian non-current assets, net	<u>211.6</u>	<u>156.0</u>
United States taxes		
Tax loss carryforwards	12.9	14.7
Valuation allowance	(12.9)	(14.7)
United States non-current assets, net	<u>-</u>	<u>-</u>
Total non-current assets, net	<u>\$ 211.6</u>	<u>\$ 156.0</u>
	<u>2011</u>	<u>2010</u>
Future income tax liabilities – non-current Canadian taxes		
Book value of tangible and intangible assets in excess of tax basis	\$ (323.8)	\$ (359.6)
Unrealized exchange gain on U.S. dollar debt	(9.4)	(4.9)
Other	(0.9)	-
Total non-current liabilities	<u>(334.1)</u>	<u>(364.5)</u>
Net non-current liabilities	<u>\$ (122.5)</u>	<u>\$ (208.5)</u>

Future income tax assets are recognized to the extent that it is determined to be more likely than not that sufficient taxable income will be available within the carryforward periods to allow the asset to be realized. The determination is made at the consolidated balance sheet dates by assessing all positive and negative evidence regarding the future sources of taxable income.

The Company's U.S. subsidiary, Cannelton Iron Ore Company ("Cannelton"), has not engaged in any business activity since the disposition of its joint venture interest (note 13) in 2002. Consequently, at March 31, 2011, a full valuation allowance of \$12.9 million (2010 - \$14.7 million) has been recorded against its future income tax assets.

Loss carryforwards

The Company has non-capital losses available of \$232.4 million of which \$29.7 million expire in 2030 and \$202.7 million in 2031.

Cannelton has non-capital losses available on a calendar year basis, which are limited to use under Internal Revenue Code 382, of approximately U.S. \$38.3 million, of which U.S. \$1.9 million expire in 2021 and U.S. \$36.4 million in 2022.

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

12. INCOME TAXES (continued)

In the second quarter of fiscal 2010, the Canada Revenue Agency (“CRA”) concluded its review of the Company’s assignment of \$160.0 million as the fair market value of the 16 million common shares issued as consideration in discharging debts under the 2002 financial reorganization. The CRA reduced the fair market value assigned to the common shares to \$126.4 million and, as a result, reassessed the Company’s , 2002 to 2006 taxation years to reflect a reduced amount of available non-capital loss carryforwards. The Company had filed an objection to the CRA reassessments and no provision had been made in the consolidated statement of loss for the income taxes or interest associated with the reassessments. The Company paid the reassessments, which totalled \$2.0 million including \$0.5 million of interest, and had reflected this amount as a recoverable netted with income and other taxes payable in the consolidated balance sheet. In October 2010 the CRA issued notices of reassessment which accepted the objection filed by the Company and refunded the amounts previously paid in addition to refund interest.

Scientific research and experimental development claims

For the fiscal years 2002-2010, the Company has filed, or intends to file, scientific research and experimental development (“SR&ED”) claims with the CRA totalling \$366.7 million. The potential tax benefit on these claims is 20% to 24% of the claims or \$74.6 million. To date, \$31.9 million of the potential tax benefit, the portion that management believes meets the threshold of “reasonable assurance” of realization, has been recognized. The determination of the amount of tax benefit to recognize requires judgement, and is subject to change based on the CRA’s audit of the claims which may result in adjustments to income.

The CRA has assessed \$3.4 million of tax credits in respect of 2002 to which the Company has objected. In August and September 2010, the Company reached agreements with the CRA on \$19.6 million of tax credits for the years 2003-2006.

13. CONTINGENCIES AND COMMITMENTS

Under operating leases for premises and equipment, the Company is obligated to make aggregate payments of \$9.6 million, comprised of:

2011	\$ 5.5
2012	2.7
2013	0.7
2014	0.4
2015 and thereafter	0.3
	<u>\$ 9.6</u>

The Company requires large quantities of iron ore, coal, oxygen, electricity and natural gas in order to satisfy the demands of the steel manufacturing operation. The Company makes most of its purchases of these principal raw materials at negotiated prices under annual and multi-year agreements. These agreements provide the Company with comfort that an adequate supply of these key raw materials will be available to the Company at a price acceptable to the Company.

ESSAR STEEL ALGOMA INC.

Notes to consolidated financial statements

Expressed in millions of Canadian dollars, except as noted

13. CONTINGENCIES AND COMMITMENTS *(continued)*

The pricing of the iron ore purchased under these contracts is based on certain published benchmark pricing factors. The calendar year 2010 price was never finalized under this formula as certain of the benchmark pricing factors ceased to be published. As a result of an Arbitration Panel ruling, replacement benchmark factors have been established. The Company announced on April 20, 2011 that it had reached an agreement.

Contractual commitments at March 31, 2011 amounted to \$21.1 million relating to authorized capital projects. The Company has committed to capital expenditures during the period 2012 to 2019 in the amount of \$59.7 million in order to comply with environmental regulations. The actual cost of the equipment and its installation could vary significantly due to cost escalation, design changes, regulatory policies, or other factors.

From time to time, in the ordinary course of business, the Company is a defendant or party to a number of pending or threatened legal actions and proceedings. Although such matters cannot be predicted with certainty, management currently considers the Company's exposure to such claims and litigation, to the extent not covered by the Company's insurance policies or otherwise provided for, not to have a material adverse effect on these consolidated financial statements. In addition, the Company is involved in and potentially subject to regular audits from federal and provincial tax authorities relating to income, capital and commodity taxes and, as a result of these audits, may receive assessments and reassessments.

14. CAPITAL STOCK

Authorized – Unlimited common shares

The following table summarizes the share capital transactions since incorporation on April 12, 2007:

	Common shares <u>Issued and Outstanding</u>	
	<u># shares</u>	<u>Stated capital</u>
Common shares issued on incorporation	10,000	\$ -
Common shares issued during the period from April 12, 2007 to December 31, 2007	<u>500,000,000</u>	<u>531.8</u>
Balance at March 31, 2008	500,010,000	531.8
Return of capital during fiscal year 2009		41.4
Balance at March 31, 2010 and 2011	<u>500,010,000</u>	<u>\$ 490.4</u>

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

15. CAPITAL DISCLOSURES

The Company's objectives when managing capital are:

- (i) to maintain a flexible capital structure which optimizes the cost of capital at acceptable risk;
- (ii) to meet external capital requirements on debt and credit facilities;
- (iii) to ensure adequate capital to support long-term growth strategy; and
- (iv) to provide an adequate return to shareholders.

The Company continuously monitors and reviews the capital structure to ensure the objectives are met.

Management defines capital as the combination of its indebtedness and equity balances and manages the capital structure within the context of the business strategy, general economic conditions, market conditions in the steel industry and the risk characteristics of assets.

16. PROFIT SHARING PLAN

The Company has a profit sharing plan for substantially all employees. As per the collective agreements negotiated with the Company's unions on August 1, 2010, profit sharing will be calculated on a fiscal year basis beginning with the period ending March 31, 2011. Profit sharing expense was calculated on a calendar year basis in previous periods. The amount of profit sharing is based on a percentage of income from operations adjusted for the effects of the purchase accounting adjustments required under GAAP as a result of the acquisition of the former Algoma Steel Inc. on June 20, 2007. The accrual for profit sharing at March 31, 2011 was nil (2010 - nil). The percentages for the accrual are defined in the Collective Bargaining Agreements as follows:

<u>Annual Income from Operations</u>	<u>Profit Sharing Percentage</u>
\$0 - \$50 million	0%
\$50 - \$100 million	6%
\$100 - \$150 million	8%
Greater than \$150 million	10%

17. CONTRIBUTED SURPLUS

	<u>2011</u>	<u>2010</u>
Balance, beginning of year	\$ 58.2	\$ 55.5
Net gain on the sale of 50.1% interest in AELP (note 23)	-	2.7
Balance, end of year	<u>\$ 58.2</u>	<u>\$ 58.2</u>

18. ACCUMULATED OTHER COMPREHENSIVE INCOME

	<u>2011</u>	<u>2010</u>
Balance, beginning of year	\$ 34.3	\$ 193.7
Other comprehensive loss for the year		
Unrealized loss on foreign exchange translation	(8.5)	(159.4)
Balance, end of year	<u>\$ 25.8</u>	<u>\$ 34.3</u>

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

19. FINANCIAL INSTRUMENTS**Financial risk management**

The Company's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risk. The Company may use derivative financial instruments to hedge certain of these risk exposures. The use of derivatives is based on established practices and parameters, which are subject to the oversight of the Board of Directors. The Company does not utilize derivative financial instruments for trading or speculative purposes.

Fair value of financial instruments

The fair value of accounts receivable, loan receivable from related party, bank indebtedness and accounts payable and accrued liabilities approximates their carrying value due to the short-term nature of these instruments. The fair value of the Senior Notes, including the embedded call options, was approximately \$351.6 million at March 31, 2011 (2010 - \$359.8 million) based on market pricing for the Senior Notes on or about that date. The fair value of the Secured Notes, including the embedded call options, was approximately \$393.7 million at March 31, 2011 (2010 - \$410.4 million) based on market pricing for the Secured Notes on or about that date.

The following table represents the fair value hierarchy of financial instruments by level as at March 31, 2011:

Financial Instrument	Measurement	Total Carrying Value	Level One	Level Two	Level Three
Cash	Fair value	\$ 5.7	\$ 5.7	\$ -	\$ -
Derivatives	Fair value	(0.5)	-	(0.5)	-

2010:

Financial Instrument	Measurement	Total Carrying Value	Level One	Level Two	Level Three
Cash	Fair value	\$ 40.2	\$ 40.2	\$ -	\$ -
Derivatives	Fair value	(2.8)	-	(2.8)	-

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises primarily from the Company's receivables from customers. The Company has an established credit policy under which each new customer is analyzed individually for creditworthiness before the Company's standard payment and delivery terms and conditions are offered. The Company's review includes a review of the potential customer's financial information, external credit ratings and bank and supplier references. Credit limits are established for each new customer and customers that fail to meet the Company's credit requirements may transact with the Company only on a prepayment basis.

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

19. FINANCIAL INSTRUMENTS *(continued)*

The maximum credit exposure at March 31, 2011 is the carrying amount of accounts receivable of \$160.4 million (2010 - \$203.5 million). One customer represents greater than 10% of this amount (2010 - one customer). As at March 31, 2011; \$7.3 million or 4.3% of accounts receivable were more than 90 days overdue (2010 - \$11.8 million, or 5.9%).

The Company establishes an allowance for doubtful accounts that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific provision that relates to individual exposures and a provision for expected losses that have been incurred but not yet identified. The allowance for doubtful accounts at March 31, 2011 was \$1.6 million (2010 - \$2.2 million).

The Company may be exposed to certain losses in the event of non-performance by counterparties to derivative financial instruments such as commodity price contracts and foreign exchange contracts. The Company mitigates this risk by entering into transactions with highly rated major financial institutions.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages liquidity risk by maintaining adequate cash balances and by appropriately utilizing the Revolving Facility to ensure that there is sufficient availability under the facility. The details of the Revolving Facility are described in note 8. The Company continuously monitors and reviews actual and forecasted cash flows to ensure adequate liquidity and anticipate liquidity requirements. The Company's objectives and processes for capital management, including the management of long-term debt, are described in note 15.

The following table shows the Company's contractually agreed (undiscounted) cash flows payable under financial liabilities and derivative financial instruments as at the consolidated balance sheet date:

2011

Undiscounted Cash Flows	Carrying Amount	Contractual Cash Flows	Less Than 1 year	1-2 years	2-5 years	More Than 5 years
Non-derivative financial liabilities						
Senior Notes	\$ 373.0	\$ (373.0)	\$ -	\$ -	\$ (373.0)	\$ -
Interest on Senior Notes	10.7	(184.2)	(36.8)	(36.8)	(110.6)	-
Secured Notes	387.8	(387.8)	-	-	(387.8)	-
Interest on Secured Notes	1.5	(145.4)	(36.4)	(36.4)	(72.6)	-
Revolving Facility	184.5	(184.5)	(184.5)	-	-	-
Trade and other payables	169.2	(169.2)	(169.2)	-	-	-
Derivative financial instruments (a)						
Gas purchase swap used for hedging	0.5	(0.5)	(0.5)	-	-	-
	\$ 1,127.2	\$ (1,444.6)	\$ (427.4)	\$ (73.2)	\$ (944.0)	\$ -

(a) – The derivative financial instruments cash outflows represent the net contractual obligation

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

19. FINANCIAL INSTRUMENTS (continued)

2010

Undiscounted Cash Flows	Carrying Amount	Contractual Cash Flows	Less Than 1 year	1-2 years	2-5 years	More Than 5 years
Non-derivative financial liabilities						
Senior Notes	\$ 390.8	\$ (390.8)	\$ -	\$ -	\$ -	\$ (390.8)
Interest on Senior Notes	11.3	(204.2)	(38.6)	(38.6)	(115.8)	(11.2)
Secured Notes	406.1	(406.1)	-	-	(406.1)	-
Interest on Secured Notes	1.7	(193.2)	(38.6)	(38.7)	(115.9)	-
Revolving Facility	92.2	(92.2)	(92.2)	-	-	-
Trade and other payables	181.1	(181.1)	(181.1)	-	-	-
Derivative financial instruments (a)						
Interest rate swap used for hedging	2.7	(2.7)	(2.7)	-	-	-
	\$ 1,085.9	\$ (1,470.3)	\$ (353.2)	\$ (77.3)	\$ (637.8)	\$ (402.0)

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and commodity prices, will affect the Company's income or the value of its holdings of financial instruments.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Company occasionally buys and sells derivatives in order to manage market risks. These activities are carried out under the oversight of the Board of Directors.

Currency risk

The Company is exposed to currency risk on purchases, labour costs and pension (note 10) and other post retirement employment benefits (note 11) liabilities that are denominated in Canadian dollars. The prices for steel products sold in Canada are derived mainly from price levels in the U.S. market in U.S. dollars converted into Canadian dollars at the prevailing exchange rates. As a result, a stronger U.S. dollar relative to the Canadian dollar increases the Company's Canadian dollar selling prices for sales in Canada.

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

19. FINANCIAL INSTRUMENTS *(continued)*

At March 31, 2011 and 2010, the Company's Canadian dollar denominated financial instruments were as follows:

	<u>2011</u>	<u>2010</u>
Cash	\$ 2.1	\$ -
Accounts receivable	77.5	100.5
Bank indebtedness	(5.2)	(92.2)
Accounts payable and accrued liabilities	(157.3)	(158.9)
Pension and post-employment benefit liabilities	(583.7)	(558.7)
Other long-term liabilities	(8.6)	(9.2)
Net Canadian dollar liability	\$ (675.2)	\$ (718.5)

A \$0.01 decrease (or increase) in the U.S. dollar relative to the Canadian dollar at March 31, 2011 would have increased (or decreased) operating income by \$1.5 million (2010 - \$6.4 million).

Interest rate risk

Interest rate risk is the risk that the value of the Company's assets and liabilities will be affected by a change in interest rates. The Company's interest rate risk mainly arises from the interest rate impact on its debt. The Company may manage interest rate risk through the periodic use of interest rate swaps.

For the year ended March 31, 2011 a one percent increase (or decrease) in interest rates would have decreased (or increased) net income by approximately \$1.0 million (2010 - \$2.1 million).

Commodity price risk

The Company is subject to price risk from fluctuations in the market prices of commodities, including natural gas, iron ore and coal. The Company enters into supply agreements for certain of these commodities as disclosed in note 13. To manage risks associated with future variability in cash flows attributable to certain commodity purchases, the Company may use derivative instruments with maturities of 12 months or less. At March 31, 2011, the fair value of natural gas swap contracts was a liability of \$0.5 million, which was included in accounts payable and accrued liabilities (2010 - nil).

20. SEGMENTED INFORMATION

The Company is viewed as a single business segment involving basic steel production for purposes of internal performance measurement and resource allocation. The total sales, by product group is as follows:

	<u>2011</u>	<u>2010</u>
Sheet and strip	\$ 1,223.8	\$ 1,008.9
Plate	369.0	234.8
Slab	-	6.0
Freight	127.2	116.0
Non-steel sales	48.3	30.2
Sale of electricity (AELP)	-	13.5
	\$ 1,768.3	\$ 1,409.4

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

20. SEGMENTED INFORMATION (continued)

Sales to customers in the U.S. were \$701.1 million for the year ended March 31, 2011 (2010 - \$560.1 million). Export sales to other countries for the year ended March 31, 2011 were \$106.0 million (2010 - \$61.9 million).

For the years ended March 31, 2011 and 2010, no single customer represented greater than 10% of total sales.

21. NET CHANGE IN NON-CASH OPERATING WORKING CAPITAL

	<u>2011</u>	<u>2010</u>
Accounts receivable	\$ 38.5	\$ (67.6)
Inventories	(9.7)	(75.4)
Prepaid expenses	2.2	37.6
Accounts payable and accrued liabilities	1.2	37.2
Income taxes payable/receivable	15.8	(76.8)
	<u>\$ 48.0</u>	<u>\$ (145.0)</u>

22. OTHER LONG-TERM LIABILITIES

	<u>2011</u>	<u>2010</u>
Asset retirement obligations (a)	\$ 8.2	\$ 8.0
Long-term lease obligation	2.4	3.4
	<u>10.6</u>	<u>11.4</u>
Less current portion:		
Asset retirement obligations	1.1	1.3
Long-term lease obligation	0.9	0.9
	<u>2.0</u>	<u>2.2</u>
	<u>\$ 8.6</u>	<u>\$ 9.2</u>

- (a) This liability represents the Company's obligations associated with asset retirement obligations determined based on the Company's best estimate of the costs to be incurred, discounted at credit-adjusted risk-free rates of 7% to 15.6% (2010 - 7% to 14.5%). Changes in future conditions could require a change in this liability.

Mining related obligations

Obligations are related to site restoration and closure for inactive iron ore mines located in northern Ontario. As there is no associated tangible long-lived asset, changes in the obligation are expensed. The undiscounted obligation at March 31, 2011 is \$12.6 million (2010 - \$12.7 million).

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

22. OTHER LONG-TERM LIABILITIES *(continued)***Chlorobiphenyl (“PCB”) Transformers**

Obligations are related to the removal of PCB Transformers. The undiscounted obligation at March 31, 2011 is \$2.1 million (2010 - \$2.1 million). It is expected that the costs related to the PCB Transformers replacement will continue to be incurred until 2014. The table below displays the obligations referred to above on a discounted basis:

	Mining Related Obligations	Chlorobiphenyl (PCB) Transformers	2011	2010
Balance, beginning of year	6.3	1.7	8.0	7.9
Revision of estimates - additions	1.4	-	1.4	1.0
Revision of estimate - other	-	0.1	0.1	(0.4)
Settlement of obligations	(1.4)	-	(1.4)	(1.0)
Accretion expense	-	0.1	0.1	0.5
Balance, end of year	6.3	1.9	8.2	8.0

23. RELATED PARTY TRANSACTIONS

The Company's major shareholder, ESSAR Steel Holdings Ltd. (“Essar”), and its commonly controlled affiliates are related parties. Related party transactions which occur in the ordinary course of business are measured at the exchange amount, which is the amount of consideration agreed to between the parties.

The Company had sales to related parties of \$20.3 million for fiscal year 2011 (2010 - \$26.2 million). The balance receivable from related parties included in accounts receivable as at March 31, 2011 is \$0.2 million (2010 - \$1.4 million).

The Company incurred amounts for services provided by related parties of \$1.3 million for the year ended March 31, 2010 (2010 - \$2.2 million). The balance payable to related parties included in accounts payable and accrued liabilities as at March 31, 2011 is \$0.6 million (2010 - \$1.2 million).

The Company entered into agreements with a related party for the purchase of coal. Under these agreements, the Company incurred amounts for purchases of \$41.6 million for the year ended March 31, 2011 (2010 – nil). The balance prepaid to related parties included in prepaid expense as at March 31, 2011 is \$0.3 million (March 31, 2010 - nil). The purchase prices in these transactions approximate market prices.

The Company incurred expenses for consulting services to a company owned by a Director of \$1.1 million for the year ended March 31, 2011 (2010 - \$1.4 million). The balance payable to related parties included in accounts payable and accrued liabilities as at March 31, 2011 is \$0.1 million (2010 – nil).

In April 2010, the Company issued a promissory note to Essar Minerals Canada Limited in the amount of \$10.7 million (US \$11.0 million). The note is unsecured, bears interest at 3.29% and is due on demand. Both the principal and interest of \$0.3 million (US \$ 0.3 million), are included in loan receivable from related party at March 31, 2011

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

23. RELATED PARTY TRANSACTIONS *(continued)*

In September 2008, the Company loaned U.S. \$13.5 million to a company under common control. The loan was repaid during the fiscal year ended March 31, 2010.

Until November 17, 2009, the assets and liabilities of AELP were shown as held for sale in the consolidated balance sheet and the 49.9% interest held by an affiliate was shown as non-controlling interest. On November 17, 2009, the same affiliate purchased the remaining 50.1% interest held by the Company in AELP for consideration of \$136.0 million, consisting of \$133.3 million in cash and a \$2.7 million note receivable.

Details of the sale of the 50.1% interest in AELP at the date of the transaction (in millions) are as follows:

Proceeds of the sale	\$ 136.0
Assets held for sale	(220.7)
Minority interest	88.1
Other	<u>(0.7)</u>
Amount recorded in contributed surplus	<u>\$ 2.7</u>

The related party transaction was accounted for at the carrying amount and the excess of \$2.7 million was recorded in contributed surplus. No income taxes were recorded on the transaction as the proceeds of the sale were approximately equal to the tax cost basis of the 50.1% investment.

Concurrent with the sale of the Company's interest in AELP, the Company entered into 20-year agreements with a related party under common control as follows:

- [i] Energy Supply Agreement to purchase electricity at the Hourly Ontario Energy Price ("HOEP") under which the Company purchased \$17.4 million (\$2.4 million during the period from November 18, 2009 to March 31, 2010) as well as provide gas and receive steam, which are transacted at nil value between the related parties;
- [ii] A Shared Services Agreement to provide employees and other services which are transacted at the exchange amount. The Company received revenue of \$2.3 million (\$0.8 million during the period from November 18, 2009 to March 31, 2010); and
- [iii] A Lease Agreement for the land on which the facility is built is for a nominal amount annually.

The balance receivable from related parties as at March 31, 2011 is \$3.6 million (2010 - \$0.5 million).

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

24. SIGNIFICANT DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

The Company's consolidated financial statements are prepared in accordance with Canadian GAAP which differs in certain respects from U.S. GAAP. Following is a summary of the effect of significant differences in GAAP on the Company's consolidated financial statements:

1) INVESTMENT TAX CREDITS

Under U.S. GAAP; FASB Accounting Standards Codification ("ASC") 740, the Company has credited investment tax credits against income tax expense whereas under Canadian GAAP these tax credits are offset against the related operating expense. There is no impact to net loss as a result of this GAAP difference.

	<u>2011</u>	<u>2010</u>
Cost of goods sold		
Balance under Canadian GAAP	\$ 1,755.4	\$ 1,362.8
ASC 740 adjustment	-	10.0
Balance under U.S. GAAP	<u>\$ 1,755.4</u>	<u>\$ 1,372.8</u>

	<u>2011</u>	<u>2010</u>
Current income tax recovery		
Balance under Canadian GAAP	\$ -	\$ 61.8
ASC 740 adjustment	-	10.0
Balance under U.S. GAAP	<u>\$ -</u>	<u>\$ 71.8</u>

2) LONG-TERM DEBT

Transaction costs have been added to the carrying value of the "Long-term debt" under Canadian GAAP whereas under U.S. GAAP, ASC 835 such costs are recorded separately within "Other assets". There is no impact to net loss as a result of this GAAP difference.

	<u>2011</u>	<u>2010</u>
Other Assets		
Balance under Canadian GAAP	\$ 1.4	\$ 2.5
ASC 835 adjustment	16.2	17.8
Balance under U.S. GAAP	<u>\$ 17.6</u>	<u>\$ 20.3</u>

	<u>2011</u>	<u>2010</u>
Long-term debt		
Balance under Canadian GAAP	\$ 742.8	\$ 776.5
ASC 835 adjustment	16.2	17.8
Balance under U.S. GAAP	<u>\$ 759.0</u>	<u>\$ 794.3</u>

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

24. SIGNIFICANT DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) (continued)**3) PENSIONS AND POST-RETIREMENT BENEFITS**

The Company is required to recognize the over or under funded status of defined benefit pension and other post-retirement benefit plans on the balance sheet under U.S. GAAP, ASC 715. The over or under funded status is measured as the difference between the fair value of the plan assets and the benefit obligation, being the projected benefit obligation for pension plans and the accumulated benefit obligation for other post-retirement benefit plans. In addition, any previously unrecognized actuarial gains and losses and prior service costs and credits that arise during the period will be recognized as a component of "Other comprehensive loss", net of tax. Under Canadian GAAP the over or under funded status of defined benefit pension and post-retirement benefit plans is not recognized in the balance sheet. Canadian GAAP recognizes an asset for contributions made in excess of amounts recognized as expense in the Consolidated Statement of Income and a liability when contributions are less than amounts recognized as expense.

	<u>2011</u>	<u>2010</u>
Comprehensive loss		
Balance under Canadian GAAP	\$ (294.4)	\$ (558.3)
ASC 715 adjustment, net of tax of \$13.2 million (2010 - net of tax of \$51.8 million)	<u>(39.3)</u>	<u>(155.4)</u>
Balance under U.S. GAAP	<u>\$ (333.7)</u>	<u>\$ (713.7)</u>
	<u>2011</u>	<u>2010</u>
Accrued pension liability		
Balance under Canadian GAAP	\$ 144.6	\$ 135.5
ASC 715 adjustment	<u>159.2</u>	<u>126.8</u>
Balance under U.S. GAAP	<u>\$ 303.8</u>	<u>\$ 262.3</u>
Accrued post-employment benefit obligation		
Balance under Canadian GAAP	\$ 418.6	\$ 405.0
ASC 715 adjustment	<u>1.8</u>	<u>(18.3)</u>
Balance under U.S. GAAP	<u>\$ 420.4</u>	<u>\$ 386.7</u>
	<u>2011</u>	<u>2010</u>
Future income tax liability		
Balance under Canadian GAAP	\$ 122.5	\$ 208.5
Tax effect of ASC 715 adjustment	<u>(40.3)</u>	<u>(27.1)</u>
Balance under U.S. GAAP	<u>\$ 82.2</u>	<u>\$ 181.4</u>

ESSAR STEEL ALGOMA INC.**Notes to consolidated financial statements**

Expressed in millions of Canadian dollars, except as noted

24. SIGNIFICANT DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) (continued)

	<u>2011</u>	<u>2010</u>
Accumulated other comprehensive (income) loss		
Balance under Canadian GAAP	\$ (25.8)	\$ (34.3)
Prior period ASC 715 accumulated other comprehensive (income) loss	80.1	(75.3)
ASC 715 adjustment, net of tax of \$13.2 million (2010 - net of tax of \$51.8 million)	39.3	155.4
Balance under U.S. GAAP	<u>\$ 93.6</u>	<u>\$ 45.8</u>

Consolidated statements of cash flows:

Canadian GAAP permits the presentation of a subtotal of the amount of funds provided by operating activities before net change in non-cash operating working capital in the consolidated statements of cash flows. U.S. GAAP does not permit this subtotal to be reported on the consolidated statements of cash flows.