MANAGEMENT'S DISCUSSION AND ANALYSIS

This MD&A is dated as of February 7, 2007 and should be read in conjunction with the 2006 Audited Consolidated Financial Statements and accompanying Notes. This discussion of the Company's business may include forward-looking information with respect to the Company, including its operations and strategies, as well as financial performance and conditions. The use of forward-looking words such as "may," "will," "expect" or similar variations generally identify such statements. Although management believes that expectations reflected in forward-looking statements are reasonable, such statements involve risks and uncertainties and should not be regarded as a representation by the Company or any other person that the anticipated results will be achieved. Investors are cautioned not to place undue reliance on such information.

Additional information about Algoma Steel Inc. is available in the Company's Annual Information Form and Proxy Information Circular, which can be accessed from SEDAR at www.sedar.com and at the Company's website at www.algoma. com.

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Use of Non-GAAP Financial Measures

The following summarizes non-GAAP financial measures utilized in the MD&A. As there is no generally accepted method of calculating these financial measures, they may not be comparable to similar measures reported by other companies. Investors are encouraged to consider these financial measures in the context of the Company's GAAP results, as provided in the attached audited consolidated financial statements.

EBITDA refers to earnings before interest, taxes, depreciation and amortization, foreign exchange, investment income, other income and premium on redemption of 11% Notes. EBITDA is not a recognized measure for financial statement presentation under Canadian generally accepted accounting principles. EBITDA is not intended to represent cash flow from operations, as defined by Canadian GAAP, and it should not be considered as an alternative to net earnings, cash flow from operations, or any other measure of performance prescribed by GAAP. The Company's EBITDA may also not be comparable to EBITDA used by other companies which may be calculated differently. The Company considers EBITDA to be a meaningful measure to assess its operating performance in addition to GAAP measures. It is included because the Company believes it can be useful in measuring its ability to service debt, fund capital expenditures, and expand its business. EBITDA is also used by investors, analysts, and the Company's lenders as a measure of the Company's financial performance.

Book Value per Share is defined as shareholders' equity divided by the number of shares outstanding at the end of the period. The Company believes that this measure is useful to investors as a measure of total shareholders' equity attributable to shareholders on a per share basis.

Fourth Quarter Results

The following table summarizes the operating results of the Company for the fourth quarter ended December 31, 2006 and 2005:

Consolidated Results of Operations

(in millions of dollars except per share amounts)	FOURTH QUARTER **2006**	2005
(Unaudited)		
Sales	**$ 418.4**	$ 477.6
Cost of sales	**(337.9)**	(374.4)
Gross margin	**80.5**	103.2
Gross margin percentage	**19.2%**	21.6%
Administrative and selling expense	**(16.3)**	(25.6)
Amortization	**(15.3)**	(14.1)
Other income	**1.5**	-
Income from operations	**50.4**	63.5
Financial income (expense)	**7.0**	(1.2)
Income before income taxes	**57.4**	62.3
Income taxes	**(7.0)**	(7.3)
Net income	**$ 50.4**	$ 55.0
Net income per common share:		
Basic	**$ 1.58**	$ 1.39
Diluted	**$ 1.57**	$ 1.38
Weighted average number of common shares outstanding – millions:		
Basic	**31.90**	39.53
Diluted	**32.16**	39.77

SUPPLEMENTAL NON-FINANCIAL INFORMATION

Operations (thousands of net tons)		
Raw steel production	**651**	671
Steel shipments	**534**	582

Sales

Sales for the fourth quarter of 2006 were $418.4 million, $98.5 million lower than the previous quarter and $59.2 million lower than the comparable period in 2005. The decrease from the previous quarter and the fourth quarter of 2005 was the result of lower average selling prices and lower shipments. Steel prices averaged $721 per ton in the fourth quarter as compared to $774 per ton in the third quarter and $751 per ton in the fourth quarter of 2005. Steel shipments totaled 534,200 tons for the fourth quarter of 2006, 88,200 tons lower than the previous quarter and 48,300 tons lower than the fourth quarter of 2005. Abnormally high customer inventory levels and continued high levels of imports impacted fourth quarter performance. In addition, the Company implemented the first phase of its new SAP Enterprise Resource Planning System late in the fourth quarter and, typical with the commissioning of a system of this complexity, experienced start-up issues that impacted shipping capabilities. The Company expects to recover these delayed shipments in the first quarter of 2007.

Details of sales of sheet and plate in the fourth quarter as compared to the third quarter were as follows:

	Q4 2006				Q3 2006			
	Shipments (tons)	**% of Total**	**Sales (millions)**	**Average Price/ Ton**	Shipments (tons)	% of Total	Sales (millions)	Average Price/ Ton
Sheet	**420**	**78.7%**	**$ 262**	**$ 624**	486	78.1%	$ 336	$ 691
Plate	**114**	**21.3%**	**123**	**1,079**	136	21.9%	146	1,070
Steel Products Sales	**534**	**100.0%**	**385**	**$ 721**	622	100.0%	482	$ 774
Freight			**19**				23	
Non-steel sales			**14**				12	
Sales			**$418**				$517	

Sales to Canadian customers totaled 306,706 tons (2005 – 425,392 tons) while sales to US and offshore customers totaled 226,890 tons (2005 – 156,110 tons) representing 57.5% (2005-73.2%) and 42.5% (2005-26.8%) respectively of total tons sold in the quarter.

Net income and Earnings Per Share

Net income for the three months ended December 31, 2006 was $50.4 million compared to $59.5 million for the third quarter of 2006 and $55.0 million for the comparable quarter of 2005. The decrease in net income from the previous quarter and from the fourth quarter of 2005 was mainly due to lower shipments and lower average selling prices, partially offset by a lower effective tax rate versus the third quarter.

Earnings per share on a basic and diluted basis were $1.58 and $1.57 respectively in the fourth quarter of 2006 as compared to $1.62 and $1.61 in the third quarter and $1.39 and $1.38 in the fourth quarter of 2005. In addition to changes in earnings over these periods, earnings per share reflect the reduction in shares outstanding due to share buybacks through the year. The weighted average diluted shares outstanding were 32.2 million in the fourth quarter of 2006 as compared to 37.0 million in the third quarter and 39.8 million in the fourth quarter of 2005.

EBITDA (i)

The following table shows the reconciliation of EBITDA and net income in accordance with GAAP:

	FOURTH QUARTER	
(in millions of dollars)	**2006**	2005
Net income	**$ 50.4**	$ 55.0
Amortization	**15.3**	14.1
Interest expense (net of interest income)	**(2.0)**	0.7
Foreign exchange loss (gain)	**(5.0)**	0.5
Other (income) expense	**(1.5)**	-
Income taxes	**7.0**	7.3
EBITDA	**$ 64.2**	$ 77.6

EBITDA for the fourth quarter was $64.2 million compared to $112.3 million for the previous quarter and $77.6 million for the fourth quarter of 2005. The decline from the previous quarter was mainly attributable to lower selling prices, which declined $53 or 6.8%, and lower shipments which declined 88,200 tons or 14.2%. The decline from the comparable quarter in 2005 was also mainly due to lower selling prices and lower shipments, partially offset by lower manufacturing costs resulting primarily from lower natural gas and iron ore costs, offset by higher coal and employment costs. Coke sales in the fourth quarter of 2006 were 10,591 tons that contributed $2.2 million to EBITDA versus coke sales of 10,500 tons in the third quarter that contributed $2.6 million to EBITDA and coke sales of 27,200 tons in the fourth quarter of 2005 that contributed $7.9 million to EBITDA.

(i) EBITDA is a non-GAAP measure and is defined on page 2 of this report.

Cost of Sales

Cost of sales before employees' profit sharing for the fourth quarter of 2006 was $334.3 million versus $378.4 million for the third quarter of 2006 and $368.5 million for the fourth quarter of 2005. The decrease over the third quarter of 2006 was mainly due to lower shipments. The decrease over the comparable period of 2005 was primarily due to lower shipments and lower natural gas costs, offset by higher coal and employment costs. Excluding employees' profit sharing expense, cost of sales per ton shipped for steel products was $568 per ton for the fourth quarter of 2006 versus $556 per ton for the previous quarter and $576 per ton for the fourth quarter in 2005. The increase from the previous quarter was primarily due to product mix and increased coal prices. The decrease from the comparable period in 2005 was mainly attributable to product mix and lower natural gas costs, offset by higher coal costs.

Approximately 20,000 tons of finished goods produced from purchased slabs were sold in the fourth quarter and these additional sales generated approximately an additional $0.1 million of operating income. This compares to approximately 70,000 tons of finished goods produced from purchased slabs that were sold in the third quarter generating approximately $4.4 million of operating income. For the entire year, approximately 165,000 tons of finished goods produced from purchased slabs were sold generating approximately $10.5 million of operating income.

A $3.6 million ($7 per ton) expense for employees' profit sharing was recorded in the fourth quarter versus an $8.4 million expense ($14 per ton) for the third quarter and $5.9 million ($10 per ton) for the fourth quarter of 2005.

Raw steel production for the three months ended December 31, 2006 totaled 651,000 tons versus 662,000 tons for the previous quarter and 671,000 tons for the fourth quarter of 2005.

Administrative and Selling Expense

Administrative and selling expenses totaled $16.3 million in the fourth quarter of 2006 as compared to $17.8 million for the third quarter and $25.6 million for the fourth quarter of 2005. The higher expenditures in the fourth quarter of 2005 were primarily due to $9.8 million of costs that either did not re-occur in the fourth quarter of 2006 or were recognized in previous quarters including donations to the local hospital, consulting fees related to research and development tax credits and management bonuses.

Amortization

Amortization of property, plant and equipment was $15.3 million for the fourth quarter of 2006 as compared to $14.6 million for the third quarter of 2006 and $14.1 million for the fourth quarter in 2005.

Financial Income (Expense)

Interest expense was $0.5 million for the fourth quarter of 2006 as compared to $0.4 million for the third quarter and $4.4 million for the fourth quarter of 2005. The reduction in interest expense in the fourth quarter of 2006 as compared to 2005 was due to the redemption of the 11% Notes on January 3, 2006. Investment income was $2.5 million for the fourth quarter of 2006 as compared to $3.7 million for the third quarter of 2006 and $3.7 million for the fourth quarter of 2005. The differences in investment income are due to fluctuations in interest rates and the balances of cash and cash equivalents and short-term investments that were lower in the fourth quarter as compared to previous quarters due primarily to the $200.0 million share buyback completed late in the third quarter of 2006.

A net foreign exchange gain of $5.0 million was realized in the fourth quarter of 2006 as compared to a loss of $0.3 million in the third quarter of 2006. These gains and losses relate to U.S. dollar exposure on cash, accounts receivable and accounts payable.

Provision for Income Taxes

The fourth quarter provision for income taxes was $7.0 million (effective rate of 13.9%) compared to $40.7 million (effective rate of 40.6%) in the third quarter of 2006 and $7.3 million (effective rate of 11.7%) in the fourth quarter of 2005. The fourth quarter provision includes a tax benefit of $21.3 million (2006 cash tax savings of $29.0 million) related to the $85.0 million of pension plan prepayments made in December 2006. The following table provides a reconciliation of the statutory tax amounts and rate to the actual provision for each quarter:

	Q4 2006		Q3 2006		Q4 2005	
	$	%	$	%	$	%
Tax Provision at the Statutory Manufacturing and Processing Rate	$ 19.6	34.1%	$ 34.2	34.1%	$ 21.3	34.1%
Provision for reassessment of prior tax years	3.5	6.1	-	-	-	-
Change in Future Tax Asset Valuation Allowance:						
Impact of Pension Expense	2.8	4.8	3.5	3.5	4.6	7.4
Impact of Pension Funding	(21.3)	(36.8)	-	-	(20.7)	(33.2)
Impact of Post-Employment Expenses	3.3	5.7	2.6	2.6	2.3	3.7
	(15.2)	(26.3)	6.1	6.1	(13.8)	(22.1)
Other	(0.9)	(1.5)	0.4	0.4	(0.2)	(0.3)
Actual Tax Provision	$ 7.0	12.4%	$ 40.7	40.6%	$ 7.3	11.7%

A $50.0 million ($44.0 million of pre-funding and a $6.0 million adjustment to 2005 funding requirements) pension contribution in December 2005 resulted in the reduction of valuation allowances against future income tax assets and a reduction in the tax expense in the fourth quarter of 2005. This prepayment of a portion of the 2006 funding obligation eliminated normal pension funding in the first nine months of 2006 and resulted in an increase to the income tax provision for that period. The current portion of the income tax provision in the quarter, which will result in cash taxes payable, was ($3.5) million versus $37.5 million in the third quarter of 2006 and $5.0 million for the fourth quarter of 2005. The effective tax rate for the fourth quarter of 2006 is significantly lower than the Company's statutory rate of 34% due to the tax benefit related to the $85.0 million of pension plan prepayments.

The Company's 2002 and 2003 taxation years are presently under audit by the Canada Revenue Agency ("CRA"). An adjustment relating to the discharging of debts under the 2002 financial reorganization has been proposed by the CRA that would reduce the available non-capital losses by $21.8 million with a corresponding increase in available capital losses. Consequently, the Company has recorded a charge of $3.5 million to the 2006 tax provision representing the full tax effect of the adjustment. The CRA is also reviewing 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 financial reorganization. The Company is defending its position with respect to the valuation, however if a reassessment is issued and the Company does not prevail through the objection process, the Company's available non-capital losses upon emergence from CCAA would be reduced by the amount of any downward adjustment to the valuation. Each $10 million reduction in the valuation of the common shares would result in an income tax reassessment and cash taxes payable of approximately $3.4 million plus any applicable interest. The Company believes its valuation is supportable and it is too early to assess the outcome of this issue. Consequently, no liability has been recorded in the financial statements.

The long-term future income tax liability of $130.2 million at December 31, 2006 primarily reflects cumulative tax depreciation deducted in excess of book amortization.

Pension and Post Employment Benefits

Pension and post employment benefit expenses for the fourth quarter were $12.5 million (2005-$13.4 million) and $7.9 million (2005-$6.8 million) respectively. The Company made an advanced contribution to its pension plans of $85.0 million in December in order to reduce cash taxes payable in February 2007, improve the funded status of the plan, and generate higher returns on the pension fund assets as compared to cash balances. A similar payment of $50.0 million was made in December 2005. As a result of the prepayment, the Company does not expect to resume monthly pension contributions until after the first quarter of 2008.

Financial Resources and Liquidity

Summary of Cash Flows

(in millions)	FOURTH QUARTER **2006**	2005
Operating activities:		
Cash flow from operations before changes in non-cash operating working capital	**$ (7.6)**	$ 29.0
Changes in non-cash operating working capital	**-**	(22.4)
	(7.6)	6.6
Investing activities:		
Acquisition of property, plant and equipment	**(27.0)**	(17.2)
Decrease (increase) in short-term investments	**3.5**	(1.8)
Other	**0.5**	0.1
	(23.0)	(18.9)
Financing activities:		
Purchase and cancellation of shares	**-**	(8.1)
Other	**-**	0.3
	-	(7.8)
Change in cash during the period	**$ (30.6)**	$ (20.1)

Cash flow from operations in the fourth quarter of 2006, before changes in non-cash operating working capital, was ($7.6) million as compared to $29.0 million in 2005. The decrease was attributable primarily to lower net earnings of $4.6 million and pension plan prepayments which increased by $41.0 million as compared to the fourth quarter of 2005. Exclusive of pension plan prepayments of $85.0 million in 2006 and $44.0 million in 2005, cash flows from operating activities total $77.4 million in 2006 and $73.0 million in 2005, representing an increase of $4.4 million or 6.0%.

There were no changes in non-cash operating working capital in the quarter as compared to $22.4 million in the comparable quarter in 2005, comprised of the following:

(in millions of dollars)	**Q4 2006**	Q4 2005
Accounts receivable	**$ 70.6**	$ 12.7
Inventories	**(55.3)**	2.9
Prepaid expenses	**13.7**	5.2
Accounts payable and accrued liabilities	**(6.3)**	(42.6)
Income and other taxes payable	**(22.7)**	(0.6)
	$ -	$(22.4)

Capital expenditures in the fourth quarter of 2006 totaled $27.0 million, compared to $17.2 million in the fourth quarter of 2005. Expenditures in the fourth quarter of 2006 included $11.4 million of payments and deposits for equipment and materials associated with the partial reline of the blast furnace scheduled for July 2007. There were no financing activities in the fourth quarter of 2006, while financing activities in the fourth quarter of 2005 included $8.1 million for the purchase and cancellation of shares pursuant to a normal course issuer bid.

Annual Corporate Financial Performance

The following table discloses the operating results of the Company for the years ended December 31, 2006, 2005 and 2004:

Consolidated Results of Operations

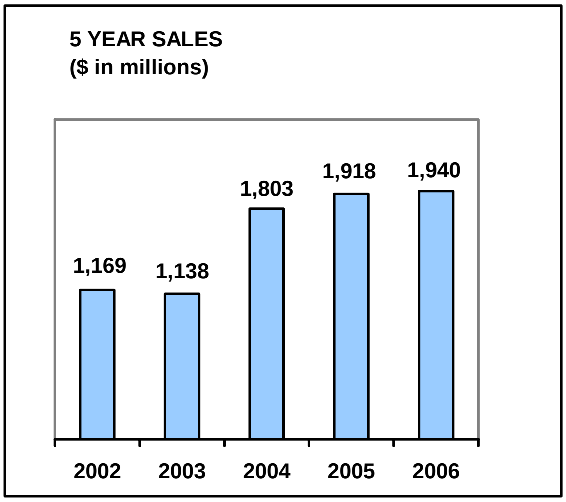
(in millions of dollars except per share amounts)	**2006**	2005	2004
Sales	**$ 1,939.7**	$ 1,917.6	$ 1,803.1
Cost of sales	**(1,488.2)**	(1,430.4)	(1,155.1)
Gross margin	**451.5**	487.2	648.0
Gross margin percentage	**23.3%**	25.4%	35.9%
Administrative and selling expense	**(70.4)**	(69.9)	(50.8)
Amortization	**(58.7)**	(56.1)	(52.2)
Other income	**2.1**	2.3	1.4
Income from operations	**324.5**	363.5	546.4
Financial (expense) income	**4.2**	0.7	(7.0)
Income before income taxes	**328.7**	364.2	539.4
Income taxes	**(106.9)**	(124.6)	(195.6)
Net income	**$ 221.8**	$ 239.6	$ 343.8
Net income per common share:			
Basic	**$ 6.10**	$ 6.04	$ 9.35
Diluted	**$ 6.06**	$ 6.00	$ 8.83
Weighted average number of common shares outstanding – millions:			
Basic	**36.36**	39.68	36.74
Diluted	**36.61**	39.94	38.96

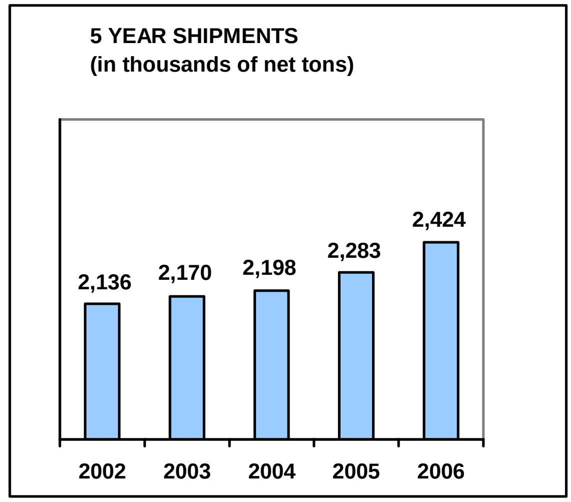
SUPPLEMENTAL NON-FINANCIAL INFORMATION

Operations (thousands of net tons)			
Raw steel production	**2,614.6**	2,576.7	2,532.4
Steel shipments	**2,424.2**	2,282.6	2,198.2

Sales

Sales totaled $1.94 billion for the year ended December 31, 2006 on steel shipments of 2.424 million tons as compared to 2005 sales of $1.92 billion on steel shipments of 2.283 million tons. Pricing for sheet products was fairly strong for the first nine months of the year averaging $672 per ton before weakening in the fourth quarter to $624 per ton as a result of high service center inventory levels, increased imports and weaker economic conditions. Pricing for plate products remained fairly strong throughout 2006 averaging $1,074 per ton, but it was approximately 11% lower than the $1,207 per ton achieved in 2005. Overall, the average realized price for steel for 2006 declined 3.7% over 2005, primarily due to very strong pricing in the first half of 2005.





The mix between sheet and plate products shifted slightly with plate products accounting for 20.8% of total shipments in 2006 as compared to 19.8% in 2005. Sheet products include hot-rolled and pickled coils, cut-to-length coils, cold-rolled coils and first-stage blanks. Total shipments of sheet products were up 4.9%. Plate products include as-rolled and heat-treated plate, and welded wide flange beams. Shipments of plate products increased 11.5% over 2005 as the Company took advantage of the continuing strength in the plate market. Overall shipments increased 141,000 tons or 6.2% versus last year mainly due to higher production levels and relatively strong steel markets.

Sales Mix

For the years ended December 31	2006		2005		Change	
	Sales (millions)	per ton	Sales (millions)	per ton	Sales (millions)	per ton
Sheet	**$ 1,269.3**	**$ 661**	$ 1,225.0	$ 669	$ 44.3	$ (8)
Plate	**541.8**	**1,074**	546.4	1,207	(4.6)	(133)
Freight	**85.3**	**35**	73.2	32	12.1	3
Total Steel Products	**1,896.4**	**782**	1,844.6	808	51.8	(26)
Non-steel Sales	**43.3**		73.0		(29.7)	
Total	**$ 1,939.7**	**$ 800**	$ 1,917.6	$ 840	$ 22.1	$ (40)

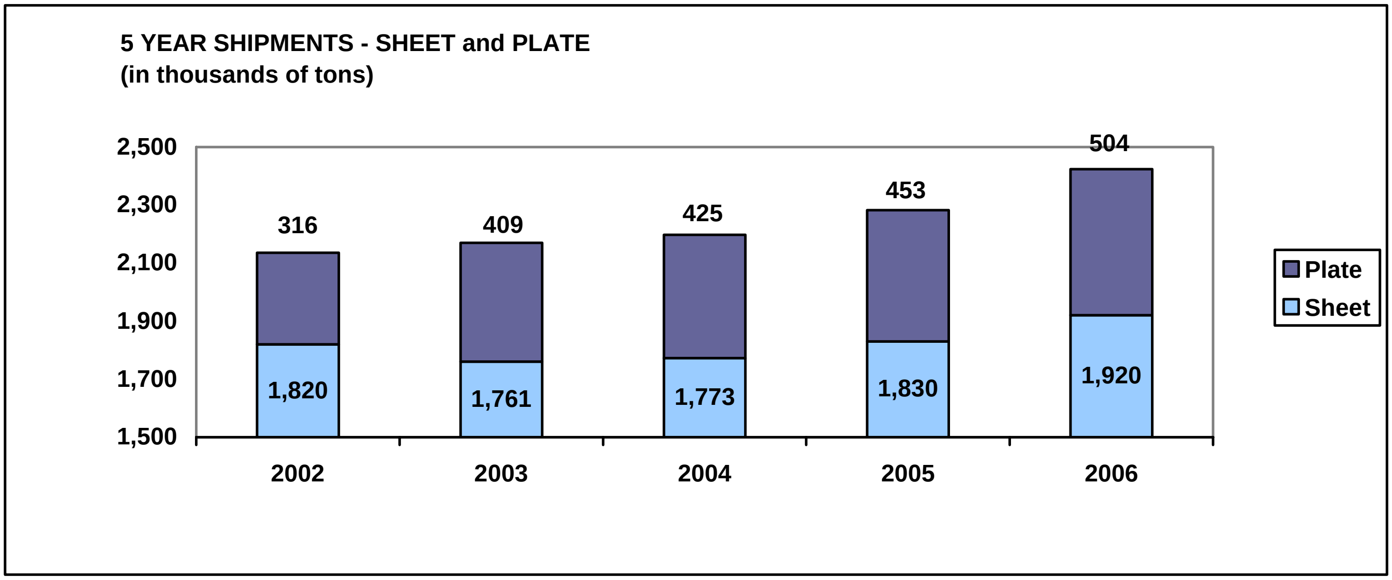
Non-steel sales were $43.3 million in 2006 as compared to $73.0 million in 2005. Non-steel sales include sales of various by-products generated in the manufacturing process. The decline in sales from 2005 relates primarily to a reduction of coke sales that totaled $13.6 million in 2006 as compared to $41.9 million in 2005.

During the year the Company remained focused on selling more products with characteristics different from base sheet and plate products in order to improve its competitive position and improve margins. During 2006 total sales of these differentiated products represented 40% of total steel shipments as compared to 38% in 2005. Differentiated product sales were 42% in the fourth quarter of 2006 indicating continued progress on this initiative.

Steel Shipments

for the years ended December 31	2006		2005		Change	
	000's tons	%	000's tons	%	000's tons	%
Sheet	**1,919.6**	**79.2%**	1,830.0	80.2%	89.6	4.9%
Plate	**504.6**	**20.8%**	452.6	19.8%	52.0	11.5%
Total	**2,424.2**	**100.0%**	2,282.6	100.0%	141.6	6.2%

Since 2002, sheet product sales have increased by 100,000 tons or 5.5% and plate product sales have increased 188,000 tons or 59.5%. Flexibility in the manufacturing process allows some production to be switched between sheet and plate in order to meet customer demands and take advantage of stronger sheet or plate markets.



Net income and Earnings Per Share

Net income for the year ended December 31, 2006 was $221.8 million compared to $239.6 million in 2005 and $343.8 million in 2004. The decrease in net income from 2005 was primarily due to lower average steel pricing for the year and lower coke shipments.

Earnings per share on a basic and diluted basis were $6.10 and $6.06 respectively in 2006 as compared to $6.04 and $6.00 in 2005 and $9.35 and $8.83 in 2004. In addition to changes in earnings over these periods, earnings per share reflect the reduction in shares outstanding due to share buybacks in 2005 and 2006. The weighted average diluted shares outstanding were 36.6 million in 2006 as compared to 39.9 million in 2005.

EBITDA (i)

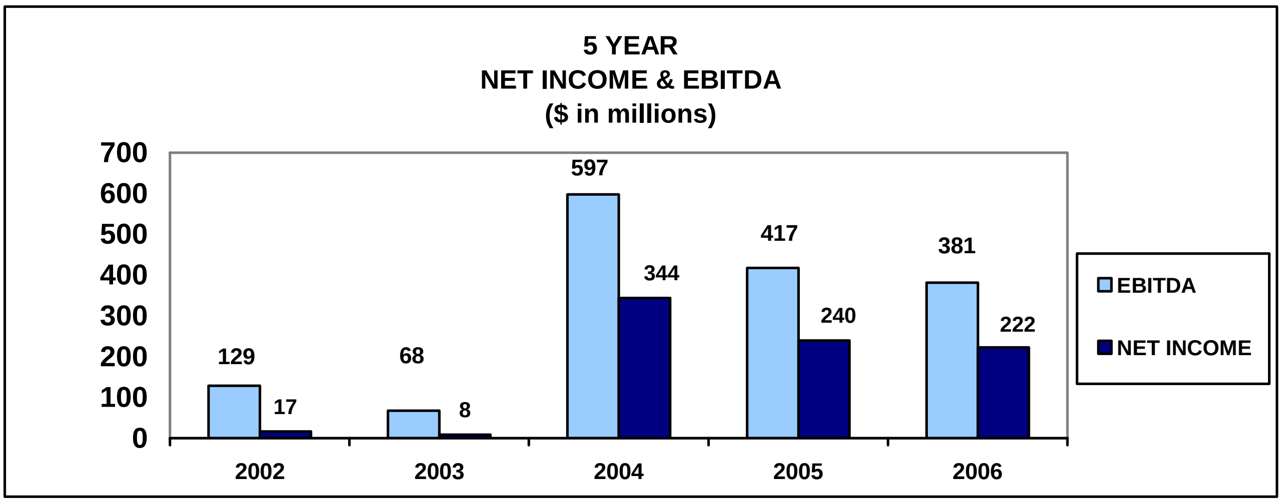
EBITDA in 2006 totaled $381.1 million compared to $417.3 million in 2005. The primary reasons for the decline were lower average steel prices in 2006 and lower coke shipments. In 2005, coke shipments totaled 93,100 tons, contributing approximately $26.4 million to EBITDA, while in 2006 coke shipments totaled 32,000 tons and contributed approximately $7.8 million to EBITDA.

(i) EBITDA is a non-GAAP measure and is defined on page 2 of this report.

The following table shows the reconciliation of EBITDA and net income in accordance with GAAP:

(in millions of dollars)	**2006**	2005	2004
Net income	**$ 221.8**	$ 239.6	$ 343.8
Amortization	**58.7**	56.1	52.2
Interest expense (income)	**(10.3)**	3.0	16.2
Premium on redemption of 11% Notes	**7.9**	-	-
Foreign exchange gain	**(1.8)**	(3.7)	(9.2)
Other income	**(2.1)**	(2.3)	(1.4)
Income taxes	**106.9**	124.6	195.6
EBITDA	**$ 381.1**	$ 417.3	$ 597.2

In the past five years the Company has generated EBITDA of $1.59 billion, or 20% of sales over the same period, and has had positive EBITDA every year since emerging from creditor protection in February 2002.



Improved EBITDA since 2003 is the result of strong steel pricing in the years 2004 through 2006, increased shipments, increased plate and differentiated product sales as a percentage of total sales, and the success of the Company's margin improvement program. Since the program's inception in 2003, the Company estimates that core business improvements related to cost reductions and improved product mix have resulted in an improvement of greater than $180 million in EBITDA. The Company is continuing with this initiative and is currently working on additional projects that exceed $130 million in potential EBITDA improvements of which management is confident that at least $65 million can be implemented over the next three years. The ability to achieve earnings and EBITDA improvements in the future is subject to the risks and uncertainties as outlined in this Management's Discussion and Analysis.

Cost of Sales

Cost of sales for the year 2006 totaled $1.49 billion, an increase of 4.0% over 2005 cost of sales of $1.43 billion. On a percentage of sales basis, cost of sales were 76.7% as compared to 74.6% in 2005. The increase in cost is mainly attributable to an increase in shipments of steel products, offset by lower shipments of coke. Excluding profit sharing, cost per ton for steel products averaged $553 for 2006, a slight decrease from the prior year. A reduction in operating income in 2006 resulted in profit sharing expense declining to $27.3 million ($11 per ton shipped) versus $31.5 million ($14 per ton shipped) for 2005. Cost of non-steel products was $35.6 million representing a decrease of $11.5 million as a result of lower sales of by-products in 2006.

Cost of sales is summarized as follows:

for the years ended December 31	**2006**		2005		Change per ton	
	per ton	**(millions)**	per ton	(millions)	$	%
Steel products	**$ 553**	**$ 1,340.0**	$ 558	$ 1,273.1	$ (5)	(0.9%)
Profit sharing	**11**	**27.3**	14	31.5	(3)	
Freight	**35**	**85.3**	32	73.2	3	
	$ 599	**$ 1,452.6**	$ 604	$ 1,377.8	$ (5)	
Non-steel products		**35.6**		47.1		
Total		**$ 1,488.2**		$ 1,424.9		

Raw Materials

Raw materials represented 51% of costs for steel products in 2006 as compared to 47% in 2005 and include coal, ore, purchased coke, purchased scrap, purchased slabs, limestone and alloys.

During the year, the Company shipped products manufactured from purchased slabs totaling 165,000 tons and representing 6% of costs for steel products. In 2005, the Company shipped 5,000 tons of products manufactured from purchased slabs, representing less than 1% of costs for steel products. Accordingly, total raw material costs, inclusive of purchased slabs, represented 51% of costs for steel products in 2006 as compared to 47% in 2005. The cost per ton of purchased slabs is greater than the cost per ton of internally manufactured steel. The majority of Algoma's raw material purchases are priced in U.S. dollars and, as a result, costs benefited from the relative overall strengthening of the Canadian dollar. The average exchange rate of the Canadian dollar to the U.S. dollar was $1.1344 in 2006 compared to $1.2114 in 2005, an appreciation of 6.4%.

Algoma obtains its coal requirements mainly through three suppliers with approximately 66% of the coal held in a consignment inventory in Sault Ste. Marie. Coal consumption in 2006 totaled $150.9 million (1.46 million tons dry basis), an increase of $12.1 million from last year's total of $138.8 million (1.43 million tons dry basis). The increase in cost was primarily due to an increase in the cost of certain types of coal and a change in the mix of coal used. The increase in the consumption quantity was primarily due to production increases. The Company produced 1,009,300 tons of coke during 2006 as compared to 995,200 tons in 2005. Net of furnace coke sales, coal costs attributed to steel products totaled $146.3 million in 2006 as compared to $125.9 million in 2005.

Algoma has an exclusive supply agreement with Cleveland-Cliffs Inc. for the supply of iron ore with 10 years remaining in the 15-year agreement. (Refer to note 15 of the notes to the consolidated financial statements for more details). Prices under the supply agreement, denominated in U.S. dollars, declined approximately 3.25% in 2006. Consumption of iron ore in 2006 totaled $312 million (3.9 million tons), an increase of 2% from 2005 in which Algoma consumed $306 million (3.8 million tons) of iron ore. The impact of the decrease in unit costs was delayed by the consumption of opening inventories valued at 2005 pricing which was consumed by the end of the second quarter. Production of hot metal increased 4% or approximately 100,000 tons from last year.

Consumption of alloys totaled $104 million in 2006 as compared to $111 million in 2005. The 6% decrease was attributable to decreases in unit prices for certain alloys, offset by higher production levels.

Algoma consumed 158,500 tons of purchased scrap in 2006 at a total cost of $35 million. This compares to consumption of 174,500 tons of purchased scrap in 2005 at a total cost of $42 million. Algoma consumes approximately 640,000 tons of scrap annually with most of its scrap requirements generated from internal sources. The decrease in consumption of purchased scrap in 2006 was mainly due to a reduction in the overall consumption of scrap that resulted from improved liquid steel production resulting in the requirement for less scrap in the manufacturing process.

Consumption of purchased coke totaled 56,500 tons at a cost of $12 million as compared to 50,500 tons in 2005 at a cost of $17 million. The purchases were made to ensure adequate supply for internal consumption and to ensure that coke sales could be completed. Agreements were in place during 2006 for the sale of coke at favourable prices relative to the spot market.

The following chart summarizes the components of total raw material costs incurred during 2006 and 2005 in absolute dollar and per ton of steel shipped:

For the years ended December 31	**2006**		2005		Change	
	$ per ton	**$ millions**	$ per ton	$ millions	$ per ton	$ millions
Iron ore	**$ 129**	**$ 312**	$ 134	$ 306	($ 5)	$ 6
Coal	**60**	**146**	55	126	5	20
Purchased coke	**4**	**9**	7	17	(3)	(8)
Alloys and other	**40**	**96**	45	102	(5)	(6)
Scrap	**14**	**35**	18	42	(4)	(7)
Purchased slabs	**37**	**91**	2	5	35	86
Total raw material costs	**$ 284**	**$ 689**	$ 261	$ 598	$ 23	$ 91
% of costs of steel products		**51%**		47%		

Employment Costs

The average labour cost per hour, including all benefit costs but excluding profit sharing, increased by approximately 2% in 2006 primarily due to negotiated rate increases. At the end of 2006, there were approximately 3,200 employees working at Algoma, up from approximately 3,000 at the end of 2005.

The Company has a profit sharing plan in which the majority of the employees participate. Plan details can be found in note 12 of the notes to the consolidated financial statements. Profit sharing costs totaled $27.5 million in 2006 or $11 per ton of steel shipped as compared to $31.5 million, $14 per ton shipped, in 2005.

Other Supplies & Services

Included in other supplies and services are costs related to the purchase of services and materials used in both operating and maintenance activities. Expenditures in 2006 totaled $170 million, net of the recognition of the benefit of research and development tax credits of $4.6 million, as compared to $156 million in 2005, which was net of the recognition of research and development tax credits of $6.5 million. The increased spending level was primarily attributable to higher maintenance costs, due to the impact of factors such as increased volume, higher labour rates and inflationary price increases.

Energy

Energy costs include natural gas, purchased electricity, oxygen and other miscellaneous items.

The Company's total energy costs declined in 2006 by 23% mainly due to a decline in the cost of natural gas. The average unit cost of natural gas decreased 20% over 2005 and natural gas accounted for approximately 59% of the Company's total energy costs in 2006 compared to 69% in 2005. Algoma can maximize coke available for sale by adjusting the fuel mix in the blast furnace displacing coke consumption for natural gas. When the profits that can be realized on the sale of coke exceed the fuel cost penalty at the blast furnace, the Company will operate on a high natural gas fuel mix to maximize coke production available for sale. These variables are monitored and adjusted regularly throughout the year. Total natural gas costs were $106 million in 2006 compared to $161 million in 2005.

The cost of purchased electricity totaled $42 million in 2006 as compared to $41 million in 2005. Total consumption of purchased electricity was up 8.1% whereas unit costs decreased 3.7%. The increase in consumption of purchased electricity was primarily due to a reduction in internally-generated electricity that resulted from a generator failure during the year.

Praxair Canada Inc. supplies oxygen, argon and nitrogen under a contract that had 8.5 years remaining at the end of December 2006. Algoma's total cost of oxygen in 2006 was down 11% from 2005 at $20 million, due to rate reductions and lower facility costs.

Gross Margin

Gross margin on steel products was $443.8 million or $183 per ton as compared to $461.3 million or $202 per ton in 2005, representing a decrease of $17.5 million or $19 per ton as a result of factors discussed earlier related to sales and cost of sales. Gross margin on non-steel sales was $7.7 million in 2006 as compared to $25.8 million in 2005, representing a decrease of $18.1 million or 70.3% as a result of significantly lower coke sales in 2006 as compared to 2005.

Gross Margin
For the years ended December 31

	2006		2005		Change	
	$ per ton	**$ millions**	$ per ton	$ millions	$ per ton	$ millions
Steel products (i)	**$ 183**	**$ 443.8**	$ 202	$ 461.3	($ 19)	($ 17.5)
Non-steel products	**-**	**7.7**	-	25.9	-	(18.2)
	$ 186	**$ 451.5**	$ 213	$ 487.2	($ 27)	($ 36.0)

(i) includes profit sharing as cost of sales of steel products

Administrative and Selling Expenses

Administrative and selling expenses for the year ended December 31, 2006 totaled $70.4 million as compared to $69.9 million for 2005. Increases in stock-based compensation expense, information technology costs and the provision for bad debts were offset by lower donations expense. In 2005, a donation of $4 million was made to the local hospital by the Company.

Amortization

Amortization expense for 2006 totaled $58.7 million as compared to $56.1 million in 2005. The increase in expense is a reflection of higher capital spending levels in the past three years.

Interest Expense / Income

Interest expense in 2006 totaled $2.0 million compared to $18.5 million in 2005 due to the redemption of the Company's U.S. $125 million 11% Notes in January 2006. Financing costs in 2006 also included a $7.9 million premium paid on the redemption of the Notes in the first quarter of 2006.

The Company earned investment income from interest bearing instruments of $12.3 million as compared to $15.5 million in 2005. This decrease results from the Company having a lower level of cash and short-term investments in 2006, primarily due to the redemption of the 11% Notes and the purchase and cancellation of shares during the year.

Foreign Exchange Gain/Loss

The Company recognized a net foreign exchange gain in 2006 of $1.8 million as compared to a gain in 2005 of $3.7 million, which reflects the impact of changes in the Canadian dollar versus the U.S. dollar in both years on U.S. dollar denominated cash, accounts receivable, accounts payable and debt.

Provision for Income Taxes

For the year ended December 31, 2006, the provision for income taxes was $106.9 million representing an effective tax rate of 32.5% as compared to $124.6 million and a rate of 34.2% for 2005. The effective rate for 2006 is lower than the Company's statutory Canadian manufacturing and processing rate of 34.1% due to the tax benefits related to future Federal tax rate reductions and the pension plan prepayments of $85 million offset by an increase in the valuation allowance in respect of the accrued post-employment benefit obligation and a $3.5 million provision for reassessments of prior tax years. The current portion of the 2006 provision was $102.7 million versus $60.6 million for 2005.

	2006		2005	
	$	%	$	%
Tax Provision at the Statutory Manufacturing and Processing Rate	$ 112.1	34.1%	$ 124.2	34.1%
Impact of Future Federal Tax Rate Reductions	(11.6)	(3.6)	-	-
Provision for reassessment of prior tax years	3.5	1.1	-	-
Change in Future Tax Asset Valuation Allowance:				
Impact of Pension Expense	12.8	3.9	18.1	5.0
Impact of Pension Funding	(21.3)	(6.5)	(27.2)	(7.5)
Impact of Post-Employment Expenses	10.9	3.3	9.2	2.5
	2.4	0.7	0.1	0.0
Other	0.5	0.2	0.3	0.1
Actual Tax Provision	$ 106.9	32.5%	$ 124.6	34.2%

The Company's 2002 and 2003 taxation years are presently under audit by the Canada Revenue Agency ("CRA"). An adjustment relating to the discharging of debts under the 2002 financial reorganization has been proposed by the CRA that would reduce the available non-capital losses by $21.8 million with a corresponding increase in available capital losses. Consequently, the Company has recorded a charge of $3.5 million to the 2006 tax provision representing the full tax effect of the adjustment. The CRA is also reviewing 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 financial reorganization. The Company is defending its position with respect to the valuation, however if a reassessment is issued and the Company does not prevail through the objection process, the Company's available non-capital losses upon emergence from CCAA would be reduced by the amount of any downward adjustment to the valuation. Each $10 million reduction in the valuation of the common shares would result in an income tax reassessment and cash taxes payable of approximately $3.4 million plus any applicable interest. The Company believes its valuation is supportable and it is too early to assess the outcome of this issue. Consequently, no liability has been recorded in the financial statements.

The long-term future tax liability of $130.2 million primarily reflects tax depreciation deducted in excess of book amortization resulting in a lower tax base of capital assets compared to their net book values. For further information, see note 14 of the notes to the consolidated financial statements.

Financial Resources and Liquidity

Summary of Cash Flows

For the years ended December 31 (in millions)	**2006**	2005
Operating activities:		
Cash flow from operations before changes in non-cash operating working capital	**$ 263.3**	$ 319.9
Changes in non-cash operating working capital	**(63.5)**	(6.8)
	199.8	313.1
Investing activities:		
Acquisition of property, plant and equipment	**(67.4)**	(56.5)
Decrease in short-term investments	**116.4**	4.8
Other	**1.5**	1.1
	50.5	(50.6)
Financing activities:		
Redemption of 11% Notes	**(153.3)**	-
Purchase and cancellation of shares	**(240.1)**	(38.0)
Dividends	**-**	(238.2)
Other	**(0.1)**	0.1
	(393.5)	(276.1)
Change in cash during the year	**$ (143.2)**	$ (13.6)

Cash Provided from Operating Activities

Cash provided from operations before changes in non-cash operating working capital in 2006 was $263.3 million compared to $319.9 million in 2005, primarily due to a pension prepayment of $85.0 million in 2006 versus $44.0 million in 2005. Exclusive of pension prepayments of $85.0 million in 2006 and $44.0 million in 2005, cash provided from operations before changes in non-cash operating working capital totals $348.3 million in 2006 as compared to $363.9 million in 2005, representing a decrease of $15.6 million or 4.3%. Changes in non-cash operating working capital resulted in a use of $63.5 million in 2006, compared to a use of $6.8 million in 2005. The increase in working capital in 2006 was mainly the result of an increase in inventories of $98.9 million, offset by a decrease in accounts receivable of $40.2 million. The increase in inventories was mainly attributable to an increase of $64.6 million in slab inventories and a $28.3 million increase in coal inventories. The increase in coal inventories reflects the fact that in 2005 all coal inventories were held on consignment from the Company's main coal supplier, while in 2006 only a portion of coal inventories are on consignment. Increases in slab inventories resulted primarily from lower than expected sales volumes in the fourth quarter. Management has adjusted planned production rates for 2007 in the context of abnormally high year end inventory levels and the scheduled blast furnace outage in July 2007 with the objective of reducing slab inventories during the year. The decrease in accounts receivable is a reflection of the lower sales in the fourth quarter of 2006 compared to 2005. Days sales outstanding were 48.1 days at the end of 2006 as compared to 46.8 days at the end of 2005. The increase in working capital in 2005 was mainly the result of an increase in inventories of $79.6 million due to higher quantities and unit costs of iron ore and higher unit costs for steel inventories. The increase in inventories was offset by an increase in accounts payable and accrued liabilities of $25.9 million and an increase in income and other taxes payable of $47.2 million. The increase in accounts payable and accrued liabilities was mainly due to the timing of payment of the accounts payable and an increase in the accrual for natural gas, offset by a reduction in the profit sharing accrual. The increase in income and other taxes payable was primarily due to an increase in the liability for income taxes.

Cash Used for Investment Activities

Cash provided by investment activities was $50.5 million in 2006 compared to the use of cash for investment activities of $50.6 million in 2005, primarily due to a decrease in short-term investments of $116.4 million in 2006. This large decrease in short-term investments in 2006 was primarily due to the significant use of cash for financing activities during the year, including the redemption of the 11% Notes and the purchase and cancellation of shares as discussed below. Acquisitions of property, plant and equipment totalled $67.4 million in 2006 as compared to the $56.5 million of acquisitions in 2005. Capital expenditures in 2006 included approximately $11.4 million of materials and equipment purchased in advance of the July 2007 blast furnace work. The Company realized $1.5 million from the sale of surplus assets in 2006, compared to $1.1 million in 2005.

At December 31, 2006, the Company had non-cancellable contractual commitments for future capital expenditures totalling $39.1 million, relating primarily to the purchase of manufacturing equipment and capital costs related to the cogeneration project. Capital expenditures in 2007 are expected to be $152 million.

Cash Provided by (Used for) Financing Activities

Financing activities in 2006 included the redemption of the 11% Notes for $153.3 million and the purchase and cancellation of 6.7 million shares totalling $240.1 million. Financing activities for the year ended December 31, 2005 included the payment of a special dividend of $6.00 per share that totalled $238.2 million and the purchase and cancellation of 1.6 million shares totalling $38.0 million. In the past two years, the number of shares outstanding has been reduced from 40.1 million at December 31, 2004 to 31.9 million at December 31, 2006, representing a decrease of 8.2 million shares or 20.5% of shares outstanding.

Contractual Obligations

Algoma's contractual obligations and their payment due dates are as follows:

Millions of Dollars	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term Debt	$ -	$ -	$ -	$ -	$ -
Operating Leases	8.9	2.9	4.6	0.7	0.7
Purchase Obligations (1)	2,914.9	446.0	458.8	458.2	1,551.9
Other Long-Term Obligations	8.0	0.5	0.2	1.0	6.3

(1) Purchase obligations of future years have been estimated based on prices and exchange rates in effect on December 31, 2006.

Purchase obligations include contracts for fixed or minimum quantities of raw materials such as iron ore and coal, as well as natural gas and other utilities.

Future contractual obligations also include pension funding obligations and post-employment benefit payments. Pension funding requirements for 2007 as determined by the Company's actuaries are expected to be $56 million. The prepayment of $85 million will fund this requirement, so there is no contractual commitment for 2007. Post-employment benefit payments in 2007 are expected to be $17 million. Pension funding and post-employment benefit payment requirements beyond 2007 have been excluded due to the uncertainty as to the amount and timing of these obligations.

Other long-term obligations are mainly comprised of environmental remediation liabilities totalling $7.4 million.

Capital Resources

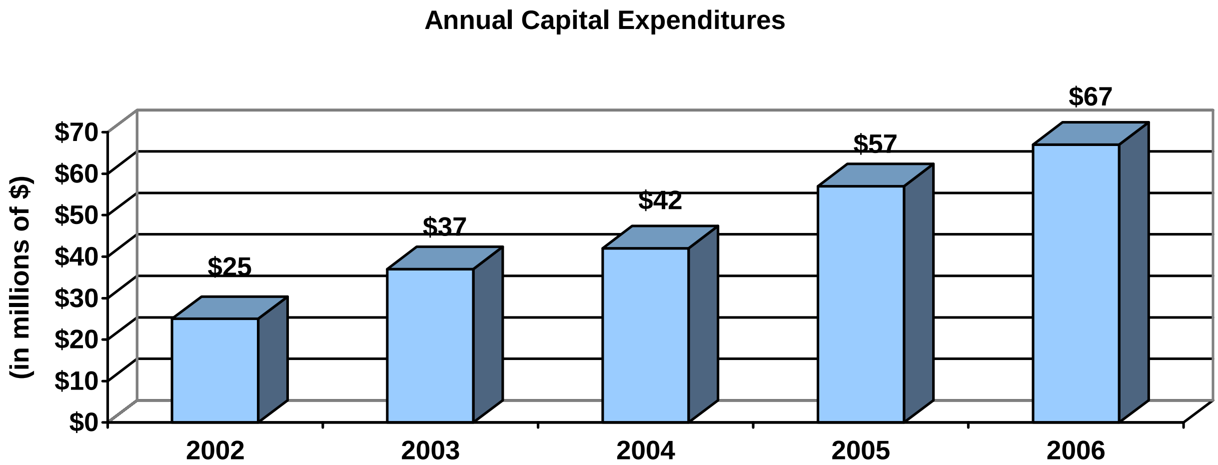
Capital resources at December 31, 2006 included cash and cash equivalents and short-term investments totalling $175.1 million, compared to $434.8 million at December 31, 2005. This strong cash position and ongoing cash flow from operations is expected to enable the Company to satisfy its anticipated operating and capital requirements for 2007.

Capital investments in 2007 are anticipated to be approximately $152 million, a substantial increase from the $67.4 million in 2006. Comparatively, capital investments totalled $56.5 million in 2005 and $42.4 million in 2004.

The most significant planned capital outlays in 2007 relate to the Blast Furnace reline and related outage for approximately $41 million (of which, approximately $12 million was purchased in 2006) and spending on the cogeneration facility for $65 million, with approximately 150 individual projects making up the balance. The Blast Furnace outage affords the opportunity for major works in downstream facilities including the Direct Strip Production Complex and other rolling mills.

Planning and procurement is underway for the July 2007 partial relining of the No. 7 Blast Furnace at an estimated capital cost of $41 million, of which $11.7 million of prepayments have been included in capital expenditures in 2006. Technology and process control improvements have allowed shorter outages and lower cash outlays to prevail with improved iron making output experienced. As a result, the planned 2006 15-day blast furnace outage was deferred to 2007 and the need for the planned 2010 reline at a cost of $125 million will be re-assessed upon completion of the partial reline work completed in July 2007.

In October 2006, the Company announced that its proposal for a new cogeneration power facility by its wholly owned Limited Partnership, Algoma Energy LP (AELP), was accepted by the Ontario Power Authority. 2007 outlays are anticipated to be approximately $65 million, with a total $135 million outlay anticipated by the end of 2008. Pursuant to the proposal, AELP will construct and operate a new 70 megawatt cogeneration power facility at the Company's plant site, supported by a 20 year power purchase agreement with the Ontario Power Authority. The new facility will be fuelled by blast furnace and coke oven gases from the Company's plant operations and will generate electricity and process steam. The facility is expected to be operational by the end of 2008. Based on the pricing formula in the power purchase agreement, the estimated cost of constructing and operating the facility and anticipated electricity and steam generation, the Company expects the new facility to contribute approximately $30 million of incremental EBITDA.



The Company has a Loan and Security Agreement that expires on September 3, 2007 and provides the Company with a revolving credit facility ("Revolving Facility") with financing equal to the lesser of $200 million and a borrowing base determined by the levels of the Company's accounts receivable and inventories less certain reserves. At December 31, 2006, there was $186.3 million of unused availability under the Revolving Facility compared to $178.2 million at December 31, 2005 as a result of $13.7 million and $21.8 million of Letters of Credit outstanding in the respective periods.

Off Balance Sheet Financing

The Company's off balance sheet financing arrangements are limited to operating lease contracts for equipment and premises and the fair value adjustment of $1.1 million related to natural gas swaps. As disclosed in note 15 to the consolidated financial statements, minimum annual lease payments under operating leases for fiscal 2007 are $2.9 million.

Related Party Transactions

There were no transactions with related parties in 2006 or 2005 that exceeded $25,000 individually or jointly.

Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in note 2 to the consolidated financial statements. Some of these accounting policies require management to make estimates and assumptions about matters that are uncertain at the time the estimates and assumptions are made. Management believes that the estimates are reasonable; however, different estimates could potentially have a material impact on the Company's financial position or results of operations.

Allowance for Doubtful Accounts Receivable

The Company is subject to credit risk with respect to its accounts receivable and provides an allowance for its estimate of those accounts receivable that will not be collected. The Company mitigates credit risk by following a process of credit evaluations for customers and potential customers. When estimating an appropriate allowance for doubtful accounts receivable, management considers each customer's historical aging and probability of default, general economic conditions and industry trends. To the extent that management's estimate is incorrect, bad debt expense and accounts receivable may be higher or lower than the amounts recorded. Credit losses incurred in 2005 and 2006 have been insignificant. As a percentage of year-end accounts receivable, the allowance for doubtful accounts was approximately 0.9% (2005 – 0.6%).

Inventory Valuation

The valuation of inventories requires a number of estimates to be made including some inventory quantities, inventory quality, condition, and obsolescence. These determinations require management to exercise judgment. Inventories are generally valued at cost, subject to adjustments required under certain circumstances to reflect net realizable value. Judgment is required in determining the appropriate market value of finished product inventory for purposes of assessment of the recoverability of costs. Cyclical changes in selling prices and/or input costs can result in material adjustments being made to the carrying value of finished product inventory. In addition, certain inventories, including coal, limestone, iron and steel scrap, are measured using quantitative estimation techniques that involve judgments.

Valuation of Income Tax Assets

In preparing the consolidated financial statements, the Company is required to estimate its income tax obligations. This process involves estimating the actual tax exposure and assessing the future tax effect of temporary differences in the tax basis of assets and liabilities and their reported amounts in the financial statements. These temporary differences, together with income tax loss carry-forwards, result in future income tax assets and liabilities, which are recorded on the balance sheet. The Company assesses the likelihood that the future income tax assets will be recovered from future taxable income and, to the extent that recovery is not "more likely than not," a valuation allowance is established. Any change in the valuation allowance in respect of tax assets that have arisen since the 2002 financial reorganization is included as an expense or benefit within the tax provision on the consolidated income statement. For tax assets existing at the time of the financial reorganization, reductions in the initially recorded valuation allowance are recorded as direct credits to contributed surplus.

Judgement is required in determining the amounts of future income tax assets and liabilities and the related valuation allowance recorded against the future income tax assets. In assessing the potential realization of future income tax assets, management considers whether it is "more likely than not" that some portion or all of the future income tax assets will be realized. The ultimate realization of future income tax assets is dependent upon the Company generating sufficient future taxable income during the period in which the future income tax assets are expected to reverse or expire. The Company has provided a full valuation allowance for its future income tax asset related to long-term post-employment benefit obligations which reverse well into the future. The Company's estimate of its tax loss carry-forwards, after giving effect to the financial reorganization in 2002, is currently under review by the Canada Revenue Agency and may be subject to change. As outlined above, a $10 million reduction in the valuation of the common shares would result in an income tax reassessment of approximately $3.4 million. The Company believes its valuation is reasonable and has not provided for any possible reassessment in the financial statements.

Employee Future Benefits

The Company provides pensions and post-retirement benefits including health care, dental care and life insurance to employees. The determination of the obligation and expense for defined benefit pension plans and post-retirement benefits is dependent on the selection of certain assumptions used by the Company's actuaries in calculating such amounts. Those assumptions are disclosed in notes 8 and 9 to the Company's consolidated financial statements, the most significant of which are the discount rate, the rate of increase of compensation, expected rates of return on plan assets, and the rate of increase in the cost of health care. The assumptions are reviewed annually and the impact of any changes in the assumptions is reflected in actuarial gains or losses as disclosed in notes 8 and 9 to the consolidated financial statements. The significant actuarial assumptions adopted are internally consistent and reflect the long-term nature of employee future benefits. Significant changes in assumptions could materially affect the Company's employee benefit obligations and future expense.

Future Environmental Remediation Liabilities

Included in "Other long-term liabilities" on the Company's consolidated balance sheet is $7.4 million related to future environmental remediation liabilities. These liabilities primarily relate to remediation required on land owned by the Company that is no longer used in the Company's operations. Remediation costs that can be reasonably estimated are recorded based on the Company's best estimates. These estimates could be affected by changes in the remediation process, escalation in capital and/or operating costs, and other factors. The timing and amount of these future expenditures are subject to significant judgement.

More specifically, in 2006, the Company filed a mine closure plan respecting its former iron ore mine in Wawa. Financial assurance for future planned activities is also required as an integral part of the closure plan submission. Financial assurance of $7.4 million will be provided to the Province of Ontario in the form of a letter of credit.

Scientific Research and Experimental Development Claims

For the years 2002, 2003 and 2004, the Company has filed scientific research and experimental development claims of $53.0 million, $43.4 million and $62.8 million respectively, with Canada Revenue Agency (CRA). These claims are currently under audit by CRA and prior to the 2002 claim, the Company had no history of filing claims of comparable size. The potential tax benefit of these claims is 20% of the claims or $31.8 million. In order to recognize the tax benefit for accounting purposes, there must be reasonable assurance that the benefit will be realized. Since the claims have not had final audit assessment, the Company has only recognized part of the related tax benefit that the Company believes meets the threshold of "reasonable assurance". The total tax benefit recognized to date is $11.1 million, of which $4.6 million was recognized in 2006. The determination of the amount of tax benefit to recognize requires judgement, and is subject to change based on CRA's audit of the claims. Furthermore, the Company has not completed the determination of the 2005 and 2006 claims, so no tax benefit has been recorded for these years.

Changes in Accounting Policy

The Company made the following change in accounting policies in 2006:

The CICA Emerging Issues Committee issued Abstract 162 (EIC-162), *"Stock-Based Compensation for Employees Eligible to Retire Before the Vesting Date"*. EIC-162 provides guidance to determine compensation costs attributable to a stock-based award under a compensation plan that contains a provision that allows an employee to continue vesting after the employee has retired. The Abstract became effective December 31, 2006. Adoption of EIC-162 did not have an impact on the financial statements of the Company.

Impact of New Accounting Pronouncements on Future Reporting Periods

The Canadian Institute of Chartered Accountants ("CICA") issued three new accounting standards related to financial instruments: Section 3855, *"Financial Instruments – Recognition and Measurement"*, Section 3865, *"Hedges"*, and Section 1530, *"Comprehensive Income"*. These new standards apply to the Company beginning January 1, 2007. Section 3855 expands on Handbook Section 3860 *"Financial Instruments – Disclosure and Presentation"*, by prescribing when a financial instrument is to be recognized on the balance sheet and at what amount. It also specifies how financial instrument gains and losses are to be presented. Section 3865 provides additional accounting treatments to Section 3855 for entities that choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on AcG – 13 *"Hedging Relationships"* and the hedging guidance in Section 1650 *"Foreign Currency Translation"* by specifying how hedge accounting is applied and the required disclosures. This new section defines three types of hedges: fair value hedge, cash flow hedge and hedge of a net investment in a self sustaining foreign operation and provides guidance on how to account for each. It also requires that any ineffectiveness in a hedging relationship be recorded immediately in income. Section 1530 introduces a new requirement to present certain revenues, expenses, gains and losses, that otherwise would not be immediately recorded in income, in a comprehensive income statement with the same prominence as other statements that constitute a complete set of financial statements. The Company is still assessing the implications of these new standards, but it has changed the documentation required for hedging relationships and may require the recognition of certain financial instruments that would previously not have been recognized. Also, beginning in 2007, the Company will be required to present a new financial statement entitled *"Comprehensive Income"*.

The CICA issued Section 3251, *"Equity"*. The Section replaces Section 3250, *"Surplus"* and incorporates amendments resulting from the issuance of Section 1530, *"Comprehensive Income"*. The Section becomes effective on January 1, 2007 and, as noted previously, the Company will be required to present a new financial statement entitled *"Comprehensive Income"*.

The CICA issued two additional accounting standards related to financial instruments: Section 3862, *"Financial Instruments – Disclosures"* and Section 3863, *"Financial Instruments – Presentation"*. These standards enhance the existing disclosure requirements in previously issued Section 3861, *"Financial Instruments – Disclosure and Presentation"*. Section 3862 places greater emphasis on disclosures about risks related to recognized and unrecognized financial instruments and how those risks are managed. Section 3863 carries forward the same presentation standards as Section 3861. Both Sections become effective for the Company on January 1, 2008 and it is not expected that they will have a significant impact.

The CICA has released Section 1535, *"Capital Disclosures"*. The Section requires an entity to disclose information about its objectives, policies and processes for managing capital and its compliance with any externally imposed capital requirements. The Section becomes effective January 1, 2007 and will require the Company to expand its disclosure in this area.

The CICA issued a revised version of Section 1506, *"Accounting Changes"*. The main features of this Section are as follows:

- Voluntary changes in accounting policy are made only if they result in the financial statements providing reliable and more relevant information.
- Changes in accounting policy are applied retrospectively unless doing so is impracticable.

- Prior period errors are corrected retrospectively.
- New disclosures are required in respect of changes in accounting policies, changes in accounting estimates and correction of errors.

This Section becomes effective on January 1, 2007, and the Company will have to comply with the Section should the need arise.

The CICA issued an Exposure Draft of new Section 3031, "*Inventories*", to replace existing Section 3031 of the same title. The proposals provide more guidance on the measurement and disclosure requirements for inventories. Specifically, they require inventories to be measured at the lower of cost and net realizable value, and provide guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. The proposals also provide guidance on the methods used to assign costs to inventories. The final standard is expected to be issued in mid 2007. This standard may have an impact on the Company's accounting and reporting for inventories, including the determination of cost, the reversal of impairment write-downs and disclosure.

Disclosure Controls and Procedures Over Financial Reporting

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure. As at December 31, 2006, the CEO and the CFO have evaluated the effectiveness of Algoma's disclosure controls and procedures as defined in *Multilateral Instrument* 52-109 of the Canadian Securities Administrators and have concluded that such disclosure controls and procedures are effective.

Internal Control Over Financial Reporting

The Company is in the process of a phased implementation of an SAP enterprise resource system to replace our legacy computer systems. The phased-in approach the Company is taking reduces the risks associated with making these changes. This project includes the re-engineering of business processes and changes to internal control processes and procedures. The Company is taking the necessary steps to monitor and maintain appropriate internal controls during this period of change. These steps include deploying resources to mitigate internal control risks and performing additional procedures and verifications to ensure data integrity.

In December 2006, management was provided information alleging that an employee of the Company had been engaged in inappropriate activity including the receipt of cash and goods from suppliers to the Company. While management's investigation and review of the situation is ongoing, management has concluded that:

(i) the evidence obtained warranted dismissal of the employee;

(ii) while controls have been adequately designed to prevent material fraud or error, some isolated instances exist in a specific area of the procurement function where key controls were weak and compensating controls that existed were not effectively deployed; and

(iii) based on findings to date, the weaknesses identified did not result in a material error in the financial statements of the Company and do not represent a material weakness in the design of internal controls of the Company.

Management is taking corrective action with respect to the issues identified as a result of this investigation.

Derivative Financial Instruments

Algoma periodically utilizes natural gas swap contracts to manage risks associated with future variability in cash flows. The Company also utilizes steel swap contracts with maturities of twelve months or less to manage the risks associated with future variability in steel prices. Where hedging instruments are not demonstrated to be highly effective or when hedge accounting is not used, these derivative instruments are recorded at fair value on the balance sheet with unrealized gains and losses recorded in earnings as they occur.

Algoma designates its natural gas hedge agreements as hedges of the underlying expense. The related expense is adjusted to include the payments made or received under the swaps. Unrealized gains and losses on the swaps are not recognized until realized. The Company's steel swap contracts are not accounted for as hedges and are recorded at fair value, which is included in Prepaid Expenses on the Consolidated Balance Sheet and Other Income on the Consolidated Statement of Income and Retained Earnings.

At December 31, 2006, the aggregate notional amount of the natural gas swaps outstanding was approximately 1.2 million MMBtus (December 31, 2005 – nil), expiring at various dates through to July 31, 2007. Under the contracts the Company pays a fixed average price of approximately $7.44 per MMBtu and receives a floating average price per MMBtu based on the settlement price per MMBtu for the NYMEX Henry Hub Natural Gas futures contract. The fair value of these natural gas swaps at December 31, 2006 was an unrecorded off-balance sheet liability totalling $1.1 million.

At December 31, 2006, the aggregate notional amount of the steel swaps outstanding was approximately 57,000 metric tonnes (December 31, 2005 – nil) expiring at various dates through to September 12, 2007. The fair value of these steel swap agreements at December 31, 2006 was $0.2 million which has been included in Prepaid Expenses on the balance sheet and Other Income on the Consolidated Statement of Income and Retained Earnings.

Trade

During 2006, there was only one trade case covering the Company's products that was reviewed by the Canadian International Trade Tribunal (CITT). In mid-August, the CITT announced its decision regarding the expiry review of its finding covering hot-rolled carbon and alloy steel sheet and strip. The finding related to the dumping in Canada of Hot Rolled Sheet originating in or exported from Brazil, Bulgaria, the People's Republic of China, Chinese Taipei, India, the former Yugoslav Republic of Macedonia, Serbia and Montenegro (formerly the Federal Republic of Yugoslavia), South Africa, and Ukraine, and the subsidizing of Hot Rolled Sheet originating in or exported from India.

The anti-dumping and subsidy finding was continued in respect of Hot Rolled Sheet originating in or exported from Brazil, the People's Republic of China, Chinese Taipei, India, South Africa and Ukraine. The finding was rescinded against goods originating in or exported from Bulgaria, the former Yugoslav Republic of Macedonia, and Serbia and Montenegro (formerly the Federal Republic of Yugoslavia).

The Company was pleased with the CITT decision as it maintained the finding on Hot Rolled Sheet from several of the largest steel producing and exporting countries whose products are often unfairly traded.

During 2007, the Company anticipates a review to commence of an anti-dumping finding covering Plate originating in or exported from China, Russia and South Africa. A public hearing is expected in November, with a decision by the CITT in early January 2008.

The Company is particularly concerned about the level and growth of Plate imports from countries that had been covered by Canadian anti-dumping findings until those were rescinded, in addition to those from countries not previously covered.

Also of concern is the massive increase in steel production capacity in China. In 2003, China was the world's largest importer of steel. By 2006 China had become the world's largest exporter of steel. For Hot Rolled Sheet alone, capacity in China is expected to increase in 2007 by 20 million tons, which is approximately four times the size of the Canadian Hot Rolled Sheet market.

There remains in place an anti-dumping finding covering imports into Canada of Chinese Hot Rolled Sheet. However, new trade cases in other jurisdictions are being considered to cover such exports. This and the likelihood that such exports will continue to displace Hot Rolled exports from other countries in markets worldwide, is likely to result in large quantities of Hot Rolled looking for export markets, one of which could be Canada. The Company will continue to carefully monitor imports of all Algoma products and will file a complaint against any that are unfairly traded.

Outlook

Sales

While the Company is anticipating continued volume growth in 2007 as it continues to execute its growth plans, actual volumes attained in 2007 will be impacted by several factors including:

(i) actual impact that blast furnace downtime has on the production of steel and the ability of the Company to have appropriate levels and grades of inventory to supply customer demand during the downtime;
(ii) levels of inventories held by service centers throughout the year;
(iii) general economic conditions in Canada and the U.S. and the impact on demand of steel intensive products and industries such as automotive, heavy machinery, housing and non-residential construction;
(iv) levels of imports from countries such as China, Brazil, India and Russia; and
(v) the ability of the Company to secure necessary amounts of purchased slabs at appropriate prices.

Early indications are that the declines in steel prices that occurred in the fourth quarter of 2006 have abated, and with continued decline in service center inventories in the first quarter of 2007 market tightness should support increased pricing taking affect in mid to late Q1. The sustainability of these increases and the likelihood of further increases will be dictated by many of the industry and economic factors outlined above.

Manufacturing Costs

The Company has not completed negotiations for 2007 iron ore unit prices, but they are expected to be in the range of 5% to 5.5% higher than 2006 pricing. The impact of higher 2007 pricing will likely not take full affect until the end of the first quarter given inventory levels at the end of the year that are at 2006 price levels. Iron ore volume is expected to be down by approximately 8% due to the scheduled partial blast furnace rebuild in July.

The Company has concluded contractual arrangements respecting 100% of its coal requirements for 2007. Algoma estimates its 2007 contract coal costs per ton will be approximately 8% lower than 2006 coal contract costs. The decrease from 2006 is mitigated by several factors which include the effect of higher cost coal at previous contract pricing to be consumed in the first half of 2007 (the FIFO inventory effect) and the assumption that the current higher level of the Canadian dollar is maintained. Management cautions that actual coal costs are subject to many variables and could vary significantly from these estimates. These variables include the value of the Canadian dollar, shipment reliability against contracts, delivery costs, the mix of coal used, and coke-making production levels.

In 2006, approximately 66% of coal inventories were carried by Algoma's primary coal supplier until the point of consumption under a consignment arrangement. This arrangement will remain in place in 2007. The balance is purchased from other suppliers at the point of delivery of the coal to Algoma.

Rail and vessel freight costs are anticipated to increase marginally, influenced by base price increases and fuel prices.

No significant market price changes are anticipated for alloys. The cost of alloys used in production is influenced by product mix.

Employment levels are not expected to change significantly from 2006 levels. Wage rates in 2007 will ultimately be influenced by the result of union contract negotiations. The current labour contract expires on July 31, 2007.

The Company plans on increasing the level of sales from purchased slabs in 2007 as a result of expected increases in volumes and to cover steel needs during the blast furnace downtime. The amount of total slabs purchased in 2007 will also be impacted by inventories maintained through the year. The cost of a purchased slab is higher than the cost of manufactured steel and, accordingly, increased levels of purchased slabs will impact the average cost of raw materials in cost of goods sold.

Financial Position and Liquidity

The Company expects to pay its 2006 income tax liability of approximately $46 million in late February and distribute the remaining approximately $12 million of the 2006 profit sharing liability in March and April 2007. The Company is obligated to make monthly income tax instalments in 2007.

The prepayment of $85.0 million of pension funding obligations in December 2006 is expected to eliminate pension funding in 2007. This funding prepayment reduced 2006 income taxes. The absence of pension funding during 2007 should not result in a corresponding increase in the income tax provision rate due to the fact that the Company will no longer be recording a valuation allowance against the future tax benefit of pension costs recorded in 2007.

The Company currently has a normal course issuer bid in effect that permits the Company to purchase up to 3.2 million shares through October 2007. As of December 31, 2006 the Company has not purchased any shares. The Company makes no assurance that it will purchase shares during 2007. Any decisions related to share repurchases in 2007 will be made in the context of market conditions, stock price performance and alternative needs for the Company's capital.

The Company plans on shutting down its blast furnace in July 2007 for a period of 31 days to perform remedial work. Capital expenditures related to this outage are currently estimated at $41 million and related expenses are estimated at $12 million. The actual capital and expense outlays could vary significantly from these estimates due to the length of the outage, cost escalation, changes in scope, and other factors as noted at the end of the Outlook section.

Capital expenditures are projected to increase to approximately $152.0 million in 2007 from $67.4 million in 2006. The increase is due, in part, to the effect of the blast furnace outage scheduled for July 2007, the cogeneration facility and the Business Systems Renewal Project.

The Company holds a 10% revenue royalty on lands near Wawa, Ontario (the "Leadbetter Extension Property") on which Dianor Resources Inc. is conducting a diamond exploration program. Dianor has reported the occurrence of diamonds in the surface sampling and drilling that it has conducted to date. Algoma also owns lands abutting the Leadbetter Extension Property. Dianor is a public company listed on the TSX Venture Exchange (DOR).

This outlook contains forward-looking statements with respect to market conditions, prices, operating costs and shipments. Some factors, among others, that could affect market conditions, steel prices, costs and shipments include global and North American product demand, product mix, level of contract sales, foreign exchange rates, global production levels, plant operating performance, North American steel production levels and capacity utilization, natural gas prices and usage, raw materials availability and prices, changes in environmental, tax and other laws, and North American and global economic performance and political developments. Steel shipments and prices could be affected by import levels and government actions or lack of actions with regard to imports. These risks and uncertainties and others are described in more detail below.

Risks and Uncertainties

Overview

The primary goals of managing risks are: (i) to ensure that risks are properly identified and controlled, (ii) to ensure that mechanisms exist to identify risks, analyze and assess their impact on the Company and, (iii) to monitor changes in those risks and communicate the risks to all levels of management, the Board of Directors as well as existing and prospective shareholders. While management is confident that the Company employs effective procedures to address all material risks, the Company is engaged in a comprehensive Enterprise Risk Management program. The objective of this program is the development of a comprehensive approach to anticipate, identify, prioritize, manage and monitor the portfolio of business risks impacting the Company and ensure the best policies, processes, accountabilities and reporting and technology are in place to successfully execute. The Audit Committee and Board of Directors plays an important role in developing risk management programs and monitoring them on a regular basis.

Highly Competitive Nature of the Global Steel Industry

In recent years, there has been a substantial increase in global steel capacity, particularly in China which has become the largest steel producer and consumer in the world. China's steel making capacity has increased to an estimated 600 million tons annually. In addition there has been consolidation of global steel producers and the emergence of an industry leader with global capacity exceeding 120 million tons representing approximately 10% of the global steel market and several other producers each producing in excess of 30 million tons of steel. Comparatively, the Company's production capacity is 2.5 million tons. A significant slowdown in growth and/or increases in capacity, which exceed consumption rates in China, could result in surplus steel which may be exported to world markets. In addition, an economic downturn which affects demand for the Company's products or an increase in the strength of the U.S. dollar or Canadian dollar relative to other currencies could increase imports. It is, therefore, possible that more unfairly priced imports could enter into the North American markets at a future date, resulting in further price erosion, which would adversely affect the Company's ability to compete, its revenue and its profitability.

Algoma competes with numerous foreign and domestic steel producers. Some of its competitors have greater financial and capital resources than Algoma does and continue to invest heavily to achieve increased production efficiencies, increased capacity and improved product quality. Algoma primarily competes with other steel producers based on the delivered price of finished products to

Algoma's customers. Algoma's labour, raw material and energy costs are higher than many foreign producers. Although freight costs for steel can often make it uneconomic for distant steel producers to compete with the Company, to the extent that they have lower cost of sales such as lower labour, raw material or energy costs or are government subsidized, they may be able to successfully compete. Although the Company is continually striving to improve its operating costs, it may not be successful in achieving labour, raw material and energy cost improvements or gaining operating efficiencies that may be necessary to remain competitive on a global scale.

The North American steel industry has faced increased competition from foreign steel producers. Some non-market economy foreign steel producers are owned, controlled or subsidized by their governments and their decisions with respect to production, sales and exports may be influenced more by political and economic policy considerations than by prevailing market conditions. In addition, foreign steel producers may be subject to less restrictive regulatory and environmental regimes that could provide a cost advantage relative to North American producers.

The domestic steel industry has experienced lengthy periods of difficult markets due to increased foreign imports. Due to unfavourable foreign economic conditions, excess foreign capacity and a strong Canadian and U.S. dollar, imports of steel products to the U.S. and Canadian markets have reached high levels and, in some cases, have been sold at prices below their combined production and export costs. From 1995 to 2005, U.S. steel industry production capacity utilization levels ranged from a high of 93.3% in 1995 to a low of 79.2% in 2001 and was approximately 87.9% in 2006.

Since the beginning of 1997, over 35 U.S. steel companies have sought protection under Chapter 11 of the *United States Bankruptcy Code*. Many of these companies continued to operate, while reducing prices to maintain volumes and cash flow and obtaining concessions from their labour unions and suppliers. Some companies have even expanded and modernized during these reorganizations. Upon emerging from reorganization, these companies, or new entities that purchased their facilities through this process, have been relieved of many obligations including environmental, employee and retiree benefits and other obligations, commonly referred to as legacy costs. As a result, they may be able to operate with lower costs than Algoma.

Low Priced Imports and Trade Regulation

The Company's business has historically been affected by both Canadian and United States trade legislation intended to limit "dumping", a practice employed by certain foreign competitors that have sold steel into the United States or Canadian markets at prices below their costs or below prices prevailing in their own domestic markets. Such practices may result in injury to companies producing goods in Canada or the U.S. in the form of suppressed prices, lost sales, lower profits and reductions in production, employment levels and the ability to raise capital. Although in a number of cases Canadian trade laws have been successfully employed in the past, they may be inadequate to prevent future unfair import pricing practices which individually or collectively could materially adversely affect the Company. If current and future trade cases do not provide relief from such trade practices, relevant Canadian trade laws are weakened, world demand for steel decreases, or the U.S. or Canadian dollars strengthen against foreign currencies, an increase in the market share of imports into Canada may occur, which could have a material adverse effect on the Company. Moreover, trade regulations in other countries, particularly the United States, could materially adversely affect Algoma to the extent that they reduce or eliminate Algoma's access to certain steel markets. There can be no assurances that the Company will be able to compete effectively in the future.

A change in the situation in China could have a significant impact on steel markets in the rest of the world. China is presently increasing steel producing capacity by millions of tons every year. They are also importing large volumes of raw materials and some finished steel. China's imports of raw materials are driving up prices in the rest of the world, particularly for iron ore, coal and scrap. Chinese demand for vessels to import raw materials and export finished products has also caused increasing ocean freight rates. The combination of these factors has provided support for steel prices. As the Chinese supply of steel is brought into balance with the demand, countries presently exporting to China will be searching for alternative markets. Since Canada and the U.S. are the largest "open market" in the world, imports from these other countries could impact the North American market resulting in a loss of sales volume, price and profitability for the Company.

Cyclicality of the North American Steel Industry

The North American steel industry is cyclical in nature and sensitive to general economic conditions. The financial condition and results of operation of companies in the steel industry are generally affected by macroeconomic fluctuations in the Canadian, U.S. and global economies. Due mainly to its product mix, Algoma has a higher exposure to spot markets than most of its North American competitors and is, therefore, subject to more volatility in its selling prices. In addition, steel prices are sensitive to trends in cyclical industries such as the North American automotive, construction, appliance, machinery and equipment, and transportation industries, which are significant markets for the Company's products. In addition, many of its customers are affected by North American and worldwide economic downturns, which have resulted, and may in the future result, in defaults in the payment of accounts receivable owing to the Company and reduced sales levels. Although the Company has fixed-price customer contracts which typically range between 35% and 50% of total shipments, the majority of the contracts do not exceed one year in duration and may be difficult to enforce if a customer does choose to breach the contract.

Supply and Cost of Raw Materials and Energy

Algoma's operations require substantial amounts of raw materials and energy including coal, iron ore, alloys, scrap, oxygen, natural gas, electricity and other inputs. The price and availability of such raw materials and inputs are subject to market forces and, in some cases, government regulations and accordingly, are subject to change. The cost of iron ore is expected to increase by approximately 5% in 2007 and coal costs are projected to decrease by 8%. Substantially more iron than coal is purchased resulting in a net cost increase. The Company could be particularly adversely affected during a period of declining selling prices for steel without a corresponding decline in raw material costs. Algoma's results of operations could be adversely affected by supply interruptions or further increases in the cost of materials. Algoma's iron ore, coal, alloy and scrap costs would be adversely affected by a decrease in the relative value of the Canadian dollar. There can be no assurance that adequate supplies of oxygen, electricity, natural gas, coal, iron ore or alloys will be available in the future or that future increases in the cost of such materials will not adversely affect Algoma's operations.

Currency Fluctuations

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 Canadian dollar relative to the U.S. dollar reduces the Company's Canadian dollar selling prices for sales in both Canada and the U.S.

Increases in the value of the Canadian dollar relative to the U.S. dollar make Canadian steel products and Canadian customers less competitive in U.S. markets and also encourage imports from the U.S. Therefore, a significant increase in the value of the Canadian dollar could materially and adversely affect Algoma's results of operations and financial condition. Algoma considers its currency hedging strategy from time to time and currently has no hedging contracts in place.

There is a high correlation between U.S. dollar exchange rates, as compared to global currencies, and the price of steel, especially commodity grades. Weakness in the U.S. dollar will generally provide support to increased steel prices. To the extent that the Canadian to U.S. dollar exchange rate moves consistently with U.S. dollar to global exchange rates, the impact of the U.S. dollar to Canadian dollar exchange rate may be offset by changes in steel prices.

Increases in the value of the Canadian dollar relative to the home currencies of global steel producers would also increase the probability of increased imports.

Under-funding of Pension Plans

The Company's pension plans had an aggregate funding deficiency of $249 million as at the measurement date of November 30, 2006 (excludes the effect of the $85 million of funding in December 2006), based on an actuarial estimate for financial reporting. The unfunded liability at December 31, 2006, on a solvency basis which currently represents the basis for annual pension funding, is estimated at $92 million and includes the effect of the $85 million of funding in December 2006. Employer contributions in 2006 were $101 million which included the $85 million prepayment of future funding obligations. Based on current interest rates, benefits and projected investment returns, the Company is obligated to fund $56 million in 2007 which has been satisfied by the $85 million pre-funding in 2006. Expected benefit payments for 2007 are $35 million. A significant portion of the estimated increased funding is expected to be a payment towards the reduction of the unfunded liabilities. The unfunded liability could increase due to changes to the collective bargaining agreements, a decline in interest rates, investment returns at less than the actuarial assumptions, or changes to the governmental regulations governing funding and other factors. The Company could be adversely affected by the resulting increases in annual funding obligations.

Post-Employment Benefits

The Company provides certain post-employment benefits to its retirees. These benefits include drug, life insurance and hospitalization coverage. The Company does not pre-fund these obligations. At the measurement date, November 30, 2006, the unfunded actuarial liability for these obligations was $395 million. The cash paid in 2006 to fund these benefits was $16 million. Expected benefit payments for 2007 are $17 million. The Company's obligation for these benefits could increase in the future due to a number of factors including changes in interest rates, changes to the collective bargaining agreements, increasing costs for these benefits, particularly drugs, and any transfer of costs currently borne by government to the Company.

Substantial Capital Investment, Capital Commitments and Maintenance Expenditures Required

The Company's operations are capital intensive. Algoma expects to be required to make ongoing capital expenditures in an effort to achieve and maintain competitive levels of capacity, cost, productivity and product quality. Total capital expenditures were $36.8 million, $42.4 million, $56.5 and $67.4 million for the years ended December 31, 2003, 2004, 2005, and 2006 respectively. Capital expenditures at these levels may not be sustained indefinitely and the Company expects to maintain a long-term annual average capital investment of $60 million excluding special initiatives such as the cogeneration facility. Capital expenditures in 2007 are currently projected at approximately $152 million.

There are two significant projects facing the company in 2007: a partial reline of the #7 Blast Furnace and the construction of a cogeneration facility. The partial reline of the #7 Blast Furnace is scheduled for July at an estimated cost of $41 million (of which, approximately $12 million was purchased in 2006). In addition to the capital expenditure for the reline, there is a substantial operating cost penalty during the partial reline related to lower production volume and the need for purchased slabs. While the expectation is that the partial reline work scheduled to be completed in 2007 may impact the timing of the full reline work currently planned for 2010 the full impact of this work can not be determined until completed.

The cogeneration investment was announced in October 2006 with planning and procurement in progress. Outlays in 2007 are anticipated to be $65 million with a total $135 million outlay anticipated by the end of 2008.

While the Company currently has cash and short-term investments totaling $175.1 million and no debt, the Company may not generate sufficient future operating cash flow and external financing sources may not be available in an amount sufficient to enable it to make anticipated capital expenditures, service or refinance its indebtedness, or fund other liquidity needs.

Variability of Financial Results

Algoma's financial results may fluctuate substantially, not only due to the cyclicality of the steel industry and fluctuations in foreign exchange rates, but also due to other factors such as Algoma's higher exposure to spot markets than most of its North American competitors, specific product competition, operating performance, uncontrollable increases in prices of raw materials and energy, and difficulties or delays in capital projects. Although selling prices were relatively high in 2005 and 2006 as compared to pre 2004 levels, no assurance can be given that these price levels will be sustained in the future.

Adverse Impact of the Company's Level of Indebtedness

The Company currently has no debt, but is considering the incurrence of some debt in order to establish a more appropriate capital structure and fund potential future capital needs. If the Company proceeds to incur debt, its debt obligations are expected to be manageable under current circumstances, but a change in steel market conditions or other variables may necessitate consideration of refinancing or the adoption of alternative strategies to reduce or delay expenditures, selling assets or seeking additional equity capital.

Financial Restrictions

The loan agreement related to the Revolving Facility and other agreements governing Algoma's indebtedness contain provisions that limit its ability to pay dividends or make other restricted payments or investments, incur additional indebtedness, create liens on assets, merge, consolidate or sell all or substantially all of its assets, and create restrictions on dividends or other payments by restricted subsidiaries. In addition, Algoma's Revolving Facility contains restrictive covenants that require Algoma to maintain a minimum unused availability of $25 million and to maintain financial ratios when unused availability is below $50 million, including minimum levels of cash flow to total debt service and maximum annual capital expenditure levels. Algoma's ability to comply with these restrictions may be affected by events beyond its control. Algoma does not currently draw on the Revolving Facility; however, results from future operations, future capital spending, or other uses of cash may make it necessary for the Company to draw on the Revolving Facility in the future. Algoma may not achieve operating results that will permit it to meet these restrictive covenants or may need to take business actions prohibited by these covenants. These covenants may also limit Algoma's ability to obtain additional or more favourable financing. In addition, substantially all of Algoma's receivables and inventories have been pledged to secure its Revolving Facility.

Labour Matters

Algoma has approximately 3,200 employees, of which approximately 3,100, representing 97% of the Company's employees, are represented by two locals of the United Steelworkers of America under two collective bargaining agreements. The collective agreements expire July 31, 2007. Algoma may be unable to successfully negotiate new collective bargaining agreements without any labour disruption.

Algoma's customers, or companies upon which Algoma is dependent for raw materials, transportation or other services, could also be affected by labour difficulties. Any such activities, disruptions or difficulties could result in a significant loss of production and sales and have a material adverse effect on Algoma's financial condition or results of operations.

Environmental Matters

Algoma's operations are required to comply with an evolving body of environmental laws concerned with, among other things, emissions into the air, discharges to surface and ground water, the investigation and remediation of contaminated property, noise control, waste management and disposal, mine closure and rehabilitation, and the generation, handling, storage, transportation, presence and disposal of toxic and hazardous substances. These laws and regulations vary depending on the location of the facility and can fall within federal, provincial or municipal jurisdictions.

In the United States and Canada, certain environmental laws and regulations impose joint and several liabilities on certain classes of persons for the costs of investigation and remediation of contaminated properties. Liability may attach regardless of fault or the legality of the original management or disposal of the substance or waste. Some of the Company's present and former facilities have been in operation for many years and, over such time, have used substances and disposed of wastes that may require investigation and remediation. Algoma could be liable for the costs of such investigations and remediation. Costs for any remediation of contamination, on or off site, whether known or not yet discovered, or to address other issues relating to waste disposal, mine closure, emissions into the air or water, or the storage of materials, could be substantial and could have a material adverse effect on Algoma's results of operations.

Pursuant to a Certificate of Approval issued by the Ontario Ministry of Environment, the Company is required to install, by 2010, certain equipment in the No. 7 Blast Furnace to reduce casthouse emissions. The cost of this equipment and its installation is currently estimated at $25-$30 million. The actual cost of the equipment and its installation could vary significantly due to cost escalation, design changes, regulatory policies, or other factors.

Pursuant to a Certificate of Approval issued by the Ontario Ministry of Environment, the Company is required to apply technology or process changes to mitigate noise levels from identified sources within the Sault Ste. Marie operations. It is estimated that the capital cost associated with the noise abatement plan is in the order of $3 million during the period of 2007 through to 2012.

The Company is required to fund the capital and operating cost of a mine closure in Wawa involving capital costs of approximately $2 million during the period of 2010 to 2020. Future operating costs for the mine closure program are estimated at $50,000 - $100,000 annually until 2020, and then $200,000 to $300,000 commencing in 2020 for the foreseeable future. Financial assurance in the order of $7.4 million will be provided to the Province of Ontario in the form of a letter of credit.

Algoma's Environment, Health and Safety Department regularly reviews and audits the Company's operating practices to monitor compliance with Algoma's environmental policies and legal requirements.

No assurance can be given that unforeseen changes, such as new laws or stricter enforcement policies, or a crisis at one of Algoma's properties or operations, will not have a material adverse effect on the business, estimated capital or operating costs, financial condition, or results of operations of Algoma. Algoma's operations are required to have governmental permits and approvals. Any of these permits or approvals may be subject to denial, revocation or modification under various circumstances. Failure to obtain or comply with the conditions of permits or approvals may adversely affect the operations of Algoma and may subject Algoma to penalties. In addition, if environmental laws are amended or are interpreted or enforced differently, or if new environmental legislation is enacted, Algoma may be required to obtain additional operating permits or approvals and incur additional costs. There can be no assurance that Algoma will be able to meet all applicable regulatory requirements. In addition, Algoma may be subject to fines, penalties or other liabilities arising from its actions imposed under environmental laws, including as a result of actions or other proceedings commenced by third parties, such as neighbors or government regulators.

Technology and Competition

There is ongoing research and technological developments with respect to the various processes associated with steel production which have the potential to reduce costs and improve quality. It is possible that certain developments could substantially impair the Company's competitive position if other companies implement new technology and the Company does not or cannot.

Competition of Products with Other Materials

In the case of certain product applications, steel competes with a number of other materials such as plastic, aluminum, and composite materials. Improvements in the technology, production, pricing or acceptance of these competitive materials relative to steel or other changes in the industries for these competitive materials could cause net sales to decline.

Unexpected Equipment Failures

Algoma's manufacturing processes are dependent upon critical steelmaking equipment such as furnaces, continuous casters, rolling mills, and electrical equipment (such as transformers), and this equipment may incur downtime as a result of unanticipated failures. The Company has experienced, and may in the future experience, plant shutdowns or periods of reduced production as a result of such equipment failures. Unexpected interruptions in production capabilities would adversely affect productivity and results of operations for the affected period. No assurance can be given that a significant shutdown will not occur in the future or that such a shutdown will not have a material adverse effect on the business, financial condition or results of operations of the Company. In addition, an unexpected failure in the Company's computer system may have the same result.

Dependence on Senior Management

Algoma's operations and prospects depend, in large part, on the performance of Algoma's senior management team. The Company cannot assure that such individuals will remain as employees. In addition, Algoma can make no assurance that it would be able to find qualified replacements for any of these individuals if their services were no longer available. The loss of the services of one or more members of senior management or difficulty in attracting, retaining and maintaining additional senior management personnel could have a material adverse effect on Algoma's business, financial condition and results of operations.

Insurance

To date, Algoma has been able to obtain liability insurance for the operation of its business. However, there can be no assurance that Algoma's existing liability insurance will be adequate, or that it will be able to be maintained, or that all possible claims that may be asserted against Algoma will be covered by insurance.

Tax Loss Carry-forwards

The Company's income tax loss carry-forwards were reduced by approximately $180 million under the financial reorganization as a result of debts being discharged for less than their principal amount. The Company had substantial amounts of Federal and Ontario non-capital loss carry-forwards, but fully utilized these losses by the third quarter of 2005. Algoma's estimate of non-capital loss carry-forwards is currently under review by the Canada Revenue Agency and could be reduced, subjecting Algoma to a tax liability if the Company is unsuccessful in supporting its positions.

Effect of Potential Future Acquisitions

Algoma believes that there continues to be significant opportunity for future growth through selective acquisitions given the pace of consolidation in the steel industry and the increasing trend of its customers to focus on fewer key suppliers. As a result, Algoma intends to continue to apply a selective and disciplined acquisition strategy. Possible future acquisitions will likely involve a number of risks.

Future acquisitions may be required for the Company to remain competitive, but there can be no assurance it can complete any such transactions on favourable terms or that it can obtain financing, if necessary, for such transactions on favourable terms. In addition, there can be no assurance that future transactions will improve the Company's competitive position and business prospects as anticipated; if they do not, its results of operations may be adversely affected.

Supplementary Data

SELECTED QUARTERLY INFORMATION

	2006				2005			
As at and for the quarter ended	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
OPERATING RESULTS (IN MILLIONS OF DOLLARS, EXCEPT SHARE AND PER SHARE AMOUNTS)								
Sales	**$ 418.4**	**$ 516.9**	**$ 504.8**	**$ 499.6**	$ 477.6	$ 446.4	$ 494.6	$ 499.0
Gross margin	**80.5**	**130.1**	**142.9**	**98.0**	103.2	78.1	133.9	172.0
EBITDA (i)	**64.2**	**112.3**	**124.1**	**80.5**	77.6	62.8	119.1	157.8
Income from operations	**50.4**	**97.2**	**110.7**	**66.2**	63.5	46.4	106.1	145.2
Income before income taxes	**57.4**	**100.2**	**110.4**	**60.7**	62.3	51.6	105.2	145.1
Net income	**$ 50.4**	**$ 59.5**	**$ 79.2**	**$ 32.7**	$ 55.0	$ 30.8	$ 64.7	$ 89.1
OPERATING PERFORMANCE								
Net income per common share – basic	**$ 1.58**	**$ 1.62**	**$ 2.07**	**$ 0.85**	$ 1.39	$ 0.77	$ 1.61	$ 2.22
Net income per common share – fully diluted	**$ 1.57**	**$ 1.61**	**$ 2.06**	**$ 0.84**	$ 1.38	$ 0.77	$ 1.60	$ 2.20
Gross margin %	**19.2%**	**25.2%**	**28.3%**	**19.6%**	21.6%	17.5%	27.1%	34.5%
EBITDA %	**15.3%**	**21.7%**	**24.6%**	**16.1%**	16.2%	14.1%	24.1%	31.6%
BALANCE SHEET INFORMATION (IN MILLIONS OF DOLLARS)								
Total assets	**$ 1,505.4**	**$ 1,535.8**	**$ 1,634.2**	**$ 1,542.4**	$ 1,683.5	$ 1,718.0	$ 1,946.4	$ 1,826.1
Cash and cash equivalents and short-term investments	**175.1**	**209.3**	**341.4**	**302.1**	434.8	453.1	700.2	602.0
Working capital	**607.9**	**605.4**	**736.2**	**696.7**	653.9	783.1	1,016.7	938.7
Property, plant and equipment	**648.8**	**637.6**	**638.0**	**641.4**	641.5	638.7	641.2	641.1
11% Notes payable	**-**	**-**	**-**	**-**	145.4	145.3	153.2	151.2
Pension, post-employment benefit obligation and other long-term liabilities	**395.9**	**413.0**	**405.4**	**410.8**	403.4	434.8	429.4	424.2
Shareholders' equity	**885.1**	**831.9**	**969.8**	**928.5**	893.5	843.6	1,077.5	1,006.9
COMMON SHARE INFORMATION								
Share price ($):								
High	**36.03**	**38.44**	**36.00**	**33.48**	27.84	32.00	34.00	40.18
Low	**30.02**	**30.83**	**29.89**	**23.14**	19.50	20.10	24.80	25.53
Close	**32.90**	**31.31**	**35.45**	**31.61**	23.62	23.00	25.05	32.75
Trading volume	**17,194,049**	**20,054,929**	**20,701,327**	**26,058,739**	20,713,717	46,377,240	24,550,754	31,723,983
Shares outstanding:								
Average - basic	**31,896,266**	**36,772,158**	**38,229,444**	**38,607,018**	38,659,167	39,810,804	40,128,897	40,119,673
Average – fully diluted	**32,156,516**	**37,036,150**	**38,482,039**	**38,839,847**	38,896,484	40,062,132	40,402,177	40,409,568
End of period	**31,896,358**	**31,893,538**	**37,366,065**	**38,608,189**	38,573,073	38,957,729	40,130,992	40,119,905
Market capitalization (in millions of dollars)	**$ 1,049.4**	**$ 998.6**	**$ 1,324.6**	**$ 1,220.4**	$ 911.1	$ 896.0	$ 1,005.3	$ 1,313.9
Book value per share – diluted (i)	**$ 27.75**	**$ 26.08**	**$ 25.95**	**$ 24.05**	$ 23.65	$ 21.65	$ 26.85	$ 25.10
Market value to book value multiple	**1.19**	**1.20**	**1.37**	**1.31**	1.00	1.06	0.93	1.30

(ii) EBITDA and Book Value per Share are non-GAAP measures and are defined on page 2 of this report

The Company's profitability is highly correlated with the level of steel prices which is a major factor causing variation in quarterly operating results. Raw material and energy costs have also emerged as significant factors in the past year. Industry pricing is largely dependent on global supply, the level of steel imports into North America and economic conditions in North America. Since U.S. markets establish pricing levels, the exchange rate of the Canadian dollar to the U.S. dollar significantly impacts pricing realizations for Canadian producers.

Pricing levels increased in the fourth quarter of 2003 and throughout the first three quarters of 2004 due to stronger global markets, particularly China, and improved steel demand in North America. Excess steel inventories at the end of 2004 and weaker North American demand from several market sectors contributed to lower prices in 2005, reaching a low in August 2005 as excess inventories were depleted. Selling prices rose in the fourth quarter due to a better balance between supply and demand. Higher contract prices partially offset the effect of declining spot prices in 2005. Prices remained relatively stable in the first quarter of 2006 and increased slightly in the second and third quarters. In the fourth quarter of 2006, excess steel inventories and weak demand resulted in lower prices.

The cost of raw materials and natural gas escalated in 2004 as input prices responded to the stronger demand. Iron ore and coal costs increased significantly in 2005. Iron ore prices, under a long-term supply agreement denominated in U.S. dollars, increased approximately 85% in 2005 versus 2004. The increase in pricing was mitigated by the consumption of opening inventories acquired at 2004 pricing and the strengthening of the Canadian dollar. The Company purchased a portion of its coal needs in 2005 at spot prices, rather than contract pricing, due to temporary disruptions in supply from the Company's primary coal supplier. The total cost penalty in 2005, versus the fixed price contract, associated with these purchases is estimated at $18.5 million. In 2006, iron ore prices declined approximately 3.25% and natural gas costs declined by approximately 20%, while coal prices increased by approximately 10%.

Supplementary Data

SELECTED QUARTERLY SALES INFORMATION (in thousands of tons)

	2006				2005			
For the quarter ended	**Q4**	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Sheet	**420**	**486**	**491**	**523**	460	478	455	436
Plate	**114**	**136**	**134**	**120**	122	110	108	113
Total	**534**	**622**	**625**	**643**	582	588	563	549