

**ALGOMA STEEL INC.**  
**2007 FIRST QUARTER REPORT TO SHAREHOLDERS (UNAUDITED)**  
**for the period ended March 31, 2007**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following discussion and analysis should be read in conjunction with the 2006 Management Discussion and Analysis and the unaudited interim consolidated financial statements and notes contained in this report. This discussion of the Company's business may include forward-looking information with respect to the Company, including its business and 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 including the factors discussed in the 2006 Management Discussion and Analysis and the Company's 2006 Annual Information Form.

This document has been reviewed by the Audit Committee of Algoma's Board of Directors and contains information that is current as of May 1, 2007. Events occurring after that date could render the information contained herein inaccurate or misleading in a material respect. Additional information about Algoma is available in the Company's Annual Information Form which can be accessed from SEDAR at [www.sedar.com](http://www.sedar.com).

**Financial and Operating Results**

*Selected Financial Data for the Eight Quarters Ended March 31, 2007*

(\$ millions except per share data)	Sales	Income	Basic Income	Diluted Income	Net Income	Basic	Diluted
		From Operations	From Operations	From Operations		Net Income	Net Income
		Per Share	Per Share	Per Share		Per Share	Per Share
2007	\$	\$	\$	\$	\$	\$	\$
1st Quarter	480	38	1.18	1.17	23	0.72	0.72
2006							
4th Quarter	418	50	1.58	1.57	50	1.58	1.57
3rd Quarter	517	97	2.64	2.62	60	1.62	1.61
2nd Quarter	505	111	2.90	2.88	79	2.07	2.06
1st Quarter	500	66	1.71	1.70	33	0.85	0.84
2005							
4th Quarter	478	64	1.61	1.60	55	1.39	1.38
3rd Quarter	446	48	1.20	1.19	31	0.77	0.77
2nd Quarter	495	106	2.65	2.63	65	1.61	1.60

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 recent years. 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 2004 due to stronger global markets, particularly China, and improved steel demand in North America. Pricing in 2005 was influenced by excess steel inventories at the end of 2004 and weaker North American demand from several market sectors, reaching a low in September 2005 as excess inventories were depleted. Selling prices rose in the fourth quarter of 2005 due to a better balance between supply and demand and rose further in the second quarter of 2006. Overall, average selling prices increased in the third quarter of 2006, but they started to decline near the end of the quarter due to excess steel service center inventories and they continued to decline in the fourth quarter. Pricing remained relatively stable for the first quarter of 2007 with only small increases from the levels reached near the end of the fourth quarter of 2006.

The cost of raw materials and natural gas escalated in 2004 and 2005 as input prices responded to the stronger demand. Natural gas costs declined in 2006 from the peaks reached in 2005. Iron ore prices, under a long-term supply agreement denominated in U.S. dollars, increased approximately 85% in 2005 but declined 3.25% in 2006. Contract prices have not yet been finalized for 2007, but they are expected to increase approximately 5% from 2006 prices. Coal costs also escalated in 2005 primarily because of spot market purchases due to temporary supply disruptions from the Company's main coal supplier. Coal costs also increased in 2006 due to the renegotiation in the first quarter of new supply agreements at less favorable prices. Algoma estimates its 2007 contract coal prices per ton will be approximately 8% lower than 2006 coal contract costs. The impact of an increase or decrease in raw material pricing on earnings is delayed by the consumption of opening inventories acquired at the previous year's price.

Income from operations and net income, on a per share basis, reflect the impact of share buybacks. In 2005, during August through October, the Company purchased 1,590,100 shares under a normal course issuer bid. The Company purchased 1,242,400 shares under a normal course issuer bid during May and June of 2006 and purchased 5,479,452 shares under a substantial issuer bid in September 2006.

### **Sales**

Sales for the first quarter of 2007 were \$479.5 million, \$61.1 million higher than the previous quarter and \$20.1 million lower than the comparable period in 2006. The increase from the previous quarter was the result of significantly higher shipments, partially offset by lower average selling prices. The decrease from the first quarter of 2006 was the result of lower average selling prices. Steel prices averaged \$699 per ton in the first quarter as compared to \$721 per ton in the fourth quarter of 2006 and \$737 per ton in the first quarter of 2006. Steel shipments totaled 642,600 tons for the quarter, 108,400 tons higher than the previous quarter and approximately the same level as the first quarter of 2006. Although shipment volumes recovered from the low levels experienced in the fourth quarter of 2006, abnormally high customer inventory levels that affected sales near the end of the fourth quarter of 2006 continued to affect selling prices in the quarter. Price increases were implemented in the first quarter, but the increases did not take effect until relatively late in the quarter and product mix negatively impacted average selling prices compared to the previous quarter. It is expected that selling prices will continue to increase in the second quarter.

### **Net Income and Earnings Per Share**

Net income for the three months ended March 31, 2007 was \$23.1 million compared to \$50.4 million for the fourth quarter of 2006 and \$32.7 million for the comparable quarter of 2006. The decrease in net income from the previous quarter was mainly due to a lower effective income tax rate in the fourth quarter of 2006 due to a pension plan prepayment of \$85.0 million. Lower average selling prices and higher natural gas and iron ore costs also contributed to lower net income in the first quarter of 2007. The decrease in net income from the first quarter of 2006 was mainly due to lower average selling prices and higher coal costs in the first quarter of 2007, partially offset by a lower effective tax rate versus the first quarter of 2006.

Earnings per share on a basic and diluted basis were both \$0.72 in the first quarter of 2007 as compared to \$1.58 and \$1.57 in the fourth quarter of 2006 and \$0.85 and \$0.84 in the first quarter of 2006. In addition to changes in earnings over these periods, earnings per share reflect the reduction in shares outstanding due to share buybacks in 2006. The weighted average diluted shares outstanding were 32.3 million in the first quarter of 2007 and 32.2 million in the fourth quarter of 2006 as compared to 38.8 million in the first quarter of 2006.

### **EBITDA**

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 indicator of operations and uses it as a measure to assess its operating performance. 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.

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

<u>(\$ millions)</u>	<u>Q1 2007</u>	<u>Q4 2006</u>	<u>Q1 2006</u>
Net Income	\$23.1	\$ 50.4	\$32.7
Amortization	16.0	15.3	14.3
Financial Expense (Income)	0.2	(7.0)	5.5
Other Expense (Income)	(0.7)	(1.5)	-
Income Taxes	<u>14.5</u>	<u>7.0</u>	<u>28.0</u>
EBITDA	<u>\$53.1</u>	<u>\$64.2</u>	<u>\$80.5</u>

EBITDA for the first quarter of 2007 was \$53.1 million compared to \$64.2 million for the previous quarter and \$80.5 million for the first quarter of 2006. The decline from the previous quarter was mainly attributable to lower average selling prices, which declined \$22 per ton or 3.1%, and higher natural gas and iron ore costs, offset by higher shipments which increased 108,400 tons or 20.3%. The decline from the comparable quarter in 2006 was mainly due to lower selling prices and higher coal costs. There were no coke sales in the first quarter of 2007 or the first quarter of 2006. Coke sales in the fourth quarter of 2006 were 10,591 tons that contributed \$2.2 million to EBITDA.

### Cost of Sales

Cost of sales before employees' profit sharing for the first quarter of 2007 was \$406.0 million versus \$334.3 million for the fourth quarter of 2006 and \$397.0 million for the first quarter of 2006. The increase over the fourth quarter of 2006 was primarily due to higher shipments, however, higher prices for iron ore and natural gas also contributed to the variance. The increase over the comparable period of 2006 was primarily due to higher coal prices.

<u>(\$ millions)</u>	<u>Q1 2007</u>	<u>Q4 2006</u>	<u>Q1 2006</u>
Cost of sales (before profit sharing)	\$406.0	\$334.3	\$397.0
Freight	(26.1)	(19.0)	(22.4)
Non-steel products	<u>(4.5)</u>	<u>(12.1)</u>	<u>(3.5)</u>
Cost of sales – steel products	<u>\$375.4</u>	<u>\$303.2</u>	<u>\$371.1</u>
Shipments (000's of tons)	643	534	643
Cost of sales per ton shipped	<u>\$584</u>	<u>\$568</u>	<u>\$577</u>

Consumption of 2007 priced iron ore during the first quarter resulted in a negative price variance compared to the fourth quarter of 2006. Natural gas pricing during the first quarter of 2007 averaged \$9.24/mmbtu compared with \$8.12/mmbtu in the fourth quarter of 2006. The impact of this price variance was a \$3.5 million increase in manufacturing costs quarter over quarter. Consumption of 2007 priced coal during the first quarter resulted in a negative price variance totaling \$11.9 million compared to the first quarter of 2006. A mix of 2005 and 2006 priced coal was consumed during the first quarter of 2006, yielding a much lower average cost per ton of coal consumed of \$83.90 compared to the average cost per ton of coal consumed in the first quarter of 2007 of \$123.54.

A \$2.9 million (\$5 per ton) expense for employees' profit sharing was recorded in the first quarter of 2007 versus a \$3.6 million expense (\$7 per ton) for the fourth quarter of 2006 and \$4.6 million (\$7 per ton) for the first quarter of 2006.

Approximately 38,000 tons of finished goods produced from purchased slabs were sold in the first quarter of 2007 and these additional sales generated approximately an additional \$1.8 million of operating income. This compares to approximately 20,000 tons of finished goods produced from purchased slabs that were sold in the fourth quarter of 2006 generating approximately \$0.1 million of operating income and 35,000 tons in the first quarter of 2006 that generated approximately \$3.0 million of operating income. The improvement from the fourth quarter of 2006 can be attributed to lower slab purchase costs and lower rolling costs in the first quarter of 2007.

Raw steel production for the three months ended March 31, 2007 totaled 606,000 tons versus 651,000 tons for the previous quarter and 637,000 tons for the first quarter of 2006. Production was lower than expectations due primarily to unplanned maintenance requirements in our steelmaking operations.

### **Administrative and Selling Expenses**

Administrative and selling expenses totaled \$17.5 million in the first quarter of 2007 as compared to \$16.3 million for the fourth quarter of 2006 and \$17.5 million for the first quarter of 2006. The differences in quarterly administrative and selling expenditures primarily relate to differences in expenditures on strategic initiatives, the business systems renewal project and executive compensation. The lower expenditures in the fourth quarter of 2006 are mainly due to lower executive compensation expense and lower consulting fees related to strategic initiatives.

### **Amortization**

Amortization of property, plant and equipment was \$16.0 million for the first quarter of 2007 as compared to \$15.3 million for the fourth quarter of 2006 and \$14.3 million for the first quarter of 2006.

### **Financial Expense (Income)**

Financial expenses in the first quarter of 2007 were \$0.4 million as compared to \$0.5 million for the fourth quarter of 2006 and \$8.5 million in the first quarter of 2006. The higher financial expense in the first quarter of 2006 was due to the premium on the redemption of the 11% Notes on January 3, 2006 for a total cost of \$7.9 million. Investment income was \$1.7 million in the first quarter of 2007 compared to \$2.5 million for the fourth quarter of 2006 and \$2.7 million for the first quarter of 2006. The differences in investment income are due to fluctuations in interest rates and the balances of cash and cash equivalents and short-term investments.

A net foreign exchange loss of \$1.5 million was realized in the first quarter of 2007 as compared to a gain of \$5.0 million in the fourth quarter of 2006 and a gain of \$0.3 million in the first quarter of 2006. These gains and losses relate to U.S. dollar exposure on cash, accounts receivable and accounts payable held during the quarter.

### **Provision for Income Taxes**

The first quarter provision for income taxes was \$14.5 million (effective rate of 38.6%) compared to \$7.0 million (effective rate of 12.2%) in the fourth quarter of 2006 and \$28.0 million (effective rate of 46.1%) in the first quarter of 2006. The 2006 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:

	<u>Q1 2007</u>		<u>Q4 2006</u>		<u>Q1 2006</u>	
	\$	%	\$	%	\$	%
Tax Provision at the Statutory Manufacturing and Processing Rate	\$ 12.8	34.1%	\$ 19.6	34.1%	\$ 20.7	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	4.9	4.1	6.7
Impact of Pension Funding	-	-	(21.3)	(37.1)	-	-
Impact of Post-Employment Expenses	<u>1.5</u>	<u>4.0</u>	<u>3.3</u>	<u>5.7</u>	<u>3.1</u>	<u>5.1</u>
	1.5	4.0	(15.2)	(26.5)	7.2	11.8
Other	<u>0.2</u>	<u>0.5</u>	<u>(0.9)</u>	<u>(1.5)</u>	<u>0.1</u>	<u>0.2</u>
Actual Tax Provision	<u>\$ 14.5</u>	<u>38.6%</u>	<u>\$ 7.0</u>	<u>12.2%</u>	<u>\$ 28.0</u>	<u>46.1%</u>

The current portion of the income tax provision in the quarter which will result in cash taxes payable was \$16.5 million versus (\$3.5) million in the fourth quarter of 2006 and \$28.2 million for the first quarter of 2006. The effective tax rate for the first quarter of 2007 is higher than the Company's statutory rate of 34% due primarily to a valuation allowance being taken against future tax assets arising in the quarter in respect of other post-employment benefit expenses. In Q1 2006, there was also a valuation allowance being taken against future tax assets arising in the quarter in respect of pension expense.

The long-term future income tax liability of \$127.6 million at March 31, 2007 primarily reflects cumulative tax depreciation deducted in excess of book amortization.

### **Pension and Post Employment Benefits**

Pension and post employment benefit expenses for the first quarter of 2007 were \$11.5 million and \$8.0 million respectively, compared to \$12.5 million and \$7.9 million in the fourth quarter of 2006 and \$13.6 million and \$7.8 million in the first quarter of 2006. The Company made an advanced contribution to its pension plans of \$85.0 million in December 2006 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*

(\$ millions)	Q1 2007	Q4 2006	Q1 2006
<b>Operating activities:</b>			
Cash flow from operations before changes in non-cash operating working capital	\$ 54.6	\$ (7.6)	\$ 72.9
Changes in non-cash operating working capital	(58.0)	-	(38.1)
	(3.4)	(7.6)	34.8
<b>Investing activities:</b>			
Acquisition of property, plant and equipment	(17.4)	(27.0)	(14.3)
Decrease in short-term investments	143.9	3.5	262.2
Other	0.1	0.5	0.2
	126.6	(23.0)	248.1
<b>Financing activities:</b>			
Redemption of 11% Notes	-	-	(153.3)
Dividend equivalents paid on exercise of share options	(0.4)	-	-
Other	0.2	-	(0.1)
	(0.2)	-	(153.4)
<b>Change in cash during the period</b>	<b>\$ 123.0</b>	<b>\$ (30.6)</b>	<b>\$ 129.5</b>

Cash flow from operations in the first quarter of 2007, before changes in non-cash operating working capital, was \$54.6 million as compared to a use of cash of \$7.6 million in the fourth quarter of 2006 and \$72.9 million in the first quarter of 2006. The increase from the fourth quarter of 2006 was attributable primarily to pension plan prepayments of \$85.0 million in the fourth quarter of 2006, offset by lower net income in the first quarter of 2007. The decrease from the first quarter of 2006 was primarily due to lower net income in the first quarter of 2007.

Changes in non-cash operating working capital were comprised of the following:

(\$ millions)	Q1 2007	Q4 2006	Q1 2006
Accounts receivable	\$ (53.3)	\$ 70.6	\$ (13.4)
Inventories	57.0	(55.3)	52.2
Prepaid expenses and other current assets	(25.9)	13.7	(34.0)
Accounts payable and accrued liabilities	(1.3)	(6.3)	(21.2)
Income and other taxes payable	(34.5)	(22.7)	(21.7)
	\$ (58.0)	\$ -	\$ (38.1)

Accounts receivable increased \$53.3 million in the quarter primarily due to higher sales compared to the fourth quarter of 2006. The decrease in the fourth quarter of 2006 was due to lower sales compared to the third quarter of 2006. Inventories declined by \$57.0 million in the quarter primarily due to a reduction of \$33.0 million in slab inventories and seasonal decreases of \$14.2 million in coal inventories and \$25.6 million in iron ore inventories, offset by an increase in scrap inventory of \$7.8 million. Prepaid expenses increased \$25.9 million in the quarter compared to an increase of \$34.0 million in the first quarter of 2006 reflecting payments to the iron ore supplier in excess of the actual receipts of iron ore, in accordance with the iron ore contract. Income and other taxes payable decreased \$34.5 million in the quarter primarily due to the payment of the remainder of the 2006 current income tax liability. A decrease in income and other taxes payable occurred in the first quarter of 2006 for the same reason.

Capital expenditures in the first quarter of 2007 totaled \$17.4 million, compared to \$27.0 million in the fourth quarter of 2006 and \$14.3 million in the first quarter of 2006. Expenditures in the first quarter of 2007 included \$5.2 million associated with preparation for the partial reline of the blast furnace scheduled for July 2007, while the fourth quarter of 2006 included \$11.4 million of such expenditures. There were minimal financing activities in the first quarter of 2007 and no financing activities in the fourth quarter of 2006, while financing activities in the first quarter of 2006 included \$153.3 million paid on the redemption of the 11% Notes.

Unused availability under the revolving credit facility at March 31, 2007 was \$175.9 million compared to \$186.3 million at December 31, 2006 and \$190.1 million at March 31, 2006 due to fluctuations in outstanding letters of credit.

### **Contractual Obligations**

Since December 31, 2006, the Company has committed to the following significant expenditures: the purchase of boilers for the cogeneration facility totaling \$19.6 million, the purchase of slabs totaling \$31.0 million and the purchase of steel totaling \$25.1 million.

### **Changes in Accounting Policy**

On January 1, 2007, the Company retroactively adopted, without restatement of prior periods, CICA Handbook Section 1530, "Comprehensive Income", Section 3251, "Equity", Section 3861, "Financial Instruments – Disclosure and Presentation", Section 3855, "Financial Instruments – Recognition and Measurement" and Section 3865, "Hedges".

Section 1530, "Comprehensive Income" introduces the concept of comprehensive income, which consists of Net Income and Other Comprehensive Income (OCI). OCI represents changes in Shareholders' Equity during a period arising from transactions and other events with non-owner sources and includes unrealized gains and losses resulting from changes in fair value of certain financial instruments. Cumulative changes in OCI are included in Accumulated Other Comprehensive Income, which is presented as a new category of Shareholders' Equity on the Consolidated Balance Sheet. Section 3251, "Equity", replaces Section 3250, "Surplus" and incorporates amendments resulting from the issuance of Section 1530.

Section 3855, "Financial Instruments – Recognition and Measurement" and Section 3861, "Financial Instruments – Disclosure and Presentation" establish standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives and related disclosures. Section 3855 requires that financial assets and financial liabilities, including derivatives, be recognized on the balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables or other financial liabilities. Held-for-trading financial instruments are subsequently measured at fair value and changes in fair value are recognized in net income in the period in which they occur. Available-for-sale financial instruments are subsequently measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired at which time the amounts would be recognized in net income. Held-to-maturity investments, loans and receivables and other financial liabilities are subsequently measured at amortized cost.

Upon adoption of Section 3855, the Company designated its cash and cash equivalents and short-term investments as held-for-trading and its accounts receivable as loans and receivables. Accounts payable and accrued liabilities were designated as other financial liabilities.

Section 3865, "Hedges" specifies the criteria that must be satisfied in order for hedge accounting to be applied and the accounting for each of the permitted hedging strategies: fair value hedges, cash flow hedges and hedges of foreign currency exposures of net investments in self-sustaining foreign operations. Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item.

Prior to the adoption of these new standards, the Company accounted for its natural gas swap contracts using hedge accounting. On the transition to the new standards, hedge accounting has not been used to account for these swaps. At January 1, 2007, these natural gas swap contracts had an unrecorded fair value liability of \$1.3 million. At March 31, 2007 natural gas swap contracts had a fair value of \$0.3 million which is now included in Prepaid expenses and other current assets. The Company also utilizes steel swap contracts, but these were not accounted for as hedges so the adoption of the new standards has no effect on the accounting for these derivatives. The fair value of the steel swap contracts at March 31, 2007 was an asset of \$0.7 million which is included in Prepaid expenses and other current assets.

The adoption of these new standards resulted in the following changes at January 1, 2007: The natural gas contracts were of a type that could qualify for hedge accounting under Section 3865 and consequently, a \$0.9 million charge was recorded in accumulated other comprehensive income; a \$0.4 million increase in future income tax assets; and, a \$1.3 million increase in liabilities for the natural gas swap liability. For the three month period ended March 31, 2007, the Company reclassified a loss \$0.9 million, net of \$0.3 million in related income taxes, into earnings. This represents the portion of the unrealized losses on the natural gas swap contracts deferred in accumulated other comprehensive income at the transition date that were realized during the period. Unrealized transition date losses of \$0.3 million that are included in accumulated other comprehensive income at March 31, 2007 will be reclassified into earnings by June 30, 2007.

The Company selected January 1, 2003 as its transition date for separation of embedded derivatives in financial instruments or contracts. An embedded derivative is a component of a financial instrument or another contract of which the characteristics are similar to a derivative. Certain contracts and instruments entered into prior to this transition date and not subsequently modified have not had embedded derivatives separated.

Transaction costs related to the issuance of debt are recorded as a component of the carrying amount of the related instrument on issue and are amortized to income using the effective interest rate method. This had no impact on the interim consolidated financial statements.

### **Trade**

In early March, the Canadian International Trade Tribunal (CITT) issued a Notice of Expiry of Order of an anti-dumping finding covering Plate originating in or exported from China, Russia and South Africa. Both Canadian plate producers requested that the CITT conduct a review of the order while foreign producers and importers took the position that a review of the order was not required and that the order should be allowed to expire.

On April 25, the CITT issued a decision that a review would be conducted. The first part of the review, by the Canada Border Services Agency (CBSA), will determine whether dumping is likely to continue or resume if the order is allowed to expire. If the CBSA decision is affirmative, the CITT portion of the review will continue, with a public hearing in November and a final decision by the CITT in early January 2008. If the CBSA decision is negative, the order will expire January 9, 2008.

During the first quarter, offshore imports have declined as a result of low prices in North America and more attractive prices in other markets including Europe. As North American prices increase, the re-emergence of significant quantities of low priced offshore imports is likely. The Company will carefully monitor imports and import offers.

### **Proposed Acquisition by Essar Global Limited**

On April 15, 2007, the Company announced that it had signed a definitive arrangement agreement with Essar Steel Holdings Limited (Essar), a subsidiary of Essar Global Limited, providing for the acquisition by Essar of all of the common shares of the Company for approximately \$1.85 billion or \$56 per share. The offer price represents a premium of 48% to the Company's volume weighted average share price for the 20-day period ending on February 14, 2007, when the Company confirmed that it was in discussions regarding a potential transaction.

Under the terms of the arrangement, the Company will undertake a court approved plan of arrangement pursuant to which an Essar subsidiary will acquire all of the shares of the Company for consideration of \$56 per share. The arrangement must be approved by two thirds of the votes cast, in person or by proxy, at a shareholders' meeting, and is subject to customary closing conditions including the necessary regulatory approvals. The arrangement agreement provides for the payment to Essar of approximately \$55.4 million in the event that the acquisition is not completed under certain circumstances.

The Company expects that the shareholders' meeting to approve the arrangement will be held in June 2007 and that the acquisition will be completed shortly thereafter if approved by the shareholders. The Board of Directors of the Company has unanimously recommended that the Company's shareholders vote in favour of the transaction.

### **Outlook**

Higher steel pricing realizations and strong shipment levels are expected in the second quarter resulting in higher operating income. The abnormally high service center inventories experienced in the fourth quarter of 2006 declined in the first quarter of 2007 leading to increased demand from service center customers and higher selling prices going into the second quarter. Steel shipment levels are expected to remain strong in the second quarter. Selling prices and costs are subject to a high degree of variability and certain factors which could cause actual costs to vary from projections are noted in the last paragraph of this outlook section.

Higher iron ore costs are expected in the second quarter due to the full effect of the 2007 price increase. The Company is currently making payments to its iron ore supplier based on its estimate of a pricing increase of 5%. The actual increase will be determined in the second quarter and could vary from this estimate depending on the outcome of global pricing negotiations.

As indicated previously, the Company will shut down its blast furnace in July 2007 to perform work related to maintenance and capital improvements. The impact on steelmaking is estimated to be equivalent to 31 days of production.

Certain statements made in this news release and report are forward-looking statements that involve risks and uncertainties, including those risks and uncertainties identified in the Company's Management Discussion and Analysis and Annual Information Form for the year ended December 31, 2006 available on SEDAR at [www.sedar.com](http://www.sedar.com). 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 steel production levels, plant operating performance, North American 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 forward-looking statements reflect the Company's best judgment based on current information, and although the Company bases these statements on circumstances that it believed to be reasonable when made, there can be no assurance that future events will not affect the accuracy of such forward-looking information. As such, the forward-looking statements are not guarantees of future performance, and actual results may vary materially from the results and expectations discussed herein. All statements, other than statements of historical facts included in this report, are forward-looking statements. All forward-looking statements speak only as of the date of this report. Algoma does not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

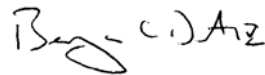
**FIRST QUARTER CONFERENCE CALL/WEBCAST PRESENTATION**

The Company will conduct a conference call/webcast presentation on first quarter earnings on Thursday, May 3<sup>rd</sup> at 10:00 a.m. ET. The call and presentation can be accessed through Algoma Steel's website at [www.algoma.com](http://www.algoma.com) under Investors, Webcasts and Presentations, Webcast of Q1-2007 Earnings Results. The conference call can also be accessed by phone at 416-620-8834. For more information on Algoma Steel, visit its website at [www.algoma.com](http://www.algoma.com).



Denis Turcotte  
*President and Chief Executive Officer*

*Sault Ste. Marie, Ontario  
May 2, 2007*



Benjamin Duster  
*Chairman of the Board*

**Algoma Steel Inc.****Consolidated Statements of Income and Comprehensive Income and Retained Earnings***(Unaudited)**(millions of Canadian dollars - except per share amounts)***Three months ended March 31**

	<u>2007</u>	<u>2006</u>
<b>Sales</b>	<b><u>\$ 479.5</u></b>	<b><u>\$ 499.6</u></b>
<b>Operating expenses</b>		
Cost of sales (before the following item)	406.0	397.0
Employees' profit sharing	<u>2.9</u>	<u>4.6</u>
	<b>408.9</b>	<b>401.6</b>
Administrative and selling	17.5	17.5
Amortization	<u>16.0</u>	<u>14.3</u>
	<b>442.4</b>	<b>433.4</b>
Other income	<u>0.7</u>	<u>-</u>
<b>Income from operations</b>	<b>37.8</b>	<b>66.2</b>
<b>Financial expense (income)</b>		
Interest on long-term liabilities	-	0.1
Foreign exchange loss (gain)	1.5	(0.3)
Premium on redemption of 11% Notes (note 4)	-	7.9
Other financial expense	0.4	0.5
Investment income	<u>(1.7)</u>	<u>(2.7)</u>
	<b>0.2</b>	<b>5.5</b>
<b>Income before income taxes</b>	<b>37.6</b>	<b>60.7</b>
<b>Income taxes (note 9)</b>		
Current	16.5	28.2
Future	<u>(2.0)</u>	<u>(0.2)</u>
	<b>14.5</b>	<b>28.0</b>
<b>Net income and comprehensive income</b>	<b><u>\$ 23.1</u></b>	<b><u>\$ 32.7</u></b>
<b>Net income per common share</b>		
Basic	<b><u>\$ 0.72</u></b>	<b><u>\$ 0.85</u></b>
Diluted	<b><u>\$ 0.72</u></b>	<b><u>\$ 0.84</u></b>
<b>Weighted average number of common shares outstanding - millions (note 6)</b>		
Basic	<b><u>32.03</u></b>	<b><u>38.61</u></b>
Diluted	<b><u>32.26</u></b>	<b><u>38.84</u></b>
<b>Retained earnings</b>		
Balance, beginning of period	\$ 393.3	\$ 346.0
Net income	23.1	32.7
Dividend equivalents paid on exercise of share options	<u>(0.4)</u>	<u>-</u>
Balance, end of period	<b><u>\$ 416.0</u></b>	<b><u>\$ 378.7</u></b>

**SUPPLEMENTAL NON-FINANCIAL INFORMATION****Operations** (thousands of net tons)

Raw steel production	<b>606</b>	637
Steel shipments	<b>643</b>	643

*See accompanying notes.*

**Algoma Steel Inc.**  
**Consolidated Balance Sheets** (*Unaudited*)  
*(millions of Canadian dollars)*

	<b>March 31</b>	December 31
	<b>2007</b>	2006
<b>Current assets</b>		
Cash and cash equivalents	\$ 152.4	\$ 29.4
Short-term investments	1.8	145.7
Accounts receivable	269.3	216.0
Inventories	363.4	420.4
Prepaid expenses and other current assets	45.0	19.1
Future income taxes (note 9)	<u>1.7</u>	<u>1.7</u>
	<b><u>833.6</u></b>	<b><u>832.3</u></b>
Property, plant and equipment	650.1	648.8
Accrued pension asset	11.8	22.6
Other long-term assets	<u>1.0</u>	<u>1.7</u>
<b>Total assets</b>	<b><u>\$ 1,496.5</u></b>	<b><u>\$ 1,505.4</u></b>
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 147.2	\$ 148.5
Income and other taxes payable	23.9	58.4
Accrued pension liability and post-employment benefit obligation	17.3	16.5
Future income tax liability (note 9)	<u>0.9</u>	<u>1.0</u>
	<b><u>189.3</u></b>	<b><u>224.4</u></b>
Accrued post-employment benefit obligation	262.5	258.0
Other long-term liabilities	7.6	7.7
Future income tax liability (note 9)	<u>127.6</u>	<u>130.2</u>
	<b><u>397.7</u></b>	<b><u>395.9</u></b>
<b>Shareholders' equity</b>		
Capital stock (notes 5 & 7)	254.6	253.6
Contributed surplus (note 9)	239.2	238.2
Retained earnings	416.0	393.3
Accumulated other comprehensive income (notes 2 and 8)	<u>(0.3)</u>	<u>-</u>
	<b><u>415.7</u></b>	<b><u>393.3</u></b>
	<b><u>909.5</u></b>	<b><u>885.1</u></b>
<b>Total liabilities and shareholders' equity</b>	<b><u>\$ 1,496.5</u></b>	<b><u>\$ 1,505.4</u></b>

*See accompanying notes.*

**Algoma Steel Inc.**  
**Consolidated Statements of Cash Flows (Unaudited)**  
(millions of Canadian dollars)

	<b>Three months ended March 31</b>	
	<u>2007</u>	<u>2006</u>
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income	\$ 23.1	\$ 32.7
Adjustments and items not affecting cash:		
Amortization	16.0	14.3
Pension expense in excess of current funding (note 10)	11.3	13.4
Post-employment benefit expense in excess of payments (note 10)	4.7	4.3
Future income tax expense	(2.0)	(0.2)
Gain on disposal of property, plant and equipment	-	(0.1)
Premium on redemption of 11% Notes	-	7.9
Stock-based compensation	1.0	0.4
Other	<u>0.5</u>	<u>0.2</u>
	54.6	72.9
Changes in non-cash operating working capital	<u>(58.0)</u>	<u>(38.1)</u>
	<u>(3.4)</u>	<u>34.8</u>
<b>Investing activities</b>		
Decrease in short-term investments	143.9	262.2
Acquisition of property, plant and equipment	(17.4)	(14.3)
Proceeds on sale of property, plant and equipment	<u>0.1</u>	<u>0.2</u>
	<u>126.6</u>	<u>248.1</u>
<b>Financing activities</b>		
Redemption of 11% Notes	-	(153.3)
Dividend equivalents paid on exercise of share options	(0.4)	-
Other	<u>0.2</u>	<u>(0.1)</u>
	<u>(0.2)</u>	<u>(153.4)</u>
<b>Cash and cash equivalents</b>		
Change during the period	123.0	129.5
Balance, beginning of period	<u>29.4</u>	<u>172.6</u>
Balance, end of period	<u>\$ 152.4</u>	<u>\$ 302.1</u>
<b>Changes in non-cash operating working capital</b>		
Accounts receivable	\$ (53.3)	\$ (13.4)
Inventories	57.0	52.2
Prepaid expenses and other current assets	(25.9)	(34.0)
Accounts payable and accrued liabilities	(1.3)	(21.2)
Income and other taxes payable	<u>(34.5)</u>	<u>(21.7)</u>
	<u>\$ (58.0)</u>	<u>\$ (38.1)</u>

See accompanying notes.

## **Algoma Steel Inc.**

### **Notes to Interim Consolidated Financial Statements (Unaudited)**

**March 31, 2007**

*(Expressed in millions of Canadian dollars, except share and per share amounts and as noted)*

#### **1. Basis of presentation and accounting policies**

These interim consolidated financial statements have been prepared using the same accounting principles and methods as were used for the consolidated financial statements for the year ended December 31, 2006, except as described in note 2. Management is required to make estimates and assumptions that affect the amounts reported in the interim financial statements. Management believes that the estimates are reasonable; however, actual results could differ from these estimates. The disclosures in these interim consolidated financial statements do not meet all disclosure requirements of Canadian generally accepted accounting principles (“GAAP”) for annual financial statements and they should be read in conjunction with the annual consolidated financial statements of the Company for the year ended December 31, 2006 and the notes thereto.

#### **2. Changes in accounting policies**

On January 1, 2007, the Company retroactively adopted, without restatement of prior periods, CICA Handbook Section 1530, “Comprehensive Income”, Section 3251, “Equity”, Section 3861, “Financial Instruments – Disclosure and Presentation”, Section 3855, “Financial Instruments – Recognition and Measurement” and Section 3865, “Hedges”.

Section 1530, “Comprehensive Income” introduces the concept of comprehensive income, which consists of Net Income and Other Comprehensive Income (OCI). OCI represents changes in Shareholders’ Equity during a period arising from transactions and other events with non-owner sources and includes unrealized gains and losses resulting from changes in fair value of certain financial instruments. Cumulative changes in OCI are included in Accumulated Other Comprehensive Income, which is presented as a new category of Shareholders’ Equity on the Consolidated Balance Sheet. Section 3251, “Equity”, replaces Section 3250, “Surplus” and incorporates amendments resulting from the issuance of Section 1530.

Section 3855, “Financial Instruments – Recognition and Measurement” and Section 3861, “Financial Instruments – Disclosure and Presentation” establish standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives and related disclosures. Section 3855 requires that financial assets and financial liabilities, including derivatives, be recognized on the balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables or other financial liabilities. Held-for-trading financial instruments are subsequently measured at fair value and changes in fair value are recognized in net income in the period in which they occur. Available-for-sale financial instruments are subsequently measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired at which time the amounts would be recognized in net income. Held-to-maturity investments, loans and receivables and other financial liabilities are subsequently measured at amortized cost.

Upon adoption of Section 3855, the Company designated its cash and cash equivalents and short-term investments as held-for-trading and its accounts receivable as loans and receivables. Accounts payable and accrued liabilities were designated as other financial liabilities.

Section 3865, “Hedges” specifies the criteria that must be satisfied in order for hedge accounting to be applied and the accounting for each of the permitted hedging strategies: fair value hedges, cash flow hedges and hedges of foreign currency exposures of net investments in self-sustaining foreign operations. Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item.

## **Algoma Steel Inc.**

### **Notes to Interim Consolidated Financial Statements (Unaudited)**

**March 31, 2007**

*(Expressed in millions of Canadian dollars, except share and per share amounts and as noted)*

#### **2. Changes in accounting policies (cont'd)**

Prior to the adoption of these new standards, the Company accounted for its natural gas swap contracts using hedge accounting. On the transition to the new standards, hedge accounting has not been used to account for these swaps. At January 1, 2007, these natural gas swap contracts had an unrecorded fair value liability of \$1.3 million. At March 31, 2007 natural gas swap contracts had a fair value of \$0.3 million which is now included in Prepaid expenses and other current assets. The Company also utilizes steel swap contracts, but these were not accounted for as hedges so the adoption of the new standards has no effect on the accounting for these derivatives. The fair value of the steel swap contracts at March 31, 2007 was an asset of \$0.7 million which is included in Prepaid expenses and other current assets.

The adoption of these new standards resulted in the following changes at January 1, 2007: The natural gas contracts were of a type that could qualify for hedge accounting under Section 3865 and consequently, a \$0.9 million charge was recorded in accumulated other comprehensive income; a \$0.4 million increase in future income tax assets; and, a \$1.3 million increase in liabilities for the natural gas swap liability. For the three month period ended March 31, 2007, the Company reclassified a loss \$0.9 million, net of \$0.3 million in related income taxes, into earnings. This represents the portion of the unrealized losses on the natural gas swap contracts deferred in accumulated other comprehensive income at the transition date that were realized during the period. Unrealized transition date losses of \$0.3 million that are included in accumulated other comprehensive income at March 31, 2007 will be reclassified into earnings by June 30, 2007.

The Company selected January 1, 2003 as its transition date for separation of embedded derivatives in financial instruments or contracts. An embedded derivative is a component of a financial instrument or another contract of which the characteristics are similar to a derivative. Certain contracts and instruments entered into prior to this transition date and not subsequently modified have not had embedded derivatives separated.

Transaction costs related to the issuance of debt are recorded as a component of the carrying amount of the related instrument on issue and are amortized to income using the effective interest rate method. This had no impact on the interim consolidated financial statements.

#### **3. Banking facilities**

The Company's Loan and Security Agreement ("Agreement") with its bank 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 March 31, 2007 there was \$175.9 million of unused availability under the Revolving Facility after taking into account \$24.1 million of outstanding letters of credit. The Company is required to maintain a minimum availability of \$25 million.

The Revolving Facility matures on September 3, 2007 and is collateralized by a first charge on short-term investments, accounts receivable and inventories. Borrowings can be made in either Canadian or United States (U.S.) funds at rates fluctuating between 0.75% and 1.5% above either the Canadian prime bank rate or the U.S. base rate or, at the Company's option, at rates fluctuating between 1.75% and 2.5% over bankers' acceptance rate or London interbank offering rate.

#### **4. 11% Notes payable**

The 11% Notes were redeemed on January 3, 2006 at a premium of 105.5% of the principal balance. The premium totaled \$7.9 million and was charged to expense in January 2006.

## Algoma Steel Inc.

### Notes to Interim Consolidated Financial Statements (Unaudited)

March 31, 2007

(Expressed in millions of Canadian dollars, except share and per share amounts and as noted)

#### 5. Share capital

Authorized - Unlimited common shares

The following table summarizes the share capital transactions since December 31, 2006:

	<u>Common Shares</u>	
	<u>Issued and Outstanding</u>	
	<u># Shares</u>	<u>Stated Capital</u>
Balance at December 31, 2006	31,896,358	\$ 253.6
Shares issued on exercise of restricted share units	55,927	0.6
Options exercised	75,407	0.3
Directors' Share Award Plan (note 7):		
Shares issued	<u>4,260</u>	<u>0.1</u>
Balance at March 31, 2007	<u>32,031,952</u>	<u>\$ 254.6</u>

#### 6. Earnings per share

Diluted net income per common share assumes the exercising of any dilutive share options and restricted share units (note 7).

	<b>Three months ended March 31 <u>2007</u></b>	Three months ended March 31 <u>2006</u>
Basic weighted average number of common shares outstanding	<b>32.03</b>	38.61
Common shares issued on the assumed exercising of employee share options and restricted share units	<u>0.23</u>	<u>0.23</u>
Diluted weighted average number of common shares outstanding	<u><b>32.26</b></u>	<u>38.84</u>

#### 7. Stock-based compensation plans

During the quarter ended March 31, 2007, 4,260 shares (2006 – nil) were awarded under the share award plan and there were no options or restricted share units granted (2006 – nil).

The compensation expense recognized for all awards granted under these plans was \$1.0 million for the three-month period ended March 31, 2007 (2006 - \$0.4 million).

## Algoma Steel Inc.

### Notes to Interim Consolidated Financial Statements (*Unaudited*)

March 31, 2007

(Expressed in millions of Canadian dollars, except share and per share amounts and as noted)

#### 8. Accumulated other comprehensive income

	<b>Three months ended March 31 <u>2007</u></b>
Balance, beginning of period	\$ -
Transition adjustment on adoption of new accounting policies	(0.9)
Amounts reclassified into earnings related to pre-transition deferred hedging amounts	<u>0.6</u>
Balance, end of period	<u>\$ (0.3)</u>

#### 9. Income taxes

The Company's effective income tax rates for the first quarter of both 2007 and 2006 are higher than its statutory manufacturing and processing rate of 34% primarily due to a valuation allowance that has been taken against future tax assets arising in the period in respect of other post-employment benefit expenses.

Any future tax benefit recognized in respect of unrecorded tax assets that arose prior to fresh start accounting is recorded as an increase to contributed surplus. The increase to contributed surplus was \$0.7 million for the three months ended March 31, 2007 (2006 - \$1.8 million).

The Company's estimate of non-capital losses available subsequent to the 2002 financial reorganization is currently under review by the Canada Revenue Agency and may be subject to change.

#### 10. Pension and other post-employment benefits

Pension expense for the three month period ended March 31, 2007 was \$11.5 million (2006 - \$13.6 million).

Post-employment benefit expense for the three month period ended March 31, 2007 was \$8.0 million (2006 - \$7.8 million).

#### 11. Subsequent event

On April 15, 2007, the Company announced that it had signed a definitive arrangement agreement with Essar Steel Holdings Limited (Essar) providing for the acquisition by Essar of all of the common shares of the Company for approximately \$1.85 billion. Under the terms of the arrangement, the Company will undertake a court approved plan of arrangement pursuant to which an Essar subsidiary will acquire all of the shares of the Company for consideration of \$56 per share. The arrangement must be approved by two thirds of the votes cast, in person or by proxy, at a shareholders' meeting, and is subject to customary closing conditions including the necessary regulatory approvals. The support agreement provides for the payment to Essar of approximately \$55.4 million in the event that the acquisition is not completed under certain circumstances.

**CORPORATE AND INVESTOR INFORMATION**

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