

ALGOMA STEEL INC.
2003 THIRD QUARTER REPORT TO SHAREHOLDERS (UNAUDITED)
for the period ended September 30, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis should be read in conjunction with Management's Discussion and Analysis section of the Company's 2002 Annual Report and the interim 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 Management's Discussion and Analysis section of the Company's 2002 Annual Report.

Financial and Operating Results

Net loss for the three months ended September 30, 2003 was \$12.3 million, a decline of \$23.3 million from net income of \$11.0 million for the three months ended September 30, 2002. The quarter over quarter decline was mainly the result of lower steel prices (appreciation of the Canadian dollar and a weak market), lower shipments and higher operating costs (lower production level), offset in part by lower financial expenses.

For the nine months ended September 30, 2003, there was a net loss of \$1.7 million compared to a net loss of \$5.5 million for the same period in 2002.

Revenue was \$239.8 million for the three months ended September 30, 2003 with average revenue per ton of \$477 compared with revenue of \$312.8 million and average revenue per ton of \$566 for the three months ended September 30, 2002. The decline in revenue per ton was due to the lower pricing environment in the third quarter of 2003 versus 2002 with the significant strengthening of the Canadian dollar in 2003 as a contributing factor. Steel shipments declined by 9% to 502,000 tons in the third quarter compared to 552,000 tons for the three months ended September 30, 2002.

Revenue for the third quarter declined by \$48.4 million versus the three months ended June 30, 2003. Shipments were down 88,000 tons (15%) versus the second quarter and the average revenue per ton fell by \$12. Steel prices hit their lowest level of the year in the third quarter and have since strengthened. The decline in steel shipments was due mainly to a much smaller drawdown of inventories and lower production levels due, in part, to two power outages.

Revenue for the nine months ended September 30, 2003 was \$826.8 million, a 2% decline from \$842.5 million realized in the comparable period of 2002. Average revenue per ton shipped of \$499 compares with \$504 per ton in the first nine months of 2002. Shipment levels were almost unchanged at 1.66 million tons in the first nine months of 2003 compared with 1.67 million tons in 2002.

Cost of sales fell to \$222 million for the three months ended September 30, 2003 from \$240.5 million for the three months ended September 30, 2002 due to lower shipments. Cost of sales per ton shipped was up 1% for the quarter at \$442 from the same period last year. For the nine months ended September 30, 2003, cost of sales was \$752.8 million or \$454 per ton shipped as compared with \$706.5 million or \$423 per ton shipped in 2002. Unit operating costs have increased in 2003 mainly due to the absence of favourable inventory valuation adjustments realized in the first half of 2002 and higher scrap, natural gas and labour costs. Partially offsetting these factors is the appreciation of the Canadian dollar which has contributed to lower raw material costs in 2003.

Cost of sales per ton shipped improved in the third quarter by \$8 (2%) over the three months ended June 30, 2003, despite lower production levels. The improvement was the result of lower labour (reduced manning), raw material (impact of strong Canadian dollar) and generally lower spending levels.

EBITDA for the quarter of \$7.2 million was \$54.3 million lower than the \$61.5 million realized in the third quarter of 2002 mainly the result of lower average revenue per ton. For the nine months ended September 30, 2003, EBITDA was \$38.5 million as compared with \$105.9 million in 2002.

EBITDA was down \$2.5 million versus the second quarter total of \$9.7 million. Lower shipments and a decline in revenue per ton shipped, offset in part by improved costs, account for the decline.

An operating loss of \$6.9 million was incurred in the third quarter of 2003 as compared with operating income of \$46.7 million in 2002. The operating loss of \$4.7 million for the nine months ended September 30, 2003 was down \$65.4 million from the \$60.7 million realized in the equivalent period of 2002.

Financial expense for the three months ended September 30, 2003 was \$6.1 million compared to \$17.5 million for the quarter ended September 30, 2002. A \$0.1 million foreign exchange gain was realized in the quarter as compared with a \$9.3 million exchange loss for the same period in 2002. Interest expense was \$2.0 million lower in the quarter at \$6.2 million versus the same period last year, the result of reduced borrowings under the revolving credit facility and lower borrowing rates.

Financial Resources and Liquidity

Cash provided by operating activities was \$37.8 million for the three months ended September 30, 2003 which included a \$24.4 million reduction in operating working capital. The significant components of the change in operating working capital were a decline in accounts receivable of \$16.6 million and a decline in prepaid expenses of \$4.3 million. For the nine months ended September 30, 2003, cash provided by operating activities was \$139.7 million which included \$96.6 million from a reduction in operating working capital, composed primarily of an \$86.0 million decrease in inventories.

Capital expenditures for the three and nine month periods ended September 30, 2003 were \$13.8 million and \$27.4 million, respectively. Expenditures in the corresponding periods of 2002 were \$6.7 million and \$15.4 million.

Financing activities for the three months ended September 30, 2003 included a \$9 million repayment of the term loan and a decrease in bank indebtedness of \$12.4 million.

On September 3, 2003, the Corporation entered into a new four-year Loan and Security Agreement providing financing under a revolving credit facility equal to the lesser of \$200 million and a borrowing base determined by the agreement. Unused availability under the revolving credit facility at September 30, 2003 was \$131 million compared to \$108 million under the previous credit facility at June 30, 2003. The Corporation is required to maintain a minimum availability of \$25 million.

TRADE

The Government of Canada has announced that they will not implement remedies relating to the Canadian Steel Safeguard despite the finding of injury by the Canadian International Trade Tribunal (CITT) in respect of several steel products. Canada is the only NAFTA partner without Safeguard remedies covering steel products. Both the United States and Mexico implemented such remedies some time ago.

Based on a complaint by Algoma, an investigation into the dumping of carbon and HSLA plate from Bulgaria, the Czech Republic and Romania was initiated earlier in the year. A preliminary determination of dumping by the Canada Customs and Revenue Agency was issued in early September imposing provisional duties ranging from 53% to 75% on imports of subject goods from these countries. An injury hearing before the CITT is scheduled for early December. A final injury determination by the CITT will be made in January 2004.

During 2004, anti dumping findings covering plate and sheet from a number of countries are scheduled to expire. At the request of the Canadian producers, the CITT has initiated reviews of both findings to determine whether they will be extended. The plate review will be completed by mid-May 2004 and the hot rolled sheet review by the end of June 2004.

The Company is very concerned about the significant increase in imports of alloy plate from Sweden in 2002 and 2003. These imports are being carefully monitored.

OUTLOOK

There has been a recent increase in manufacturing activity in North America which is contributing to improved steel demand. The steel industry has announced several price increases in recent months which should result in an improvement in profitability in the fourth quarter. Bank indebtedness is expected to increase in the fourth quarter due to raw material purchases preceding the close of the navigation season and the payment of interest on the 11% and 1% Notes in December.



Denis Turcotte
President and Chief Executive Officer



Benjamin Duster
Chairman of the Board

*Sault Ste. Marie, Ontario
October 29, 2003*

Algoma Steel Inc.

Consolidated Statements of Income (Loss) and Retained Earnings (Deficit) (Unaudited)

(millions of Canadian dollars - except per share amounts)

	Three months Ended September 30 2003	Nine months Ended September 30 2003	Three months Ended September 30 2002	Eight months Ended September 30 2002	One month Ended January 31 2002 Pre-reorganization (Notes 1,2)
Sales	\$ 239.8	\$ 826.8	\$ 312.8	\$ 758.6	\$ 83.9
Operating expenses					
Cost of sales	222.0	752.8	240.5	621.2	85.3
Administrative and selling	10.6	35.5	10.8	26.8	3.3
Depreciation and amortization	14.1	43.2	14.8	39.4	5.8
	<u>246.7</u>	<u>831.5</u>	<u>266.1</u>	<u>687.4</u>	<u>94.4</u>
Income (loss) from operations	(6.9)	(4.7)	46.7	71.2	(10.5)
Financial expense (income)					
Interest on long-term debt (note 4)	4.8	15.0	5.5	14.8	-
Foreign exchange (gain) loss	(0.1)	(32.6)	9.3	0.7	(2.3)
Other interest	1.4	5.5	2.7	8.3	7.6
	<u>6.1</u>	<u>(12.1)</u>	<u>17.5</u>	<u>23.8</u>	<u>5.3</u>
Income (loss) before the following	(13.0)	7.4	29.2	47.4	(15.8)
Loss on disposal of joint venture interest (note 7)	-	-	-	-	(6.8)
Reorganization expenses	-	-	-	-	(3.3)
Income (loss) before income taxes	(13.0)	7.4	29.2	47.4	(25.9)
Provision for income taxes - current (note 9)	(0.7)	9.1	18.2	26.8	0.2
Net income (loss)	<u>\$ (12.3)</u>	<u>\$ (1.7)</u>	<u>\$ 11.0</u>	<u>\$ 20.6</u>	<u>\$ (26.1)</u>
Net income (loss) per common share (note 6)					
Basic	<u>\$ (0.52)</u>	<u>\$ (0.09)</u>	<u>\$ 0.45</u>	<u>\$ 0.93</u>	<u>\$ (0.49)</u>
Diluted	<u>\$ (0.52)</u>	<u>\$ (0.09)</u>	<u>\$ 0.37</u>	<u>\$ 0.70</u>	<u>\$ (0.49)</u>
Weighted average number of common shares outstanding - millions (note 6)					
Basic	<u>24.06</u>	<u>23.97</u>	<u>23.74</u>	<u>21.52</u>	<u>53.65</u>
Diluted	<u>30.15</u>	<u>30.12</u>	<u>30.03</u>	<u>30.02</u>	<u>53.65</u>
Retained earnings (deficit)					
Balance, beginning of period	\$ 26.2	\$ 15.9	\$ 9.3	\$ -	\$ (264.6)
Net income (loss)	(12.3)	(1.7)	11.0	20.6	(26.1)
Accretion of equity component of convertible debt	(0.2)	(0.5)	(0.2)	(0.5)	-
Fresh start adjustment (note 1)	-	-	-	-	290.7
Balance, end of period	<u>\$ 13.7</u>	<u>\$ 13.7</u>	<u>\$ 20.1</u>	<u>\$ 20.1</u>	<u>\$ -</u>

SUPPLEMENTAL NON-FINANCIAL INFORMATION

Operations (thousands of net tons)

Raw steel production	570	1,823	631	1,667	186
Steel shipments	502	1,658	552	1,478	194

See accompanying notes.

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

	September 30 <u>2003</u>	December 31 <u>2002</u>
Current assets		
Marketable securities	\$ 0.2	\$ -
Accounts receivable	140.5	154.3
Inventories	185.4	271.4
Prepaid expenses	<u>18.0</u>	<u>19.0</u>
	<u>344.1</u>	<u>444.7</u>
Capital assets, net	656.0	684.8
Capital assets held for sale (note 10)	12.0	-
Deferred charges	<u>4.6</u>	<u>2.3</u>
Total assets	<u>\$ 1,016.7</u>	<u>\$ 1,131.8</u>
Current liabilities		
Bank indebtedness (note 3)	\$ 7.9	\$ 88.5
Accounts payable and accrued liabilities	90.1	87.4
Accrued interest on long-term debt (note 4(a))	31.4	20.0
Income and other taxes payable	5.3	4.7
Accrued pension liability and post-employment benefit obligation	28.7	28.7
Current portion of term loan (note 3)	<u>-</u>	<u>29.0</u>
	<u>163.4</u>	<u>258.3</u>
Long-term debt (note 4)	171.8	200.6
Accrued pension liability and post-employment benefit obligation	314.7	311.2
Other long-term liabilities	<u>15.9</u>	<u>16.8</u>
	<u>502.4</u>	<u>528.6</u>
Shareholders' equity		
Share capital (notes 5 & 6)	214.7	214.1
Convertible long-term debt (note 4)	19.4	19.3
Contributed surplus	103.1	95.6
Retained earnings	<u>13.7</u>	<u>15.9</u>
	<u>350.9</u>	<u>344.9</u>
Total liabilities and shareholders' equity	<u>\$ 1,016.7</u>	<u>\$ 1,131.8</u>

See accompanying notes.

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

	Three months Ended September 30 <u>2003</u>	Nine months Ended September 30 <u>2003</u>	Three months Ended September 30 <u>2002</u>	Eight months Ended September 30 <u>2002</u>	One month Ended January 31 <u>2002</u>
					Pre-reorganization (Notes 1,2)
Cash provided by (used in)					
Operating activities					
Net income (loss)	\$ (12.3)	\$ (1.7)	\$ 11.0	\$ 20.6	\$ (26.1)
Adjust for items not affecting cash:					
Depreciation and amortization	14.1	43.2	14.8	39.4	5.8
Future income tax expense	(1.3)	7.3	17.6	25.2	-
Exchange (gain) loss on long-term debt	0.3	(32.0)	(9.1)	0.1	(1.9)
Loss on disposal of joint venture interest (note 7)	-	-	-	-	6.8
Other	<u>12.6</u>	<u>26.3</u>	<u>26.2</u>	<u>17.5</u>	<u>(2.6)</u>
	13.4	43.1	60.5	102.8	(18.0)
Changes in operating working capital	<u>24.4</u>	<u>96.6</u>	<u>(24.4)</u>	<u>(45.7)</u>	<u>49.0</u>
	<u>37.8</u>	<u>139.7</u>	<u>36.1</u>	<u>57.1</u>	<u>31.0</u>
Investing activities					
Capital asset expenditures	<u>(13.8)</u>	<u>(27.4)</u>	<u>(6.7)</u>	<u>(14.1)</u>	<u>(1.3)</u>
Financing activities					
Proceeds (repayment) of term loan (note 3)	(9.0)	(29.0)	(10.6)	(10.6)	
50.0					
Increase (decrease) in other long-term liabilities	(0.2)	1.9	-	-	-
Financing expense	(2.4)	(4.6)	-	-	-
Decrease in bank indebtedness	<u>(12.4)</u>	<u>(80.6)</u>	<u>(18.8)</u>	<u>(32.4)</u>	<u>(79.7)</u>
	<u>(24.0)</u>	<u>(112.3)</u>	<u>(29.4)</u>	<u>(43.0)</u>	<u>(29.7)</u>
Cash and cash equivalents					
Change during the period	-	-	-	-	-
Balance, beginning of period	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance, end of period	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes.

Algoma Steel Inc.
Notes to Interim Consolidated Financial Statements (*Unaudited*)
(*millions of Canadian dollars*)

1. Financial reorganization

As a result of a financial reorganization on January 29, 2002, the Corporation's assets and liabilities were comprehensively revalued using the principles of fresh start accounting as required under Canadian generally accepted accounting principles ("GAAP"). For accounting purposes, the Corporation has used an effective date of January 31, 2002. Under fresh start accounting, all assets and liabilities were revalued at estimated fair values. In order to establish the fresh start balance sheet, an equity value of \$300 million was calculated based on the net present value of estimated future free cash flows reduced by bank indebtedness, long-term debt and pension and post-employment obligations. The Corporation's previous Board of Directors passed a resolution setting the stated capital of the new common shares issued under the reorganization at \$10 per share based upon the calculated equity value. The book values of the assets and liabilities at January 31, 2002 approximated their fair values, with the exception of capital assets and the pension and post-employment benefit obligations. The fair values of the pension and post-employment obligations were determined by an independent actuary. The fair value of the capital assets was calculated as the excess of the equity value and liabilities over the fair value of the remaining assets. The revaluation adjustment of \$441.4 million and the \$290.7 million deficit were classified as contributed surplus, resulting in a net increase of \$150.7 million.

2. Basis of presentation and accounting policies

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 interim financial statements do not conform in all respects to the disclosure requirements of Canadian GAAP for annual financial statements and should therefore be read in conjunction with the Corporation's 2002 Annual Report.

The interim financial statements have been prepared on a "going concern" basis that assumes the Corporation will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. These interim financial statements do not reflect any adjustments that would be necessary if the "going concern" assumption was not appropriate. The Corporation is dependent upon a strong North American steel market and improving financial results. The outcome of these matters is not determinable at this time.

Comparative financial information for the month of January 2002 is required under securities legislation and may be of limited interest to readers of these interim financial statements. In reviewing the comparative information, readers are reminded that the information does not reflect the effects of the financial reorganization or the application of fresh start accounting.

Certain items in the December 31, 2002 consolidated balance sheet have been reclassified to conform to the presentation adopted in the current period.

3. Banking facilities

On September 3, 2003, the Corporation entered into a new Loan and Security Agreement ("Agreement"). The Agreement provides the Corporation 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 Corporation's accounts receivable and inventories less certain reserves. At September 30, 2003, there was \$131 million of unused availability under the Revolving Facility after taking into account \$35 million of outstanding letters of credit. Under the previous banking agreement, at December 31, 2002, there was \$68 million of availability with \$26 million of letters of credit. The Corporation 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 accounts receivable and inventories. Borrowings can be made in either Canadian or United States (U.S.) funds at rates fluctuating between 1.0% and 1.75% above either the Canadian prime bank rate or the U.S. base rate or, at the Corporation's option, at rates fluctuating between 2.0% and 2.75% over bankers' acceptance rate or London interbank offering rate ("LIBOR").

Algoma Steel Inc.
Notes to Interim Consolidated Financial Statements (Unaudited)
(millions of Canadian dollars)

4. Long-term debt

	September 30 <u>2003</u>	December 31 <u>2002</u>
Secured 11% Notes maturing December 31, 2009 principal value U.S. \$125 million (a)	\$ 168.7	\$ 197.2
Secured 1% convertible Notes maturing December 31, 2030 principal value U.S. \$38 million (b)	<u>3.1</u>	<u>3.4</u>
	171.8	200.6
Less: current portion	<u>-</u>	<u>-</u>
	<u>\$ 171.8</u>	<u>\$ 200.6</u>

(a) The 11% Notes are redeemable after 2005 at a declining premium ranging from 105.5% of principal in 2006 to 101.4% in 2008. Mandatory redemptions of U.S. \$12.5 million per year are required commencing December 31, 2007 with the balance payable at maturity. Interest for 2002 and the first half of 2003 will accrue and be paid on December 31, 2003. Interest for the second half of 2003 will accrue and be paid on June 30, 2004. After 2003, interest will be paid semi-annually on June 30 and December 31 of each year. The 11% Notes are collateralized by a first charge on capital assets, subject to collateral on the Term Facility (note 3), and a second charge on other assets.

(b) The collateral and interest accrual and payment terms are the same as for the 11% Notes. The 1% Notes are convertible into common shares at the holder's option at a conversion price per share of \$10 ("Conversion Price"). After December 31, 2002, the Corporation may convert all or any part of the principal amount at the Conversion Price if the average trading price of the common shares exceeds 125% of the Conversion Price for 30 consecutive trading days, or at any time after December 31, 2009. For conversion purposes, the exchange rate to be used is U.S. \$1.00 = CDN \$1.60. As required by Canadian GAAP, the 1% Notes are separated into debt and equity components in the consolidated balance sheets. The present value of the interest payments up to and including 2009 are presented as debt. The present value of the principal payment in 2030 and interest for the period 2010 through 2030 plus the value ascribed to the holder conversion option are presented as equity. All present value amounts were determined using an 11% discount rate.

During the nine months ended September 30, 2003, U.S. \$0.6 million principal value of 1% Notes were converted at the holder's option into 0.1 million common shares resulting in \$0.3 million of the equity component and \$0.1 million of the debt component being transferred to share capital.

Algoma Steel Inc.
Notes to Interim Consolidated Financial Statements (Unaudited)
(millions of Canadian dollars)

5. Share capital

Authorized - Unlimited common shares

The following table summarizes the share capital transactions since January 31, 2002 in millions of shares and dollars:

	Stock Options		Common Shares			
	# Options	Ascribed Value	To Be Issued # Shares	Stated Capital	Issued and Outstanding # Shares	Stated Capital
Balance at January 31, 2002	4.0	\$ 40.0	16.0	\$ 160.0	-	\$ -
Issued pursuant to Plan of Arrangement to:						
First Mortgage Note holders			(15.0)	(150.0)	15.0	150.0
Unsecured creditors			(1.0)	(10.0)	1.0	10.0
Stock options exercised by employees	(4.0)	(40.0)			4.0	40.0
Conversion of long-term debt (note 4(b))					3.8	13.7
Shares issued as employee compensation					-	0.2
Directors' Share Award Plan (note 8):						
Shares granted			-	0.2		
Shares issued				(0.1)		0.1
Balance at December 31, 2002	-	\$ -	-	\$ 0.1	23.8	\$ 214.0
Conversion of long-term debt (note 4(b))					0.1	0.4
Stock options granted (note 8)	0.3	0.3				
Directors' Share Award Plan (note 8):						
Shares granted			0.1	0.2		
Shares issued			(0.1)	(0.2)	0.1	0.2
Balance at September 30, 2003	<u>0.3</u>	<u>\$ 0.3</u>	<u></u>	<u>\$ 0.1</u>	<u>24.0</u>	<u>\$ 214.6</u>

6. Earnings per share

Basic net income (loss) per common share is calculated by adjusting reported net income (loss) by the net charge to retained earnings related to the accretion of the equity component of the 1% convertible Notes. Diluted net income (loss) per common share assumes the dilutive effect of the conversion of the 1% convertible Notes at the Conversion Price (note 4) and the exercising of any share options and restricted share units (note 8).

Algoma Steel Inc.
Notes to Interim Consolidated Financial Statements (Unaudited)
(millions of Canadian dollars)

6. **Earnings per share (continued)**

	Three months Ended September 30 2003	Nine months Ended September 30 2003	Three months Ended September 30 2002	Eight months Ended September 30 2002
Basic				
Net income (loss)	\$ (12.3)	\$ (1.7)	\$ 11.0	\$ 20.6
Convertible long-term debt - net charge to retained earnings	<u>(0.2)</u>	<u>(0.5)</u>	<u>(0.2)</u>	<u>(0.5)</u>
Net income attributable to common shareholders	<u>\$ (12.5)</u>	<u>\$ (2.2)</u>	<u>\$ 10.8</u>	<u>\$ 20.1</u>
Diluted				
Net income	\$ (12.3)	\$ (1.7)	\$ 11.0	\$ 20.6
Convertible long-term debt - net charge (inclusion) in income	<u>-</u>	<u>(0.3)</u>	<u>0.1</u>	<u>0.3</u>
Net income attributable to common shareholders	<u>\$ (12.3)</u>	<u>\$ (2.0)</u>	<u>\$ 11.1</u>	<u>\$ 20.9</u>
Basic weighted average number of common shares outstanding	24.06	23.97	23.74	21.52
Common shares issued on the assumed conversion of convertible long-term debt and exercising of stock options	<u>6.09</u>	<u>6.15</u>	<u>6.29</u>	<u>8.50</u>
Diluted weighted average number of common shares outstanding	<u>30.15</u>	<u>30.12</u>	<u>30.03</u>	<u>30.02</u>

In calculating the basic weighted average number of common shares outstanding for the eight months ended September 30, 2002, the 16 million common shares issued to the holders of the First Mortgage Notes and the unsecured creditors were assumed to have been issued on February 1, 2002, and the 4 million shares issued to employees were included as of February 12, 2002.

7. **Disposition of joint venture interest**

In January 2002, the Corporation's wholly-owned U.S. subsidiary, Cannelton Iron Ore Company ("CIOC"), completed an agreement with Cleveland-Cliffs Inc. ("Cliffs") to transfer CIOC's 45% interest in the Tilden Mining Company L.C. ("Tilden") in exchange for the assumption by Cliffs of CIOC's share of Tilden's liabilities and no cash consideration. As part of this arrangement, the Corporation has entered into an exclusive 15-year supply agreement with Cliffs for a minimum annual supply of 2.5 million tons of iron ore at market prices. If the Corporation defaults under the supply agreement prior to December 31, 2008, then 50% of the liabilities assumed by Cliffs will revert back to CIOC and the Corporation. These assumed liabilities may include contingent obligations, such as environmental costs, that are not reflected in Tilden's financial statements.

8. **Stock-based compensation plans**

The Corporation uses the fair value method to account for awards granted under its stock-based compensation plans. The compensation expense recognized for all awards granted under these plans for the three and nine month periods ended September 30, 2003 was \$0.07 million and \$0.39 million, respectively.

Share Award Plan

The plan permits the Corporation, at its option, to award common shares to eligible directors as a component of their compensation. The Corporation accrues for this compensation based on the fair market value of the shares granted. Any shares awarded are issued quarterly. During the nine months ended September 30, 2003, 70,445 shares were awarded with an average fair market value of \$2.38 per share, including 22,900 shares awarded with an average fair market value of \$2.69 per share in the third quarter. The maximum number of shares that may be issued pursuant to the terms of the plan shall not exceed 500,000 common shares.

Algoma Steel Inc.
Notes to Interim Consolidated Financial Statements (Unaudited)
(millions of Canadian dollars)

8. **Stock-based compensation plans** *(continued)*

Share Option Plan

In May 2003, the Corporation's shareholders approved the creation of a Share Option Plan that permits the Corporation, at its option, to award common share options to senior management and directors. The Corporation has reserved 2 million common shares for issuance under the plan. The exercise price of a share option may not be less than the market value of the common shares on the date of the grant. The options have a term not exceeding ten years and may not be exercised until the third anniversary of the date granted. Additional plan details are outlined in the Corporation's Management Information Circular dated March 28, 2003. There were no options granted in the third quarter. During the second quarter, 260,777 options were granted with a weighted average exercise price of \$1.78 per share. Options for 123,112 shares vested on the grant date with the remainder vesting on the first, second and third anniversary dates. The estimated weighted average fair value of the options of \$1.08 per share was determined using the Black-Scholes model with the following assumptions:

Expected time until exercise	5 years
Risk-free interest rate	4%
Expected volatility in stock price	70%
Expected dividend yield	0%

Restricted Share Unit Plan

In May 2003, the Corporation's shareholders approved the creation of a Restricted Share Unit Plan that permits the Corporation, at its option, to award restricted share units to senior management and directors. A restricted share unit vests on the grant date and entitles the participant to one common share to be issued from treasury on the third anniversary. The Corporation has reserved 1 million common shares for issuance under the plan. Additional plan details are outlined in the Corporation's Management Information Circular dated March 28, 2003. There were no restricted share units granted in the third quarter. During the second quarter the Corporation granted 27,300 restricted share units with a grant-date fair value of \$1.67 per unit.

9. **Income taxes**

The Corporation's effective income tax rate is higher than its statutory manufacturing and processing rate of 33% primarily due to the following factors: the benefit of tax items that arose prior to the application of fresh start accounting is recorded through contributed surplus; and, a valuation allowance has been taken against future tax assets arising in periods after the application of fresh start accounting.

The Corporation's income tax loss carryforwards were reduced by approximately \$180 million under the financial reorganization as a result of debts being discharged for less than their principal amount. Federal and Ontario non-capital loss carryforwards at September 30, 2003 are estimated to be \$76 million and \$195 million, respectively, the benefit of which has not been recognized in the financial statements. The Corporation's estimate of non-capital loss carryforwards has not been reviewed by the Canada Customs and Revenue Agency and may be subject to change. Any future benefit recognized in respect of these non-capital losses will result in an increase to contributed surplus.

10. **Capital assets held for sale**

The Corporation has signed an agreement of purchase and sale dated September 2, 2003 for the sale of its tube manufacturing facilities by the end of 2003. The net realizable value from the sale is expected to approximate the assets book value of \$12 million.

CORPORATE AND INVESTOR INFORMATION

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