ALGOMA STEEL

Future success demands outstanding customer service and higher-valued, lower-cost quality products, manufactured by a skilled and dedicated work-force.

Annual Report 1986

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THE ALGOMA STEEL CORPORATION, LIMITED

Executive Offices
503 Queen Street East
Sault Ste. Marie, Ontario
P6A 5P2
(705) 945-2788

Auditors
Peat, Marwick, Mitchell & Co.

Incorporation
Under the laws of the Province of Ontario

Share Transfer Agents and Registrars
Montreal Trust Company, Halifax, Saint John, Montreal, Toronto, Winnipeg, Regina, Calgary and Vancouver

The Royal Bank of Canada Trust Company, New York

Shares Listed
Montreal, Toronto and Vancouver Stock Exchanges

Trustee for Debentures
Montreal Trust Company, Toronto, Ontario

Registrar for Debentures
Montreal Trust Company, Halifax, Montreal, Toronto, Winnipeg, Regina, Calgary and Vancouver

Valuation Day Values
(for Canadian Income Tax Purposes)

Series C Debenture	$ 94.00
Series D Debenture	$103.50
Common Share	$ 13.38

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ANNUAL MEETING

The Annual Meeting of Shareholders will be held at the Algoma Steel Club, 89 Foster Drive, Sault Ste. Marie, Ontario, Wednesday, April 15, 1987 at 2:15 p.m. Eastern Standard Time. A Notice of Meeting, an Information Circular and a Proxy are mailed with this Annual Report to each shareholder.

Les actionnaires qui désirent recevoir ce rapport en français sont priés d'en faire la demande au Secrétaire, Aciers Algoma Limitée, Sault-Sainte-Marie (Ontario).

CORPORATE PROFILE

Algoma Steel was formed in 1901 as a rail producer supplying the rapidly expanding Canadian and United States railroads. The Corporation was reorganized by Sir James Dunn in 1935 and began to expand its range of products. Today, Algoma is a fully integrated steel producer with five principal product lines consisting of sheet and strip, plate, seamless tubulars, structural shapes and rails. It also produces and sells both steam and metallurgical coal. Algoma employs directly and through its United States subsidiaries approximately 8,300 employees.

The Corporation's steelworks and head office are located in Sault Ste. Marie, Ontario. It has sales offices in Mississauga, Ontario and Calgary, Alberta and in two United States locations. Through direct ownership, Algoma can satisfy all its iron ore and the majority of its coal requirements. Iron ore is obtained from mines in Wawa, Ontario and Ishpeming, Michigan and coal from mining locations in West Virginia. The United States mining operations and tubular sales are conducted through Algoma's principal subsidiary, Cannelton Industries, Inc.

Canadian ownership of Algoma Steel exceeds 99 per cent. Canadian Pacific Limited, with a 54-per-cent interest, is the principal shareholder.

ALGOMA STEEL

HIGHLIGHTS

Tons and dollars in millions except per share data	1986	1985
Shipments of steel products (tons)	**2.032**	2.063
Sales	**$ 1,093.3**	$ 1,176.7
Earnings (loss) from operations	**$ (9.2)**	$ 52.1
Earnings (loss) before income taxes and equity in earnings of AMCA International Limited	**$ (72.1)**	$ (17.4)
Net earnings (loss)	**$ (134.8)**	$ (3.0)
– from integrated steel operations	**$ (51.0)**	$ (7.1)
– from AMCA International Limited	**$ (2.4)**	$ (2.7)
– from extraordinary gains (losses)	**$ (81.4)**	$ 6.8
Per common share data		
Net earnings (loss)	**$ (10.07)***	$ (1.32)**
Dividends paid in cash	**$ —**	$ —
Book value	**$ 26.67**	$ 38.93
Cash provided from operations	**$ 113.7**	$ 102.4
Long term debt as a per cent of capitalization	**43%**	45%
Return on average total investment	**(7.2)%**	2.0%
Return on average common shareholders' equity	**(29.1)%**	(3.3)%
Closing market price		
– 8% tax deferred preference share	**$ 13.63**	$ 25.00
– class B convertible preference share	**$ 14.38**	$ 23.50
– common share	**$ 11.00**	$ 20.00

*Includes an extraordinary loss of $5.42 per share
**Includes an extraordinary gain of 45 cents per share

Chairman John Macnamara fields questions from tube mill workers.

REPORT TO SHAREHOLDERS

The decline in world oil prices and a related decrease in North American oil and gas drilling activity to the lowest level since 1975 were principal factors contributing to the Corporation's 1986 loss of $54 million, before extraordinary items. Shipments of prime seamless tubulars fell by 70 per cent and the No. 1 tube mill was shut down for extended periods. If Canadian and United States oil and gas drilling were to remain at the low 1986 level, North America could become captive to the oil exporting countries. We do not believe this will be allowed to happen. It is our belief that North American oil and gas drilling will increase and this, combined with line-pipe and mechanical-tubing demand, will provide a growing future market for seamless tubulars.

Total steel product shipments were unchanged from 1985, but the product mix was unfavourable, resulting in a nine-per-cent decline in the average sales return per ton shipped. This was compounded by increased unit costs for labour and services and the combined effect could not be overcome by improvements in operating efficiency.

Successful trial rolling of high-quality seamless tubulars on the new No. 2 seamless tube mill was a 1986 highlight, despite low 1986 tubular sales and a difficult outlook for oil-country tubular goods. This world-class mill provides a unique capability to serve North American oil and gas and manufacturing customers with seamless tubular products that would otherwise have to be imported. We are exploring ways of ensuring a reasonable operating level on the new mill in the event oil and gas drilling activity remains depressed.

The Program of Action announced at the April 1986 annual meeting set out a series of actions designed to stabilize the Corporation's financial position and restore Algoma to profitability. The Program is being carried through without compromise. There has been good progress towards achieving all of the objectives as described below.

- Long term debt was reduced to $501 million, its lowest level since 1982. This was achieved through asset sales, principally the equity interest in AMCA International Limited, the issue of common shares and a reduction in operating working capital;
- raw steel production capacity was reduced and the move to 100-per-cent continuous casting is underway. The proportion of raw steel continuously cast increased to 72 per cent in 1986 and it is expected that the planned elimination of ingot production will permit 100-per-cent continuous casting by the end of 1987;
- a review was completed of all assets on the Corporation's books and write-downs were taken as appropriate. The after-tax amounts of the 1986 write-downs were $115 million in respect of Algoma Steel's operations and $24 million in respect of the Corporation's equity interest in AMCA. These extraordinary loss provisions were partially offset by an extraordinary gain of $58 million, resulting from the sale of the Corporation's 34.5-per-cent equity interest in AMCA;
- capital spending was restricted in keeping with the requirement for cash conservation. Engineering is advancing on three major projects:
  - installation of ladle metallurgy in No. 1 steelmaking shop,
  - conversion of the bloom caster to continuously cast rounds, and
  - installation of in-line equipment to produce head-hardened premium rails.

  Actual construction on these projects has been deferred pending settlement of a new labour contract in 1987;
- wage-and-benefit reductions were implemented for salaried employees which reduced individual employment costs by amounts ranging from eight per cent to 18 per cent. The unionized workers rejected concessions under the existing contract. However, in preparation for 1987 labour negotiations, the Corporation agreed to have its books and records examined by consultants for the United Steelworkers of America to verify to the union that wage concessions are necessary to restore Algoma to profitability and maintain a competitive position. The report of the consultants, completed in early 1987, confirms the seriousness of Algoma's situation and agrees that cost reduction and higher-valued products must be integral parts of Algoma's recovery plans. This new shared appreciation of the Corporation's situation should assist in the difficult labour negotiations to be faced in 1987;
- iron ore operations were restructured to decrease costs. Production capacity at the Algoma Ore Division was reduced to 900,000 gross tons annually, and efforts were directed towards achieving the additional cost

President Peter Nixon meets with Accounting Department personnel.

efficiencies which are required for continued operation. Programs were put in place to reduce the cost of Algoma's equity tonnage from its partnership interest in the Tilden Mine in Michigan and to lower the delivered cost of purchased iron ore;

- coal mine production costs were reduced and steam-coal sales were expanded by 53 per cent to two million tons. Negotiations are in progress for further expansion of Cannelton's profitable steam-coal business;
- efforts were directed towards improving manufacturing efficiency through crew-size reduction, improved yields and the application of Statistical Process Control;
- product quality and delivery reliability were improved as measured by Algoma and its customers. In several instances, the improved performance translated into increased market share at major accounts;
- marketing strategy was directed towards increasing the average sales return on steel products shipped through an improved product mix.

The benefits of the above actions have not yet been fully realized and there are other actions still to be implemented. Final elimination of ingot production will bring with it a significant reduction in fixed costs and a simplified manufacturing process which will be more responsive to customer needs.

A concern, which is expected to escalate in 1987, is the pressure from various United States constituents to limit the quantity of Canadian steel entering the United States. We believe that the Government of Canada must take a stronger stand in identifying Canadian companies which are unfairly exploiting the U.S. steel markets and in finding ways to restrict their activity. Access to the U.S. market is far too important to Canada and to Canadian steel producers to have it jeopardized by an irresponsible few.

We see 1987 as a year of challenge and opportunity. We must achieve a responsible labour agreement with our unions as a condition of future stability and security for Algoma Steel, its employees and the communities that it supports. We must follow through with the Program of Action and ensure that all of its elements are completed, including the move to 100-per-cent continuous casting. We must relentlessly pursue and find new opportunities for cost reduction. We must complete restructuring of our raw material properties. We must use aggressive salesmanship and outstanding customer service to gain a greater share of the available markets.

The management reorganization which became effective January 1, 1987 provides improved cohesiveness between Sales and Operations and enhances co-ordination of the technical services, which play an increasing role in the instrumentation and computerization of operating facilities and in the gathering and dissemination of information. The appointments of Paul Paciocco, as Assistant Vice President – Engineering and Technical Services, and James Melville, as Vice President, Treasurer and General Counsel, bring two capable young people into our executive group.

We note with regret the retirement from our Board of Directors of Earle McLaughlin, who reached the mandatory retirement age. Mr. McLaughlin was one of Algoma's most outstanding Directors. He served the Corporation with distinction for 24 years and we miss his wise counsel and unfailing good humour. James F. Hankinson, Group Vice-President of Canadian Pacific Limited, joined the Board during the year.

In January 1987, Henry C. Winters, Vice President – Marketing and Planning, resigned. The contribution of Mr. Winters, who held various management positions over 20 years, is appreciated.

We acknowledge the support of all of our shareholders, particularly Canadian Pacific Limited, through this period of difficulty. On behalf of shareholders and Directors we also recognize the contribution of employees who have worked hard in trying circumstances to overcome adversity and restore Algoma to stability and profitability. With their continuing help and the support of customers and suppliers we will move successfully through the transition year of 1987 and on to profitability in 1988 and beyond.

Chairman and Chief Executive Officer

President and Chief Operating Officer

Sault Ste. Marie, Ontario
February 13, 1987

On-site customer inspection of Algoma's modern rail finishing facilities, an important step in increasing sales.

ALGOMA

SALES AND MARKETING

Consolidated sales of $1.1 billion were seven per cent lower than in 1985. Steel shipments were two per cent below 1985 levels.

The Corporation suffered serious declines in the markets for its higher-valued seamless tubular and rail products. The lost volume was replaced with semi-finished and offshore sales, resulting in an unfavourable product mix and a nine-per-cent reduction in average sales return per ton shipped.

The collapse in crude oil prices and the resultant decline in oil and gas drilling in North America had a devastating effect on Algoma's seamless tubular business, with 1986 prime shipments 70 per cent below 1985 levels. However, the new No. 2 seamless tube mill, which began trial rollings late in 1986, will make Algoma a preferred supplier of a wide range of premium oil-country tubular goods. The new mill's expanded product range, plus an agreement with Stelco Inc., will allow the Corporation to significantly increase its participation in the mechanical-tubing, line-pipe and standard-pipe markets. The increased quality and expanded product range will provide the opportunity for greater seamless tubular sales in 1987 even if world energy prices remain depressed.

Falling domestic rail demand, interruptions during the installation of new equipment and imports of head-hardened rails were principal reasons for lower rail shipment levels. As part of Algoma's commitment to being a world-class rail supplier, new and improved facilities to produce and finish long-length rails began operation in the second quarter of 1986.

Planned capital projects for ladle metallurgy and Algoma's patented AWC process for heat treating rails will permit Algoma to provide North American railway customers with a full range of rail products, including head-hardened premium rails. The commitment to proceed with these projects should result in increased rail sales in 1987 and beyond.

The 1986 automotive market remained firm, resulting in relatively steady demand for Algoma's sheet and strip products. The steel supply agreement with Ferrum Inc. (formerly Sonco Steel Tube) continued to provide an advantageous base load for sheet and strip production. Algoma intends to exercise its option to take a 50-per-cent ownership interest in Ferrum in order to continue the supply relationship.

Algoma's Finished Steel Product Shipments By Product Classification

	1986	1985
Plate & Sheet	**69%**	64%
Structural Shapes	**16%**	17%
Seamless Tubulars & Skelp	**11%**	14%
Rails and Fastenings	**4%**	5%
Total	**100%**	100%

The demand for Algoma's plate products remained at a low level in 1986. This was a result of foreign competition and weak markets in the key sectors of shipbuilding, rail cars and heavy equipment. The Corporation successfully penetrated new markets for its quenched-and-tempered plate products and continued with the development of other high-strength steels. Algoma's concentration on this value-added segment of the plate market will continue in 1987.

Market demand for structural products remained at about 1985 levels. Foreign competition depressed domestic prices and limited Algoma's ability to penetrate export

Our marketing direction is higher-valued products and superior quality and customer service.

Algoma's future marketing direction has been clearly set. We will search out the market opportunities that can be best served by Algoma. We will continue to strive to further improve the quality of our products and the service we provide to our customers.

Additional sales of higher-value-added products will increase the average sales return per ton shipped for all product lines.

markets. The Corporation is preparing to file an unfair trade complaint against one or more foreign producers in 1987.

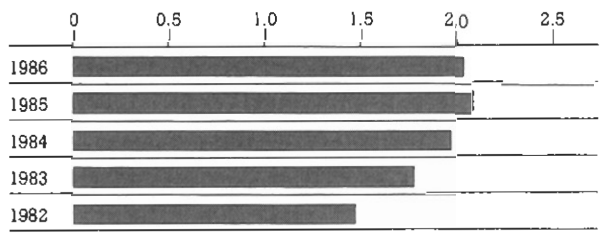
Protectionist sentiment in the U.S. continued to grow in 1986. During the year the U.S. Department of Commerce imposed a dumping duty on Canadian shipments of oil-country tubulars. The Corporation disputes the appropriateness of the U.S. action in respect of seamless products and has filed an appeal of the finding. Algoma will continue its policy of acting as a fair and responsible supplier to U.S. customers and working with all levels of government to maintain access to this essential market.

The requirement for permits on all steel products entering Canada, instituted in 1986, was a positive step by the Canadian government in the defence against unfairly traded imports. The permits provide for quicker recognition of, and reaction against, unfairly traded imports. In response to an Algoma complaint, in late 1986 the Government of Canada accepted a price undertaking on seamless tubular products imported from Japan. This undertaking will ensure that future Japanese tubular goods entering Canada will be fairly priced.

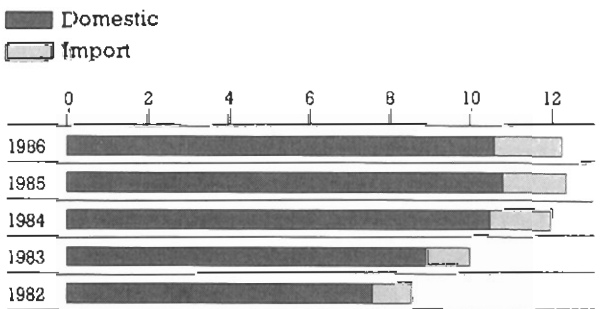
Through Statistical Process Control, greater union and management employee involvement, an internal "customer-awareness" program, upgraded facilities and improved process capability, Algoma's quality and service reputation in the market-place improved in 1986.

Algoma's future marketing direction has been clearly set. Product quality and customer service will be further improved and the average sales return per ton shipped for all product lines will be increased through additional sales of higher-value-added products.

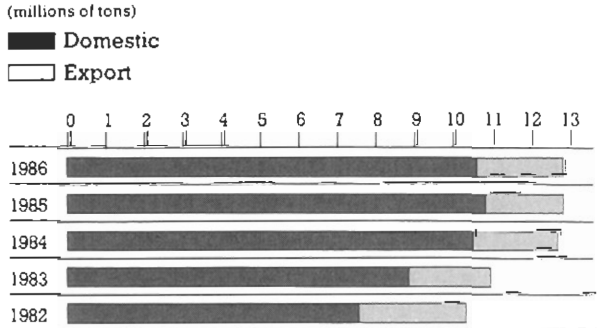
ALGOMA'S STEEL PRODUCT SHIPMENTS
(millions of tons)



CANADIAN STEEL CONSUMPTION
(millions of tons)



CANADIAN STEEL MILL SHIPMENTS
(millions of tons)



Continuous casting of blooms for rail, tubular and structural products.

ALGOMA

REVIEW OF OPERATIONS

To be successful, Algoma's pursuit of lower operating costs and higher product quality must be relentless. A clear direction towards these goals was laid down in 1986 by Algoma's Program of Action. Work accomplished in 1986 towards the downsizing of operations, implementation of 100-per-cent continuous casting and other operating and quality improvements will form the foundation for Algoma's future success.

Mining

In 1986, efficiency improvements were attained at both the Algoma Ore Division in Wawa and the Tilden Mine in Michigan. However, the improvements were not sufficient for the delivered iron ore costs to be competitive with the delivered cost of iron ore from readily available alternate North American sources. Algoma's Program of Action requires the Algoma Ore Division and Tilden to become competitive or face shutdown.

Planned 1987 reductions in product costs must be achieved to justify continued operation of Algoma Ore Division. At Tilden, the high fixed costs must be reduced if it is to be a survivor in the fiercely competitive North American iron ore industry.

Algoma's U.S. subsidiary, Cannelton Industries, Inc., continued cost and quality improvements at its coal mines in West Virginia. Cannelton's steam-coal sales were at a record two million tons in 1986 and discussions are underway to further expand this profitable business.

Manufacturing

The slight decline in 1986 steel shipments and a planned inventory reduction program led to lower operating levels in cokemaking, ironmaking and steelmaking. Difficulties with the bosh on the Steelworks' largest blast furnace required down periods for repairs at various times during the year. However, by year-end the condition had stabilized. A new bosh of superior design will be available early in 1987 if required.

Seventy-two per cent (1.7 million tons) of Algoma's raw steel production was continuously cast in 1986. Through increased and more efficient use of the casting process improvements were obtained in production rates, yields and quality. To achieve Algoma's 1987 goal of 100-per-cent continuous casting with related cost and quality benefits, modifications are underway to increase the productivity of the slab caster. Engineering is proceeding for conversion of the bloom caster to also cast rounds and for the installation of ladle metallurgy in the No. 1 steelmaking shop.

Improvements obtained in the Corporation's rolling mills in 1986 included increases in operating efficiency and a significant improvement in the prime yield of finished product recovered per ton of raw steel rolled.

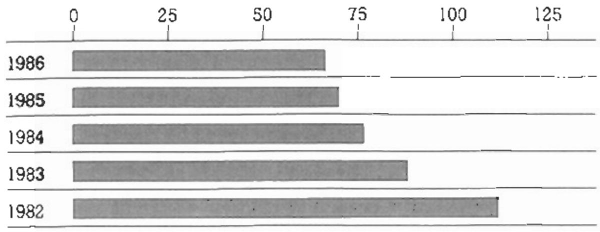
During the year, substantial changes were made to operating facilities. The installation of automatic gauge control on the 106-inch strip mill began in 1986 and is expected to be fully operational by mid 1987. This technological advancement will provide for greater dimensional control on hot-rolled sheet products. Modifications to the rail mill and the construction of new rail-mill finishing facilities, completed in 1986, provided for production of roller-straightened, magnetic-particle and ultrasonically tested, precisely end-finished 25-metre rails. Engineering is underway to install in-line head-hardening equipment using

Continuous casting brings gains in cost and quality.

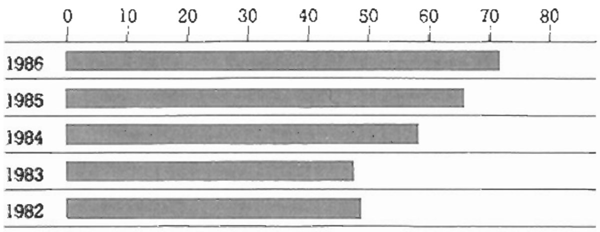
Since 1967 Algoma Steel has been a front-runner in continuous casting. Casting capacity has been steadily expanded to include blooms, beam blanks and slabs for the production of rails, tubulars, structurals and flat-rolled products.

The percentage of raw steel continuously cast reached 72 per cent in 1986 and will soon be 100 per cent.

INDEX OF MAN-HOURS PER TON OF FINISHED STEEL PRODUCT
1972 100



PERCENTAGE OF RAW STEEL CONTINUOUSLY CAST



Algoma's own patented technology. This will permit the Corporation to compete in the growing North American premium-rail market which is now supplied by offshore producers.

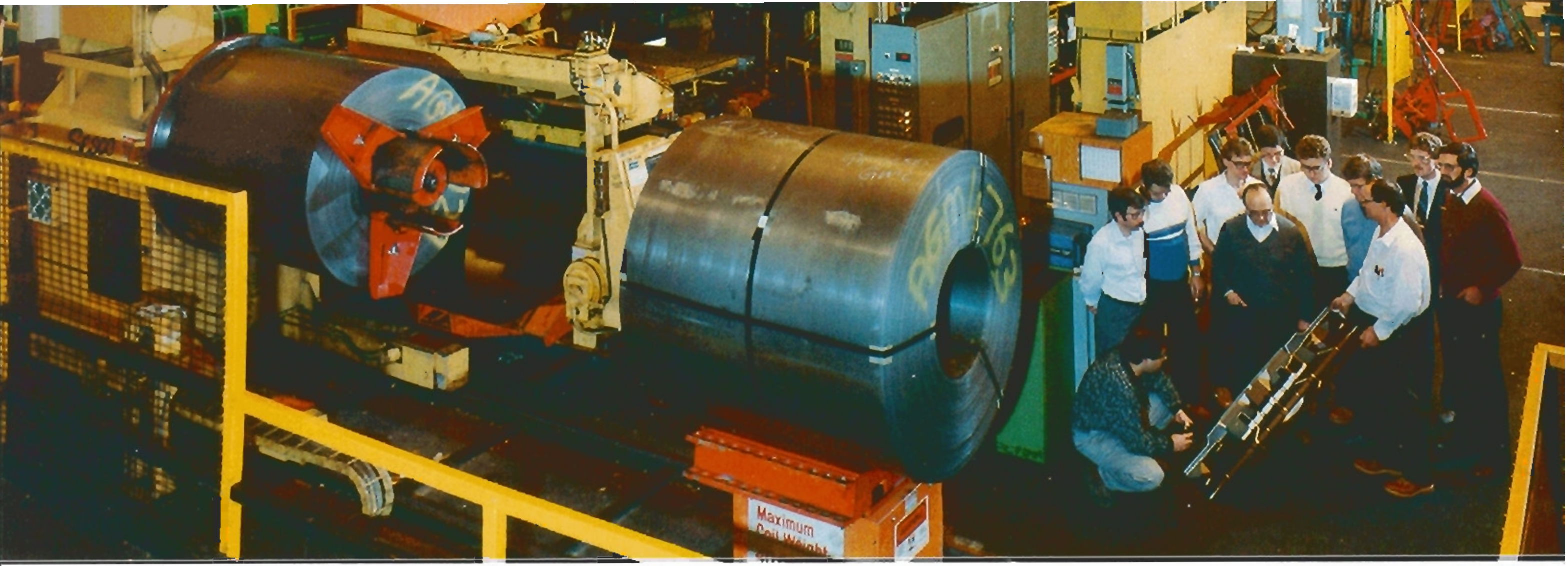
Construction of the new No. 2 tube mill was completed successfully. This computer-controlled world-class facility began trial rollings in December and is scheduled to be fully operational during 1987. Production and quality results to date have exceeded expectations.

The Corporation's technical and computer-based groups have been instrumental in the development and successful implementation of manufacturing facility improvements. They will continue to play a vital role in the planning and implementation of the facility improvements set out in the Program of Action.

Good progress was made in 1986 in the ongoing implementation of Statistical Process Control (SPC). The 70 SPC teams which are now operational made valuable contributions in the areas of process measurement and control, quality improvement and cost reduction.

Algoma's Joint Management and Union Health & Safety Committee continued to function effectively in a difficult period of downsizing and force reduction. Although the accident frequency rate decreased at manufacturing operations by 13 per cent, the number of days lost per accident increased dramatically. This is of concern to both management and union health and safety representatives and actions to reverse the trend are being considered. Pains and strains accounted for 73 per cent of lost-time accidents.

Environmental expenditures in 1986 totalled $4.4 million which included funds for the completion of pushing-emission control on Algoma's No. 8 and No. 9 coke oven batteries. New control orders were negotiated with the Ministry of the Environment for both the Steelworks in Sault Ste. Marie and the Ore Division in Wawa.



A union-management Employee Involvement Group visits a major automotive plant to learn first-hand from customers.

EMPLOYEE RELATIONS

The Program of Action announced in April 1986 called for a reduction in the labour cost per ton for each of Algoma's steel products. The savings were to be achieved through a combination of decreases in the work-force and lower union and management unit-employment costs.

Wage-and-benefit reductions ranging from 18 per cent at the top end of the salary scale to eight per cent at the low end were introduced for salaried employees effective June 1, 1986. The Corporation also approached its unions with a request to revise the collective agreements by introducing similar reductions. The various union locals rejected a request to reopen the labour agreements which expire on July 31, 1987. However, at the request of the United Steelworkers of America, the Corporation co-operated in a study of Algoma's financial affairs by Union consultants. The recently completed study has confirmed that the Corporation has been correctly representing its financial affairs in its communications with employees.

The early resolution of new collective agreements is necessary to avoid market-share losses. It is vital that labour agreements ratified by hourly workers in 1987 reflect market conditions and the Corporation's difficult financial position.

A 16-per-cent reduction in Algoma's Canadian work-force occurred in 1986 and additional reductions are expected in 1987 with the elimination of ingot production. Algoma has attempted to alleviate the hardship associated with job losses through retirement incentives and the formation of three Committees of Adjustment for laid-off employees. These committees, composed of both management and union personnel, assess the needs of displaced workers and, with government assistance, direct them towards retraining, relocation, alternate employment and other available programs.

Efforts in 1986 to improve employee communications included the formation of a Communications Advisory Committee, initiation of a monthly newspaper, increased use of audio-visual presentations and the holding of several informal shop-floor meetings between either the Chief Executive Officer or the Chief Operating Officer and different employee groups. These efforts will be expanded in 1987 with the objective of achieving two-way communication and mutual understanding of the difficult problems faced by Algoma and its employees.

Employee participation increased in 1986. Various Employee Involvement Groups were formed throughout the Steelworks. These groups, comprised of both salary and union workers, successfully introduced several programs which contributed to improved quality, cost reduction and better management and worker understanding.

The year 1987 will be critical for the Corporation and all those who depend on it. To ensure future prosperity Algoma and its employees together must find a fair method to reduce employment costs and make greater use of the talents, skills and experience of the entire work-force.

Major Employment Cost Elements
(millions of dollars)

	1986	1985
Wages and Salaries		
For time worked	**$271**	$292
For vacation and statutory holidays	**44**	49
Benefits		
Company pension plans	**30**	35
Workers' compensation	**13**	14
Unemployment insurance	**7**	7
Group insurance plans and other benefits	**36**	35
	$401	$432

We are making greater use of the talents, skills and experience of the entire work-force.

Participation by Algoma Steel employees increased dramatically in 1986. Throughout the Corporation, groups made up of both salary and hourly workers, introduced numerous programs which improved quality, reduced costs and lead to better management and worker understanding. The future security of all employees depends on a return to profitability.

FINANCE

The 1986 loss before extraordinary items of $54 million ($10 million in 1985) was a reversal of the improving trend of the previous two years. After extraordinary items, amounting to $81 million, the net loss was $135 million. This compares with a net loss of $3 million in 1985 after an extraordinary gain of $7 million.

The 1986 extraordinary items, net of taxes, consisted of a $115-million write-down of fixed assets, a $24-million write-down of the Corporation's equity interest in AMCA International Limited and a $58-million gain on the sale of the 34.5-per-cent equity interest in AMCA to Canadian Pacific Limited.

The loss applicable to common shareholders, before extraordinary items but after deducting a $16-million provision for the payment of dividends on preferred shares, was $4.65 per share compared with $1.77 per share in 1985. The extraordinary items increased the loss to $10.07 per share.

Pretax Earnings (Loss) by Quarter Year
(millions of dollars)

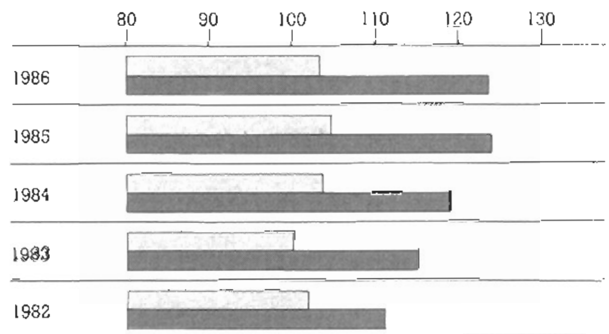
Quarter	1986	1985
1	$(17.0)	$ .7
2	(15.4)	(2.7)
3	(27.1)	(9.6)
4	(12.6)	(5.8)
Year	$(72.1)	$(17.4)

The quarterly pretax loss from integrated steel operations increased sharply in the first quarter of 1986 and remained at a high level in subsequent quarters, due principally to the impact of low world-oil prices on Algoma's seamless tubular business. Although the depressed tubular business was the largest contributor to the Corporation's poor performance in 1986, lower rail shipments and an unfavourable product mix with lower average sales returns also contributed to the loss.

SALES RETURN INDEX COMPARED WITH COMBINED LABOUR, MATERIALS & SERVICE PRICE INDEX
1981 100

Sales Return Index (Including offshore sales and adjusted to a common mix of finished products)

Combined Labour, Materials and Service Price Index

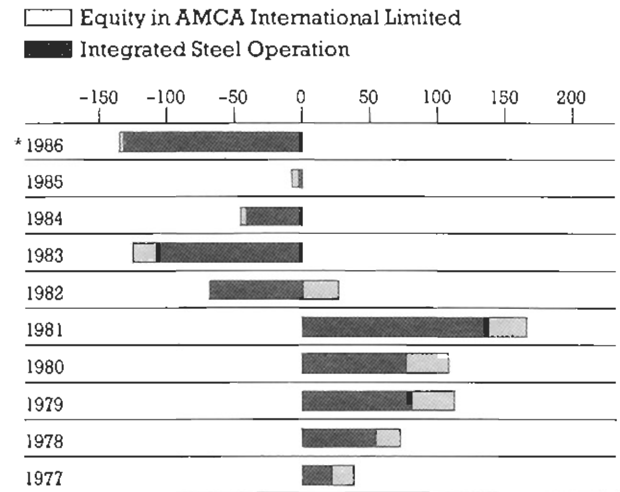


The Corporation's comprehensive Program of Action includes plans and objectives for improvements in costs. It is expected that upon full implementation of the Program annual cost savings of more than $100 million will be achieved.

A strong emphasis has been placed on Algoma's cash management during the last several years and 1986 was no exception. The Corporation continued to benefit from The Superior Limited Partnership arrangement which will provide virtually all the cash to finance the $170-million completion of the No. 2 seamless tube mill. During the second quarter the interest-rate swap arrangement with regard to the U.S. $100-million Series M debenture was renegotiated resulting in an estimated $3-million annual saving in interest cost for the period November 1987 to November 1990. On August 11, 1986 the Corporation sold its 34.5-per-cent equity interest in AMCA for $193 million. The proceeds were used to reduce long term debt and fund capital expenditures.

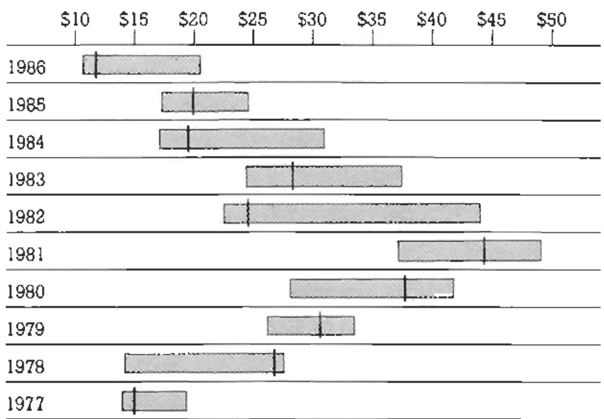
Agreement was reached to convert the tube mill financing arrangement from a term loan to a revolving line of credit and to establish the maximum commitment under the line at $325 million (formerly $250 million in Canadian or U.S. funds) which will decline over time. The revolving nature of the new arrangement will reduce financing costs.

NET EARNINGS (LOSS)
(millions of dollars)



*Includes $81 million extraordinary loss

COMMON SHARE PRICE RANGE
(| closing price)



Common Share Price Range for 1986
(dollars)

Quarter	High	Low
1	$20-1/2	$16-1/2
2	19-1/4	14-3/4
3	15	12-1/2
4	15	10-3/4

In December 1986, the Corporation sold two million common shares with associated share-purchase tax credits for proceeds of $29 million ($14.43 per share). The structure of the issue did not allow for participation by Canadian Pacific Limited and as a result its equity shareholding in Algoma fell to 54 per cent at December 31, 1986 (61 per cent at year-end 1985).

Algoma's cash flow from operations, before changes in operating working capital, was $47 million compared with $136 million in 1985, $83 million in 1984 and a deficit of $44 million in 1983. A reduction in operating working capital (primarily steel inventories) contributed $67 million of cash in 1986.

The $115-million provision for write-down of assets reflects reductions in the recorded values of certain iron ore and coal assets and of some existing or partially completed facilities at the Steelworks. The write-down of Steelworks' assets relates to facilities which will be shut down or diminished in value as a result of the decision to downsize operations and continuously cast 100 per cent of raw steel production.

At December 31, 1986, estimated expenditures to complete projects authorized by the Board of Directors and committed by the Corporation were $20 million. A further $25 million of expenditures were authorized but not yet committed.

Long term debt of $501 million at December 31, 1986 was $168 million lower than the previous year-end and represented 43 per cent of total capitalization (45 per cent in 1985). Although the Corporation has substantial unused lines of credit in place, its objective is to fund additional capital expenditures from operating cash flow. This will only be possible if the planned improvements in earnings from the Program of Action are achieved.

The Corporation is required to invite tenders for the purchase of all outstanding Series C preference shares (in May 1987) and Series D preference shares (in December 1987) in the aggregate amount of $80 million. At present, the Corporation's plans are to use existing lines of credit to meet these obligations.

Dividends paid to preference shareholders during 1986 amounted to $16 million. A common-share stock dividend equivalent to $0.30 per common share was issued in the fourth quarter.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The consolidated financial statements of The Algoma Steel Corporation, Limited have been prepared in accordance with generally accepted accounting principles and necessarily include some amounts based upon management's estimates and judgments. Algoma's management is responsible to ensure that these statements reasonably reflect the Corporation's business transactions and financial position.

The integrity and reliability of Algoma's reporting systems are achieved through the use of formal policies and procedures, the careful selection of employees and an appropriate division of responsibilities. Internal accounting controls are continually monitored by an internal audit staff through ongoing reviews and comprehensive audit programs. Algoma's Code of Business Conduct policy, which is regularly communicated throughout the organization, requires employees to maintain high ethical standards in their conduct of the Corporation's affairs.

Peat, Marwick, Mitchell & Co., Chartered Accountants, the shareholders' auditors, have performed an independent examination and have attested to the fairness of presentation of financial data contained in these statements. Their examination was made in accordance with generally accepted auditing standards and accordingly included an evaluation of the Corporation's system of internal control to determine audit scope and such tests of the accounting systems and records and other audit procedures as they deemed necessary. Their report appears below.

The Board of Directors annually appoints an Audit Committee comprised of directors the majority of whom are neither employees of the Corporation nor of companies related to the Corporation. This Committee meets regularly with management, the internal auditor and the shareholders' auditors to review significant accounting, reporting and internal control matters. Both the internal and shareholders' auditors have unrestricted access to the Audit Committee. Following its review of the financial statements and discussions with the shareholders' auditors, the Audit Committee reports to the Board of Directors prior to its approval of the financial statements.

Chairman and Chief
Executive Officer

Vice President –
Finance and Accounting

February 13, 1987

PEAT
MARWICK

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated statement of financial position of The Algoma Steel Corporation, Limited as at December 31, 1986 and the consolidated statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

Chartered Accountants

Sault Ste. Marie, Canada
February 13, 1987

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of all subsidiary companies and The Superior Limited Partnership. Inter-company transactions are eliminated. The investments in AMCA International Limited and the Tilden Mining Company (a joint venture) are included in long term investments. AMCA is an associated company and its earnings (to date of sale in August 1986) are accounted for by the equity method. The Tilden Mining Company is a cost sharing joint venture producing iron ore pellets for use by the Corporation, and accordingly, costs associated with this operation are included with cost of sales in the statement of Earnings.

Translation of Foreign Currencies

The financial statements of foreign subsidiaries and the joint venture and foreign currency denominated balances of domestic operations are translated using year-end closing exchange rates for cash and short term investments, accounts receivable, current liabilities, long term debt and accrued past service pension cost. Historic exchange rates are used to translate inventories, prepaid expenses, fixed assets and deferred income taxes. Exchange rates in effect at the date of transaction are used to translate revenues and expenses, other than depreciation and amortization which are translated using the same historic rates applied in the translation of the related assets.

Exchange gains and losses on translation of long term debt are deferred and amortized to earnings over the remaining life of the debt. Exchange gains and losses from the translation of other balances together with gains and losses on transactions are included in the statement of Earnings.

The financial position of the associated company, a self-sustaining entity, is translated using year-end closing exchange rates and revenues and expenses are translated using exchange rates in effect at the date of transaction.

Inventories

Finished products and work in process are valued at the lower of cost and net realizable value. Raw materials and supplies are valued at the lower of cost and replacement cost.

Fixed Assets

Property, plant and equipment are recorded at cost. Expenditures for improvements and renewals which extend economic life and for mine development are capitalized. Maintenance and repairs are charged to earnings as incurred excepting expenditures for periodic relines of blast furnaces which are accrued for in advance on a unit of production basis. The provision for such expenditures is included with net fixed assets.

Depreciation of manufacturing plant and equipment, which comprises over 80 per cent of fixed assets, is provided using the straight-line method applied to the cost of the assets based on their estimated useful composite life of approximately 20 years commencing with commercial operation.

Plant and equipment at raw material properties and mine development costs are either depreciated using the straight-line method at rates intended to amortize the cost of these assets over their estimated economic lives or amortized on a unit of production basis over the estimated recoverable raw material reserves.

Interest incurred on funds borrowed to directly finance the development of new raw material properties and the construction of new manufacturing facilities is capitalized during the period of construction and initial development.

Exploration, Research and Start-Up Expenses

Expenses in exploring for raw materials, investigating and holding raw material properties and costs of research and start-up of new production facilities are charged to earnings as incurred.

Income Taxes

Income taxes are provided for on the deferred tax allocation basis. Since regulations in Canada and the United States permit the deduction of expenses in calculating taxable income which may not coincide with amounts recorded for financial reporting purposes, such differences, principally relating to depreciation, give rise to deferred income taxes in the financial statements.

Investment tax credits on qualifying expenditures for production facilities and for research are deducted from such costs provided there is reasonable assurance that the credits will be realized.

EARNINGS AND RETAINED EARNINGS

For the years ended December 31

Thousands of Dollars	1986	1985
Sales	**$1,093,342**	$1,176,694
Expenses		
Cost of sales	**1,048,985**	1,070,472
Depreciation and amortization	**53,520**	54,120
	1,102,505	1,124,592
Earnings (loss) from operations	**(9,163)**	52,102
Financial Expense (Income)		
Interest expense (note 2)	**52,617**	54,453
Interest and other income	**(2,709)**	(1,737)
Exchange loss on foreign currencies	**13,057**	16,747
	62,965	69,463
Earnings (loss) before income taxes and equity earnings	**(72,128)**	(17,361)
Income taxes – deferred (credit) (note 3)	**(21,137)**	(10,258)
Earnings (loss) before equity earnings	**(50,991)**	(7,103)
Equity in earnings (loss) of associated company	**(2,474)**	(2,692)
Earnings (loss) before extraordinary items	**(53,465)**	(9,795)
Extraordinary gains (losses) (note 4)	**(81,380)**	6,820
Net earnings (loss)	**$ (134,845)**	$ (2,975)
Provision for dividends on preference shares	**$ 16,368**	$ 16,746
Net earnings (loss) applicable to common shares	**$ (151,213)**	$ (19,721)
Per common share		
Earnings (loss) before extraordinary items	**$ (4.65)**	$ (1.77)*
Net earnings (loss) applicable to common shares	**$ (10.07)**	$ (1.32)*

*Restated to reflect shares issued as stock dividend in December 1986

Retained Earnings	1986	1985
Balance at beginning of year as restated (note 1)	**$ 482,371**	$ 506,528
Net earnings (loss)	**(134,845)**	(2,975)
Dividends declared (note 13)	**(20,798)**	(21,182)
Expenses relating to issue of common shares, net of income taxes of $493	**(615)**	—
Balance at end of year	**$ 326,113**	$ 482,371

See summary of significant accounting policies and notes to consolidated financial statements.

FINANCIAL POSITION

As at December 31

Thousands of Dollars	1986	1985
Current Assets		
Cash	$ 14,074	$ —
Accounts receivable	202,687	202,666
Inventories (note 5)	297,895	378,730
Prepaid expenses	4,656	4,411
	519,312	585,807
Current Liabilities		
Bank overdraft	—	3,068
Accounts payable and accrued liabilities	193,405	208,312
Taxes payable	13,572	12,491
Long term debt due within one year	20,060	10,329
	227,037	234,200
Working Capital		
Current assets less current liabilities	292,275	351,607
Other Assets		
Long term investments (note 6)	64,723	194,295
Net fixed assets (note 7)	877,015	967,789
Unamortized exchange loss on foreign currencies	21,370	33,659
Unamortized debenture expense	2,263	2,598
	965,371	1,198,341
Total Investment		
Working capital plus other assets	1,257,646	1,549,948
Other Liabilities		
Long term debt (note 8)	481,368	659,475
Accrued pension cost	33,060	30,096
Deferred income taxes (note 1)	72,572	57,674
	587,000	747,245
Excess of total investment over other liabilities	$ 670,646	$ 802,703
Commitments (notes 9, 10 and 11)		
Shareholders' Equity		
Capital stock (note 12)		
Preference shares	$ 215,440	$ 218,483
Common shares	129,093	101,849
Retained earnings	326,113	482,371
	$ 670,646	$ 802,703

See summary of significant accounting policies and notes to consolidated financial statements.

On behalf of the Board:

J. Macnamara
Director

A. H. Mingay
Director

CHANGES IN FINANCIAL POSITION

For the years ended December 31

Thousands of Dollars	1986	1985
Cash Provided From (Used For)		
Operations		
Earnings (loss) from operations	$ (9,163)	$ 52,102
Items included in earnings not resulting in an outlay of cash	56,071	84,032
Decrease (increase) in operating working capital	66,743	(33,727)
	113,651	102,407
Investment Activities		
Fixed assets – manufacturing plants	(120,985)	(128,782)
– raw material properties	(9,641)	(14,401)
	(130,626)	(143,183)
Long term investments	(13,371)	(14,910)
Proceeds from sale of investment in associated company	193,411	—
Interest and other income	2,709	1,737
	52,123	(156,356)
Financing Activities		
Interest on debt	(52,283)	(54,119)
Dividends	(16,420)	(16,854)
Reduction of long term debt	(162,840)	(9,016)
Preference shares purchased for cancellation	(3,043)	(1,125)
Other	(6,081)	(465)
Additional financing		
Proceeds from issue of common shares	21,758	—
Funds received for seamless tube mill construction	70,277	55,081
Proceeds from long term loans	—	76,547
	(148,632)	50,049
Cash (Loan) Position		
Increase (decrease) during year	17,142	(3,900)
Balance at beginning of year	(3,068)	832
Balance at end of year	$ 14,074	$ (3,068)
Changes In Operating Working Capital		
Decrease (increase) in accounts receivable	$ (21)	$ (23,117)
Decrease (increase) in inventories	80,835	(29,431)
Decrease (increase) in prepaid expenses	(245)	1,362
Increase (decrease) in accounts payable and accrued liabilities	(14,907)	13,284
Increase (decrease) in taxes payable	1,081	4,175
Decrease (increase) in operating working capital	$ 66,743	$ (33,727)

See summary of significant accounting policies and notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Restatement of Prior Years' Earnings

The provision for deferred income taxes relating to years prior to 1983 have been increased by $5.8 million as a result of a reassessment by Revenue Canada in 1986. Accordingly, deferred income taxes in the 1985 statement of Financial Position have been increased and retained earnings decreased by a corresponding amount.

2. Interest Expense

Thousands of Dollars	1986	1985
Interest and expense on long term debt	$ 70,759	$ 66,840
Other interest	578	1,066
Interest capitalized on loans for seamless tube mill construction	(18,720)	(13,453)
	$ 52,617	$ 54,453

3. Income Taxes

The effective income tax rate for the Corporation differs from the composite income tax rate of the various taxing jurisdictions in which it operates. A reconciliation between these rates follows:

	1986	1985
Composite income tax rate	(50.6)%	(52.3)%
Increase (decrease) resulting from:		
Operating losses of United States subsidiaries not tax effected	12.8	—
Certain exchange losses on foreign currency not tax effected	4.7	29.3
Interest expense on income debentures	4.6	20.6
Manufacturing and processing allowance	4.0	4.7
Federal and provincial resource allowances	(4.0)	(34.2)
Inventory allowance	(0.6)	(20.0)
Other	(0.2)	(7.2)
Effective income tax rate	(29.3)%	(59.1)%

4. Extraordinary Gains (Losses)

Thousands of Dollars	1986	1985
Provision for write-down of assets and restructuring of operations (net of income tax credit of $59,400)	$ (115,000)*	$ —
Loss from restructuring of operations by associated company	(24,000)	—
Gain on sale of investment in associated company (net of income taxes of $25,600)	57,620	—
Reduction in income taxes from application of prior years' losses	—	6,820
	$ (81,380)	$ 6,820

* The Corporation has initiated a plan to reduce steelmaking capacity and restructure its facilities to enable the production of all raw steel by the continuous casting method in 1987. Accordingly, certain Steelworks facilities, which are considered to be redundant or diminished in value, have been written-down. In addition, write-downs were recorded at several of the Corporation's raw material properties because the forecast long term prices for iron ore and metallurgical coal are not adequate to provide for a recovery of the capital investment in these properties.

5. Inventories

Thousands of Dollars	1986	1985
Finished products	$ 77,694	$ 108,494
Work in process	66,178	92,946
Raw materials and supplies	154,023	177,290
	$ 297,895	$ 378,730

6. Long Term Investments

Thousands of Dollars	1986	1985
Associated company	$ —	$ 136,619
Joint Venture	50,591	49,951
Other	14,132	7,725
	$ 64,723	$ 194,295

7. Net Fixed Assets

Thousands of Dollars	1986	1985
Property, plant and equipment		
Manufacturing plants	$1,566,023	$1,500,691
Raw material properties	239,432	238,918
	1,805,455*	1,739,609
Accumulated depreciation and amortization, and provision for blast furnace relines	928,440**	771,820
	$ 877,015	$ 967,789

* Includes construction in progress of approximately $384 million.
** Includes $104 million respecting a write-down of manufacturing and mining assets still in use.

8. Long Term Debt

Thousands of Dollars	1986	1985
Debentures (a)		
$7^{3}/_{8}$% series C maturing 1987	$ 12,000	$ 12,000
$8^{3}/_{4}$% series D maturing 1991	20,727	22,322
$10^{3}/_{8}$% series E maturing 1994	31,072	32,000
11 % series F maturing 1995	45,300	49,310
$17^{3}/_{8}$% series L maturing 1997	46,600	50,000
Floating rate series G maturing 1999 (b)	60,000	60,000
Floating rate series I maturing 1994 (b)	55,220	55,932
14.27% series M maturing 1990 (c)	138,050	139,830
Floating rate series N maturing 1995 (d)	53,805	181,779
Bank loans	—	14,682
Short term promissory notes	—	10,000
9.65% note maturing 2000 (e)	38,654	41,949
Total amount outstanding	501,428	669,804
Less due within one year	20,060	10,329
	$ 481,368	$ 659,475

Sinking fund and other repayment requirements for each of the next five years, commencing in 1987, are (in millions of dollars) $20.1, $22.4, $29.3, $160.4 and $28.5.

(a) The debentures rank pari passu and are secured by a Trust Indenture containing a first floating charge on all assets of the Corporation in Ontario.

(b) Series G are income debentures and bear non-taxable interest at $1^{1}/_{8}$% over one-half of the prime lending rate of a Canadian chartered bank. The Corporation is permitted to convert this obligation into series H debentures bearing taxable interest which varies from $^{1}/_{4}$% to $^{3}/_{4}$% over the prime lending rate of the bank.

Series I are income debentures in the principal amount of U.S. $40 million and bear non-taxable interest which varies from $1^{1}/_{4}$% to $1^{1}/_{2}$% over one-half of the London Interbank Offering Rate (LIBOR) or, at the option of the Corporation, from 1% to $1^{1}/_{4}$% over one-half of the prime lending rate of a Canadian chartered bank on United States dollar demand loans to commercial customers resident in Canada. The debentures are convertible, at the option of the Corporation, into a Canadian currency obligation bearing interest which varies from 1% to $1^{1}/_{4}$% over one-half of the prime lending rate of the bank. The Corporation is permitted to convert this obligation into series J debentures bearing taxable interest at various rates and, at the option of the Corporation, may be in either United States or Canadian currency. A United States currency loan would bear interest which varies from $^{3}/_{4}$% to 1% over LIBOR or, at the option of the Corporation, from .30% to .55% over the prime lending rate of the bank on United States dollar demand loans to commercial customers resident in Canada. A Canadian currency loan would bear interest which varies from .30% to .55% over the prime lending rate of the bank.

(c) Series M debentures in the principal amount of U.S. $100 million bear interest based on the London Interbank Offering Rate. Concurrent with this borrowing, the Corporation entered into an Exchange Agreement with a foreign financial institution thus enabling the Corporation to convert its floating rate liability into an effective annualized fixed rate obligation of 14.27%. During 1986 the terms of the Exchange Agreement were renegotiated resulting in a decrease in the effective interest rate to 11.71% commencing November 20, 1987. The debentures mature in November 1990 and the Corporation's original prepayment privileges have been eliminated under the revised terms of the Agreement.

(d) An agreement with three Canadian chartered banks respecting the financing of construction of a new seamless tube mill was renegotiated in 1986. The new arrangements provide a revolving line of credit aggregating $325 million in Canadian or equivalent United States funds. Commencing December 31, 1987 the maximum borrowing available declines annually until maturity at December 31, 1995. Loans under this line of credit total $53.8 million consisting of bank loans of U.S. $10.0 million bearing interest at 1/2% over the London Interbank Offering Rate and $40.0 million bankers acceptances.

(e) The 9.65% note, in the principal amount of U.S. $28 million, is an obligation of a United States subsidiary and is repayable in annual instalments of U.S. $2 million.

9. Commitments

(a) The Corporation, as a participant in the Tilden Mining Company joint venture, is entitled to receive its 30% share of production and is committed to pay its share of costs including minimum charges for utilities, and principal and interest to cover the servicing of long term debt. The Corporation's share of such minimum charges was $31.5 million in 1986 and will average approximately $26.7 million annually during the next five years. The Corporation's share of long term debt at December 31, 1986 was $112.3 million (U.S. $81.3 million).

(b) The estimated amount required to complete approved capital projects is $45 million which includes $21 million for the new seamless tube mill. At December 31, 1986 contractual commitments amount to $20 million in respect of these projects.

10. Long Term Leases

Rentals under long term leases amounted to $10.4 million in 1986. Future minimum rentals will aggregate $48.6 million and in each of the next five years will be (in millions of dollars) $7.7, $7.3, $6.0, $5.5 and $5.0. These rentals are payable principally under leases of steel processing plant and equipment which contain options to purchase and under leases of raw material properties.

11. Pensions

The unfunded liability for pensions in respect of past service is $129 million, as estimated by independent actuaries, of which $31.3 million is accrued and recorded in the statement of Financial Position. It is expected that planned payments will discharge this liability by the year 2000. Pension costs charged to earnings were $29.7 million in 1986 ($35.1 million in 1985).

12. Capital Stock

(a) Preference shares

Authorized – 7,217,600 Preference Shares, which rank prior to Class B Preference Shares and are issuable in series, of which 1,617,600 shares are reserved for conversion of series A shares into series B shares.

– 12,000,000 Class B Preference Shares, issuable in series.

Thousands of Dollars	**1986**	**1986**	1985
Issued at December 31	**Number of Shares**	**Stated Capital**	
Preference Shares			
8% cumulative redeemable tax deferred series A	**1,617,600**	**$ 40,440**	$ 43,483
Floating rate cumulative redeemable retractable series C	**2,000,000**	**50,000**	50,000
Floating rate cumulative redeemable retractable series D	**1,200,000**	**30,000**	30,000
Class B Preference Shares			
$2.00 cumulative redeemable convertible series 1	**3,800,000**	**95,000**	95,000
		$ 215,440	$ 218,483

Series A shares are entitled to annual dividends of $2.00 per share payable quarterly; commencing with the quarterly payment December 1, 1988, dividends received on that and future quarterly dates will be taxable. They are redeemable at the option of the Corporation at $25.00 per share and are exchangeable after September 1, 1988 on a share for share basis at the option of the holder into 9 3/4% cumulative redeemable Preference Shares series B on which dividends will be taxable. The Corporation is obligated to purchase in each twelve month period ending May 31 up to 120,000 series A or B shares to the extent that they are available at market prices not exceeding $25.00 per share. The Corporation purchased for cancellation 121,700 series A shares in 1986 at prices averaging $19.01 per share.

Series C shares are entitled to quarterly dividends at a rate equal to 1 1/2% over one-half of the mean prime lending rate of five Canadian chartered banks. They are redeemable at the option of the Corporation at $25.00 per share. The shares have a retractable feature which required the Corporation to invite tenders, in December 1986, for the purchase of all such shares and to purchase at May 31, 1987 at $25.00 per share plus accrued and unpaid dividends all shares deposited with the Corporation pursuant to the invitation. Not less than 45 days prior to May 31, 1987 the Corporation is permitted to offer an increased dividend rate or to create additional retraction privileges for the benefit of shares not so purchased.

Series D shares are similar to series C except that they are entitled to quarterly dividends at a rate equal to 1 3/8% over one-half of the mean prime lending rate of five Canadian chartered banks. The Corporation is similarly required to invite tenders in July 1987 for the purchase of these shares and to purchase shares so tendered at December 31, 1987.

Class B series 1 shares are entitled to annual dividends of $2.00 per share payable quarterly. Subject to certain conditions, they are redeemable at the option of the Corporation at $25.00 per share and a premium of $1.50 which reduces annually. They are convertible at the option of the holder into .8557 of a common share at any time up to December 1, 1990. Commencing January 1, 1991 the Corporation is obligated to purchase annually 4% of the balance of Class B series 1 shares outstanding at December 2, 1990, to the extent that they are available at market prices not exceeding $25.00 per share.

(b) Common shares
Authorized – 30,186,632 shares of which 3,251,660 are reserved for conversion of Class B preference shares series 1 into common shares.

Thousands of Dollars

Issued	**Number of Shares**	**Stated Capital**
Balance at January 1, 1986	**14,606,206**	$ 101,849
Shares associated with Canadian Exploration Expenses at $18.75 per share (i)	**46,179**	866
Shares associated with sale of tax credits at $11.00 per share (ii)	**2,000,000**	22,000
Shares associated with stock dividend at $11.875 per share	**368,723**	4,378
Balance at December 31, 1986	**17,021,108**	$ 129,093

(i) During 1986 the Corporation issued 46,179 flow-through shares for cash consideration of $1,939,782 in connection with the joint financing of a gold exploration program at its Kremzar property. Of this amount $866,121 has been included in share capital and the remaining $1,073,661 has been applied in reduction of deferred exploration and development expenditures.

(ii) In December the Corporation sold 2,000,000 shares together with certain share-purchase tax credits for cash consideration of $28,852,460. Of this amount $22,000,000 has been included in share capital and the remainder applied in reduction of the cost of plant and equipment additions and research activities.

13. Dividends

Dividends were declared as follows:

Thousands of Dollars	1986	1985
Cash dividends		
Preference Shares		
Series A		
$2.00 per share in 1986 and 1985	$ 3,371	$ 3,502
Series C		
$1.71 per share in 1986 and $1.81 in 1985	3,416	3,615
Series D		
$1.67 per share in 1986 and $1.75 in 1985	2,009	2,094
Class B Preference Shares		
Series 1		
$2.00 per share in 1986 and 1985	7,600	7,600
Common Shares	24*	43*
	16,420	16,854
Stock dividends		
Common Shares		
For each 100 shares held, two and one-half shares equivalent to $.30 per share in 1986, and one and one-half shares equivalent to $.30 in 1985	4,378	4,328
	$ 20,798	$ 21,182

* Cash in lieu of fractional shares arising from stock dividend.

14. Related Party Transactions

The Corporation is a subsidiary of Canadian Pacific Enterprises Limited which at December 31, 1986 held approximately 54% of the Corporation's outstanding common shares. Canadian Pacific Enterprises Limited is a wholly-owned subsidiary of Canadian Pacific Limited, a diversified corporation with its head office in Montreal, Quebec, and consequently the Corporation is related to the numerous companies in the Canadian Pacific group.

The Corporation holds a 30% interest in the Tilden Mining Company and held 34.5% of the common shares of AMCA International Limited, until August 1986, when this investment was sold to Canadian Pacific Limited.

In the normal course of business the Corporation sells its products at prevailing market prices and credit terms to Canadian Pacific Limited and its subsidiary companies. Similarly, the Corporation regularly purchases iron ore pellets, transportation and other services and capital goods from the related parties. The Corporation has a revolving operating line of credit at competitive rates with Canadian Pacific Securities Limited in the amount of $40 million. There were no borrowings under this line at December 31, 1986.

Transactions with related parties and balances at year-end are as follows:

Thousands of Dollars	1986	1985
Transactions during year		
Sales of product	$ 56,027	$ 89,738
Purchases, principally iron ore pellets, transportation and capital goods	95,180	112,840
Interest income from short term investments	950	—
Interest expense on long term debt	1,438	1,416
Funds received for seamless tube mill construction	78,131	60,481
Proceeds from sale of common shares of AMCA International Limited to Canadian Pacific Limited	193,411	—
Balances at December 31		
Accounts receivable	10,146	13,719
Accounts payable	739	2,011
Short term promissory notes	—	10,000

15. Business Segments Information

LINES OF BUSINESS

The Corporation is a vertically integrated steel producer which obtains most of its iron ore and coal requirements from properties which it owns, leases or in which it has an interest in Canada and the United States. The Corporation's revenue is derived almost entirely from the sale of rolled steel products, coal and by-products. Virtually all of the Corporation's assets, except the investment in the associated company, are related to integrated steelmaking activities.

OPERATIONS BY GEOGRAPHIC AREA

Thousands of Dollars	1986	1985	1986	1985	1986	1985
	Consolidated		**Canada**		**United States**	
Sales						
External	**$1,093,342**	$1,176,694	**$ 942,870**	$1,023,054	**$ 150,472**	$ 153,640
Intra-enterprise sales between geographic areas	**183,128**	298,742	**53,536**	98,461	**129,592**	200,281
	1,276,470	1,475,436	**996,406**	1,121,515	**280,064**	353,921
Eliminations	**(183,128)**	(298,742)	**(53,536)**	(98,461)	**(129,592)**	(200,281)
Total	**$1,093,342**	$1,176,694	**$ 942,870**	$1,023,054	**$ 150,472**	$ 153,640
Earnings (loss)						
From operations	**$ (32,010)**	$ 61,544	**$ (21,133)**	$ 25,805	**$ (10,877)**	$ 35,739
Eliminations	**22,847**	(9,442)	**1,435**	2,190	**21,412**	(11,632)
	(9,163)	52,102	**$ (19,698)**	$ 27,995	**$ 10,535**	$ 24,107
Other income	**2,709**	1,737				
Interest expense	**(52,617)**	(54,453)				
Exchange loss on foreign currencies	**(13,057)**	(16,747)				
Income taxes – credit	**21,137**	10,258				
Equity in earnings (loss) of associated company	**(2,474)**	(2,692)				
Earnings (loss) before extraordinary items	**(53,465)**	(9,795)				
Extraordinary items	**(81,380)**	6,820				
Net earnings (loss)	**$ (134,845)**	$ (2,975)				
Assets at December 31						
Identifiable	**$1,484,683**	$1,647,529	**$1,329,604**	$1,469,674	**$ 155,079**	$ 177,855
Investment in associated company	**—**	136,619				
	$1,484,683	$1,784,148				

Intra-enterprise sales between geographic areas are at market prices for similar products. Canadian operations include export sales of approximately $199 million in 1986 ($207 million in 1985).

TEN-YEAR SUMMARY OF OPERATING AND FINANCIAL DATA

Tons in thousands and dollars in millions excepting per share data		1986	1985	1984
Operations				
Production – Iron Ore (1)	G.T.	**2,394**	2,978	2,866
– Coal (2)	N.T.	**3,516**	3,449	2,918
– Coke	N.T.	**1,139**	1,334	1,246
– Iron	N.T.	**2,184**	2,506	2,307
– Raw Steel	N.T.	**2,422**	2,742	2,528
Shipments – Steel Products	N.T.	**2,032**	2,063	1,951
Earnings and Related Statistics				
Sales	$	**1,093.3**	1,176.7	1,104.3
Earnings Before Income Taxes and Equity Earnings	$	**(72.1)**	(17.4)	(61.8)
Income Taxes	$	**(21.1)**	(10.3)	(21.6)
Equity in Earnings of Associated Company	$	**(2.4)**	(2.7)	(5.5)
Net Earnings	$	**(134.8) (12)**	(3.0) (14)	(45.7)
Applicable to Preference Shares	$	**16.4**	16.7	17.2
Applicable to Common Shares	$	**(151.2) (12)**	(19.7) (14)	(62.9)
Dividends Paid in Cash				
On Preference Shares	$	**16.4**	16.8	16.7
On Common Shares	$	**—**	—	—
Earnings Retained in Business	$	**(156.3)**	(24.2)	(66.3)
Cash Provided From Operations	$	**113.7**	102.4	73.6
Per Common Share – Net Earnings (3)(4)	$	**(10.07) (12)**	(1.32) (14)	(4.20)
– Cash Flow From Earnings (3)(4)	$	**6.48**	5.72	3.77
– Dividends Paid in Cash	$	**—**	—	—
Net Earnings as percent of				
– Sales	%	**(12.3)**	(0.3)	(4.1)
– Average Common Shareholders' Equity (5)	%	**(29.1)**	(3.3)	(9.9)
– Average Total Investment (6)	%	**(7.2)**	2.0	(1.4)
Cost of Products Sold as percent of Sales	%	**93.5**	88.8	91.5
Depreciation and Amortization	$	**53.5**	54.1	55.5
Capital Expenditures				
Manufacturing Facilities	$	**121.0**	128.8	12.0
Mining Properties	$	**9.6**	14.4	12.4
Total	$	**130.6**	143.2	24.4
Long Term Debt				
Borrowings – Debentures	$	**—**	—	—
– Other	$	**—**	76.5	36.4
– Total	$	**—**	76.5	36.4
Repayments	$	**162.8**	9.0	22.3
Increase (Decrease) Due to Change in Exchange Rate	$	**(5.5)**	16.5	18.2
Interest and Expense	$	**52.0 (13)**	53.4 (13)	66.8
Financial Position at Year-End				
Current Assets	$	**519.3**	585.8	535.4
Current Liabilities	$	**227.0**	234.2	212.3
Working Capital	$	**292.3**	351.6	323.1
Operating Working Capital (7)	$	**298.3**	365.0	331.3
Long Term Investments	$	**64.7**	194.3	190.5
Net Fixed Assets	$	**877.0**	967.8	895.3
Total Assets	$	**1,484.7**	1,784.1	1,646.8
Total Investment (8)	$	**1,257.7**	1,549.9	1,434.5
Long Term Debt (9)	$	**481.4**	659.5	576.8
Preference Shares	$	**215.4**	218.5	219.6
Common Shareholders' Equity	$	**455.2**	584.2	604.0
Number of Common Shares Issued (000) (10)	No.	**17,021**	14,975	14,975
Common Shareholders' Equity Per Share (11)	$	**26.67**	38.93	40.25
Number of Common Shareholders	No.	**4,415**	4,929	5,188

Notes

(1) Includes mines operated by the Corporation and its share of production from joint ventures.

(2) Metallurgical and steam coal.

(3) After provision for dividends on preference shares.

(4) Based on weighted average number of common shares outstanding during the year restated for stock dividends declared in 1983, 1984, 1985 and 1986.

(5) Net earnings are after deduction of amount applicable to preference shares.

(6) Net earnings are before deduction of interest on long term debt net of income taxes, and total investment is before deduction of long term debt due within one year.

(7) Includes accounts receivable, inventories and prepaid expenses, less accounts payable and accrued liabilities, and taxes payable.

1983	1982	1981	1980	1979	1978	1977
2,424	1,983	3,643	3,732	4,125	4,109	3,839
2,490	2,488	2,732	2,907	2,868	2,069	1,929
1,042	1,009	1,411	1,470	1,546	1,424	1,371
2,155	1,809	2,907	3,039	3,374	3,148	2,848
2,306	1,899	3,017	3,179	3,528	3,317	2,974
1,757	1,472	2,519	2,415	2,597	2,456	2,201
859.5	874.2	1,426.4	1,149.1	1,081.2	864.2	687.8
(186.4)	(123.8)	225.8	121.2	120.2	57.7	5.5
(79.4)	(57.7)	93.4	38.8	35.3	10.7	(15.8)
(19.7)	25.7	26.8	26.8	27.0	22.6	16.0
(126.6)	(40.4)	159.2	109.2	111.9	77.1 (15)	37.3
10.1	12.3	12.8	11.6	10.7	9.5	6.9
(136.8)	(52.7)	146.4	97.6	101.2	67.6 (15)	30.4
10.0	12.5	12.6	11.6	10.6	9.4	6.8
—	14.0	15.4	12.3	8.2	—	2.3
(140.8)	(66.9)	131.2	85.3	93.1	67.7	28.2
(56.7)	59.6	207.2	155.0	154.9	93.0	35.2
(9.13)	(3.52)	9.78	7.70	8.11	5.43 (15)	2.44
(4.46)	3.16	12.98	11.30	11.56	6.70	2.27
—	1.00	1.10	1.00	.70	—	.20
(14.7)	(4.6)	11.2	9.5	10.3	8.9	5.4
(18.6)	(6.3)	18.2	14.8	19.0	15.0	7.5
(5.7)	(0.9)	13.2	11.0	13.3	10.6	6.2
105.4	100.5	78.2	81.2	80.9	84.1	88.2
55.4	53.5	49.7	47.3	39.9	35.7	33.6
25.1	175.5	246.6	82.4	65.2	24.2	15.1
6.5	9.9	18.1	24.8	24.1	15.0	14.5
31.6	185.4	264.7	107.2	89.3	39.2	29.6
—	172.4	—	—	106.9	—	—
55.7	34.3	—	35.0	0.3	3.5	3.5
55.7	206.7	—	35.0	107.2	3.5	3.5
7.9	—	3.2	39.9	62.7	17.1	5.9
—	—	—	—	—	—	—
63.4	40.2	29.8	27.5	27.6	24.8	22.5
514.6	492.1	608.6	562.1	435.5	362.4	298.4
194.7	173.9	235.8	157.2	150.9	155.5	145.2
319.9	318.2	372.8	405.0	284.6	206.9	153.2
321.6	309.3	377.0	319.8	279.8	238.5	201.4
205.7	242.2	227.3	212.1	197.2	134.2	110.1
944.7	990.8	879.5	644.8	587.0	549.8	557.9
1,668.2	1,728.7	1,718.2	1,422.1	1,224.1	1,050.8	973.1
1,473.5	1,554.8	1,482.4	1,264.9	1,073.2	895.3	827.9
533.8	489.6	290.6	293.7	298.6	248.7	251.3
222.7	130.5	133.5	136.5	139.8	140.0	140.0
666.5	805.3	872.2	741.0	578.7	485.4	417.7
14,975	14,975	14,975	12,690	12,476	12,458	12,458
44.45	53.73	58.18	58.34	46.33	38.90	33.48
5,701	6,489	7,142	7,812	8,748	9,369	10,393

(8) Total assets less current liabilities.

(9) Excludes long term debt due within one year.

(10) At December 31 restated for stock dividends declared in 1983, 1984, 1985 and 1986.

(11) Based on common shares issued at December 31 restated as in Note (10).

(12) Includes an extraordinary debit of $81.4 million amounting to $5.42 per common share.

(13) Excludes capitalized interest of $18.7 million and $13.5 million for 1986 and 1985 respectively.

(14) Includes an extraordinary credit of $6.8 million amounting to 45¢ per common share.

(15) Includes an extraordinary credit of $7.5 million amounting to 60¢ per common share.

DIRECTORS

#Russell S. Allison
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President
CP Rail

*Robert W. Campbell
Calgary, Alberta
Chairman
Canadian Pacific Limited

†Stuart E. Eagles
Toronto, Ontario
Vice-President Corporate
Canadian Pacific Limited

§James F. Hankinson
Calgary, Alberta
Group Vice-President
Canadian Pacific Limited

§Charles H. Hantho
Islington, Ontario
Chairman and Chief
Executive Officer
C-I-L Inc.

*#John Macnamara
Sault Ste. Marie, Ontario
Chairman and Chief
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Corporate Director

*Peter M. Nixon
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President and Chief
Operating Officer
The Algoma Steel
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†Leonard N. Savoie
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#Robert J. Theis
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†Adam H. Zimmerman
Toronto, Ontario
President and Chief
Operating Officer
Noranda Inc.

*Member of Executive Committee
†Member of Compensation Committee
§Member of Audit Committee
#Member of Nominating Committee

PRINCIPAL OFFICERS

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Executive Officer

Peter M. Nixon
President and Chief
Operating Officer

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Vice President – Finance and Accounting

Samuel H. Ellens
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R. Gordon Paterson
Vice President – Engineering and Technical Services

Gary S. Lucenti
Vice President – Manufacturing

Gerry B. Hudson
Vice President – Sales

James T. Melville
Vice President, Treasurer and General Counsel

Paul J. Paciocco
Assistant Vice President – Engineering and Technical Services

Paul C. Finley
Secretary

William J. Reed
Controller – Steel and Iron Ore Operations

CORPORATE INFORMATION

Executive Offices
Sault Ste. Marie, Ontario

Manufacturing and Mining Facilities

Canada

Sault Ste. Marie, Ontario

The Algoma Steel Corporation, Limited
- Steelworks Division
- Marine Division
- Welded Beam Division

The Superior Limited Partnership (formerly the Tube Division)

Wawa, Ontario
- Algoma Ore Division

United States

West Virginia

Cannelton Industries, Inc.
- Kanawha Division, Cannelton
- Pocahontas Division, Superior
- Indian Creek Division, Peytona

Maple Meadow Mining Company, Fairdale

Michigan

Cannelton Iron Ore Company

Tilden Mine Joint Venture, Ishpeming

PRODUCTS AND SALES OFFICE LOCATIONS

Products

Sheet
- Hot Rolled and Cold Rolled Coils and Cut to Length
- Cold Rolled Sheet for Motor Laminations

Plate
- Hot Rolled
  - Sheared and Gas Cut
  - Floor (Pattern)
- Heat Treated
  - Normalized
  - Quenched and Tempered

Seamless Tubular Products
- Casing
- Tubing
- Line Pipe
- Standard Pipe
- Mechanical Tubing
- Couplings and Coupling Stock

Structurals
- Wide Flange
- Bearing Pile Shapes
- Standard Angles, Channels and Beams
- Welded Wide Flange Shapes
- Welded Special Shapes

Rails and Tie Plates

Sales Offices

Head Sales Office
- Mississauga, Ontario

Regional Sales Office
- Calgary, Alberta

Algoma Tube Corporation
- Houston, Texas
- Denver, Colorado

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