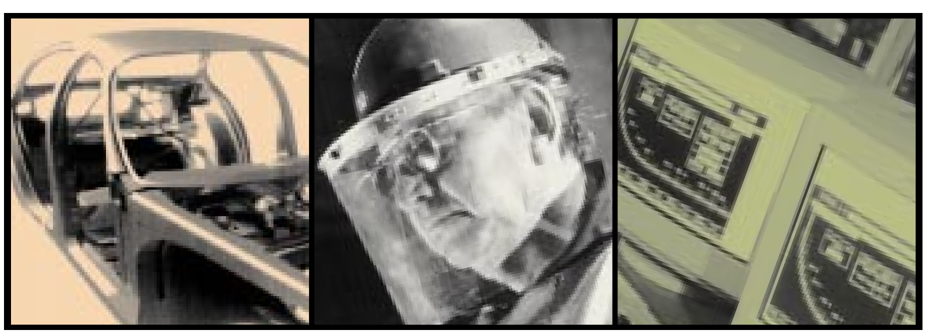
Stelco Inc. 1997 Annual Report

stelco



Our Mission

Stelco is a market-driven, technologically advanced group of businesses that are committed to maintaining leadership roles as steel producers and fabricators. These businesses are dedicated to meeting the requirements of their customers as well as collectively providing an appropriate return for Stelco shareholders. The people in these Business Units will achieve these objectives in healthy and safe environments through maximum development of their skills; by the creation and application of innovative process and product technology; through the identification and pursuit of new market opportunities; and by providing superior levels of quality and service.

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Corporate Profile

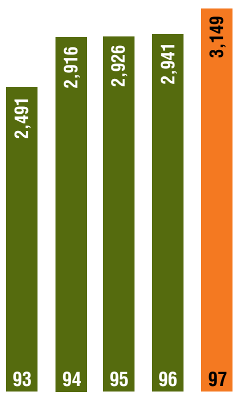
Stelco Inc., through its Business Units (one Division and eleven wholly owned subsidiaries) and jointly owned corporate entities, is in the business of producing and fabricating steel. Stelco is Canada's largest steel producer, with an annual steelmaking capacity of 5.3 million tons. Stelco owns four steel-producing Business Units: Hilton Works in Hamilton, Ontario; Lake Erie Steel Company Ltd. in Nanticoke, Ontario; Stelco-McMaster Ltée in Contrecoeur, Quebec; and AltaSteel Ltd. in Edmonton, Alberta. Stelco also owns a number of steel-fabricating businesses. Steel products supplied by Stelco businesses to the North American market include hot rolled, cold rolled, and coated sheet, plate, bars and wire rod, and manufactured products, such as wire and wire products, and pipe and tubular products.

In 1997, the Stelco Group of Businesses produced 5.1 million tons of steel and shipped 4.8 million tons of steel products valued at $3.1 billion.

This logo represents the steel industry's commitment to recycling and environmental responsibility. The steel industry needs old steel to make new steel. In 1996, steel was recycled at an overall rate of 65%, including consumer products, demolition materials as well as home and prompt scrap from manufacturing. Stelco is proud to be part of this commitment.

North America's Steel #1 Recycled Material

The Year at a Glance



Net sales
(millions of dollars)

Steel shipments
(thousands of net tons)

Driven by favourable economic conditions, Canadian steel consumption in 1997 reached a record high. The Stelco Group of Businesses took full advantage of the favourable demand conditions. Net sales, at $3,149 million, exceeded $3 billion for the first time and were up 7% from $2,941 million in 1996. Shipments rose to 4,818,000 tons from 4,577,000 tons in 1996, and average selling price per ton increased to $654 from $642 in 1996.

Semi-finished steel production in 1997, at 5,108,000 tons, was up 2% from 5,009,000 tons in 1996. Both Lake Erie Steel Company Ltd. and Stelco-McMaster Ltée achieved record steel output in 1997, but unplanned blast furnace outages at Hilton Works caused reduced steel output at this Unit.

High production activity at most Business Units, improving operational performance, and the absence of major maintenance projects combined to reduce operating expenses per ton to $600 in 1997 from $605 in 1996. Reduced unit cost, coupled with the improved average selling price, produced an operating income per ton of $54, up significantly from $37 in 1996. Net income was $137 million ($1.17 per share) for 1997 compared with $79 million ($0.63 per share) in 1996. In June, the Corporation instituted a common share dividend programme – a step that reflects the substantial improvement in financial performance over the past several years.

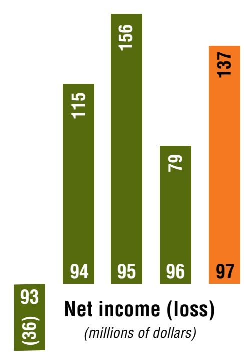
The Corporation is moving ahead with several priority capital projects. Capital spending on these and other projects totalled $252 million in 1997. These priority projects are scheduled for completion in 1998.

Years ended December 31 (Dollars in millions except as indicated)*

Financial		**1997**	1996	% Change increase (decrease)
Net sales	$	**3,149**	2,941	7
Net income	$	**137**	79	72
Income per common share †	*$	**1.17**	0.63	
Dividends declared				
– preferred	$	**13**	13	
– common	$	**9**	–	
Per common share	*$	**0.09**	–	
Common shareholders' equity	$	**1,288**	1,159	11
Per common share	*$	**12.00**	11.02	
Return on average common shareholders' equity	%	**10.2**	5.9	
Return on average capital employed	%	**7.8**	5.5	
Cash flow from operating activities	$	**291**	191	52
Capital expenditures	$	**252**	53	375
Debt-to-equity ratio		**27:73**	25:75	
Operations				
Income from operations per ton shipped	*$	**54**	37	45
Average number of employees		**11,732**	12,076	(3)
Production of semi-finished steel – thousands of net tons		**5,108**	5,009	2
Steel shipments – thousands of net tons		**4,818**	4,577	5

† *After dividends on cumulative preferred shares.*

Production of semi-finished steel
(thousands of net tons)



Net income (loss)
(millions of dollars)

Stelco at a Glance

Stelco Inc.
Hamilton, Ontario

Executive Management, Financial, Information Services, Legal, Raw Material Management, and Strategic Purchasing

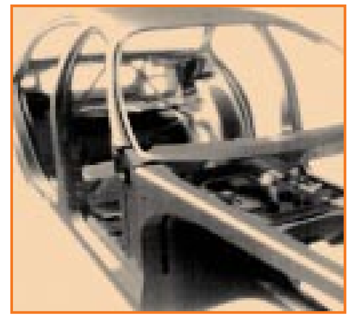
Manufacturing

	Product Description	Year	Net sales *(in millions)*	Shipments *(in tons)*	Production of semi-finished steel *(in tons)*	Employees	% Owned
Hilton Works *Hamilton, Ontario (unincorporated)*	Hot rolled, cold rolled, and coated sheet; plate; bars and rods	**97**	**$ 1,951**	**2,933,000**	**2,432,000**	**6,558**	**100**
		96	$ 1,881	2,945,000	2,607,000	6,695	
Lake Erie Steel Company Ltd. *Nanticoke, Ontario*	Hot rolled sheet	**97**	**$ 969**	**1,936,000**	**1,903,000**	**1,311**	**100**
		96	$ 802	1,637,000	1,651,000	1,305	
Stelco-McMaster Ltée *Contrecoeur, Quebec*	Billets, merchant bars, and special quality bar products	**97**	**$ 197**	**490,000**	**503,000**	**416**	**100**
		96	$ 177	459,000	484,000	428	
AltaSteel Ltd. *Edmonton, Alberta*	Merchant and special quality bars	**97**	**$ 124**	**244,000**	**270,000**	**373**	**100**
		96	$ 124	248,000	267,000	376	
Stelwire Ltd. *Hamilton, Ontario*	Wire and nails	**97**	**$ 206**	**254,000**		**543**	**100**
		96	$ 178	222,000		512	
Frost Wire Products Ltd. *Hamilton, Ontario*	Wire fence and wire mesh products	**97**	**$ 34**	**30,000**		**143**	**100**
		96	$ 34	28,000		131	
Stelfil Ltée *Lachine, Quebec*	Wire and wire products	**97**	**$ 75**	**81,000**		**276**	**100**
		96	$ 66	73,000		266	
Stelco Fasteners Ltd. *Brantford, Ontario (sold January 1998)*	Engineered fasteners primarily for the automotive industry	**97**	**$ 65**	**34,000**		**307**	**100**
		96	$ 57	32,000		298	
Stelpipe Ltd. *Welland, Ontario*	Tubular products ranging in diameter from 0.5 inches to 16 inches	**97**	**$ 31**	**36,000**		**425**	**100**
		96	$ 146	170,000		456	
Welland Pipe Ltd. *Welland, Ontario*	Large-diameter transmission pipe for the oil and gas industry	**97**	**$ 92**	**85,000**		**205**	**100**
		96	$ 58	50,000		160	
Camrose Pipe Company *Camrose, Alberta*	Large- and small-diameter pipe for the oil and gas industry	**97**	**$ 184**	**189,000**		**242**	**40**
		96	$ 107	114,000		179	
MOLY-COP Canada *Kamloops, B.C.*	Forged grinding balls for the mining and mineral industry	**97**	**$ 50**	**78,000**		**49**	**50**
		96	$ 52	78,000		47	

Integrated steelmaking **Mini-mills** **Fabricating**

Steel Processing

	Description	Year	Net sales *(in millions)*	% Owned
CHT Steel Company Inc. *Richmond Hill, Ontario*	Heat treatment of plate	**97**	**$ 7**	**100**
		96	$ 8	
Stelco USA, Inc. *Troy, Michigan*	Processing, warehousing, and sale of steel products	**97**	**US $ 61**	**100**
		96	US $ 45	
Z-Line Company *Hamilton, Ontario*	Zinc coating of cold rolled steel	**97**	**$ 62**	**60**
		96	$ 57	
Baycoat *Hamilton, Ontario*	Application of paint finishes to flat rolled steel coils	**97**	**$ 84**	**50**
		96	$ 76	
Torcad Limited *Toronto, Ontario*	Metal plating and finishing	**97**	**$ 15**	**50**
		96	$ 12	



Raw Materials

	Product Description	Year	Net sales *(in millions)*	% Owned
Chisholm Coal Company *Kentucky*	Metallurgical coal	**97**	**US $ 30**	**100**
		96	US $ 33	
Wabush Mines *Newfoundland and Quebec*	Iron ore	**97**	**$ 233**	**38**
		96	$ 205	
Hibbing Mine *Minnesota*	Iron ore	**97**	**US $ 292**	**15**
		96	US $ 313	
Eveleth Mines L.L.C. *Minnesota*	Iron ore	**97**	**US $ 170**	**15**
		96	US $ 101	
Tilden Mining Company L.C. *Michigan*	Iron ore	**97**	**US $ 237**	**15**
		96	US $ 263	
Fers et Métaux Recyclés Ltée *Quebec and New Brunswick*	Scrap	**97**	**$ 70**	**50**
		96	$ 69	

Net sales and shipments include inter-Unit transactions at market prices.

For entities in which the Corporation has an ownership interest less than 100%, the net sales, shipments, and number of employees represent 100% of the business activity of these entities.

President's Letter to Shareholders

James C. Alfano
President
and Chief Executive Officer

Nineteen ninety-seven was a year of transition and progress for the Stelco Group of Businesses. We successfully shifted our focus from survival and recovery to further strengthening and growing the business.

Strong U.S. and Canadian economic growth in 1997 resulted in a record level of Canadian steel consumption. Good operating performance allowed us to capitalize on the favourable market conditions and establish new records in semi-finished steel production, shipments, and sales revenue, which resulted in improved financial performance. Net income per share in 1997 was $1.17 compared with $0.63 per share in 1996. Several factors underlie the improvement. First, increased output and better operational performance contributed to reduced unit production costs. Second, the strong steel demand allowed for modest price improvement and a favourable mix of products sold. Finally, results in 1996 were negatively affected by the scheduled 35-day suspension of steel production at Lake Erie Steel Company Ltd. because of repairs to the blast furnace and other major maintenance projects. Setting aside exceptional events in both years, net income grew 40% in 1997 over 1996.

Our strategic objective of enhancing shareholder value through improved earnings was achieved in 1997. The market value of Stelco's outstanding common shares at December 31, 1997, plus dividends paid, less proceeds from issues during the year, was 14% higher than at December 31, 1996. We were also successful in meeting our objective of maintaining a solid financial position. At year-end, the cash balance was $300 million – a $152 million increase from the previous year; the debt-to-equity ratio was 27:73 compared with 25:75 at year-end 1996; and common shareholders' equity grew by $129 million to $1,288 million or $12.00 per common share. Last June, the Corporation declared the first common share dividend in six years. On February 2, 1998, we announced that we had exercised our right to redeem about 60% of the outstanding preferred shares and that we had put into place a plan to purchase up to 5% of the outstanding common shares. These steps reflect the substantial strengthening of the balance sheet and our confidence in the future.

To achieve improvement in financial performance, our strategy is to upgrade operational performance in productivity, quality, product yields, and energy usage; grow the value-added mix of products sold; and secure access to our chosen markets and customers through improved quality, service, and supply dependability. It is imperative that we engage and support all our people in this improvement process.

Indicative of the improvement in operational performance and productivity in 1997 is the continuing improvement in shipments per employee which rose to

452 tons in 1997 from 417 tons in 1996. Some of the more notable achievements were: record shipments and production at Lake Erie Steel Company Ltd., where annual production records were set in Ironmaking, Steelmaking, and Hot Strip Rolling; elimination of ingot production at Hilton Works which permitted substantial improvements in yield and energy usage; record cold rolled and coated production at Hilton Works; record production and shipments at Stelco-McMaster Ltée; and highest-ever shipment levels at both Stelwire Ltd. and Stelfil Ltée.

It is particularly gratifying to see operational improvements combined with improvement in health and safety. Through the diligent efforts of our employees, we achieved a reduction in lost-time accident frequency and severity ratings of 5% and 18%, respectively, in 1997 compared with 1996.

Progress was made in growing the value-added mix of products sold, particularly at Hilton Works. More significant progress will be made in 1998 and beyond. Increased outputs of plate, high-quality hot rolled sheet, and cold rolled and coated sheets are among the benefits expected from capital projects currently underway at Hilton Works and Lake Erie Steel Company Ltd. Investments at Stelco-McMaster Ltée and AltaSteel Ltd. will also move them to a higher-quality product mix.

All Business Units are registered to the ISO 9002 quality standard and those Units shipping directly to automotive customers are registered to QS-9000 automotive industry standard. The Stelco Group of Businesses is delivering high-quality products to a very discriminating marketplace. Our goal is to take this performance to an ever-higher level through advanced quality-planning initiatives, facility upgrades, and international technology programmes.

In addition to our internal Research and Development programmes, which support Business Unit improvement, we are active in industry-wide programmes directed at making steel the material of choice for the future. These include the UltraLight Steel Auto Body project (ULSAB), which is directed at ensuring that steel remains the preeminent material in automobile body construction, and The**Steel**Alliance, whose objective is to promote a positive image for steel by educating consumers on the value steel has in their lives, through emphasis on steel's attributes of safety, security, durability, and recyclability.

Significant progress was made on our $350 million capital programme with an expenditure of $252 million in 1997. The investment in new technology supports our people in implementing our strategy for improving financial results. This programme will be complete in 1998 and we expect the benefits to become fully apparent in the 1999 results.

During the year there were changes in the executive officers of the Corporation and to the Board of Directors.

Following the Annual Meeting, Frederick H. Telmer retired as Chief Executive Officer, continuing to serve as Chairman of the Board. On April 24, James C. Alfano, formerly President and Chief Operating Officer, was appointed President and Chief Executive Officer.

Robert J. Milbourne's decision to not stand for reelection to the Board of Directors at the Annual Meeting ended a valued association with the Corporation, dating back to 1963. He served as President and Chief Operating Officer from 1991 to 1996, when he became Vice Chairman.
He was instrumental in the transformation of Stelco to a diversified group of steel and steel-related businesses and in guiding the improvements in performance that facilitated the dramatic deleveraging of the Corporation since 1991.

Mr. Milbourne was elected to the Board of Directors in 1992. He was Chair of the Health, Safety and Environment Committee and a member of the Pension Committee. His significant contributions to the organization are very much appreciated.

Lynton R. Wilson retired from the Board effective October 20. Mr. Wilson served as a Director for twelve years. Most recently, Mr. Wilson was Chair of the Committee on Directors and a member of the Human Resources and Compensation Committee. His dedication to the affairs of the Corporation is sincerely appreciated.

John E. Caldwell and Peter J. Nicholson were appointed to the Board on September 22. Mr. Caldwell is President and Chief Executive Officer, CAE Inc. Mr. Nicholson is Executive Vice-President, Corporate Strategy, BCE Inc.

In addition to supporting our people with selective capital investments, we must equip them with the necessary knowledge and skills. To this end, the Corporation has many training and development programmes. The W•I•N (Winning in the Nineties) organizational learning programme continued during 1997. The current phase of the programme, W•I•N III, provides participants with specific skills and techniques to better manage production logistics so as to increase throughput with less investment in inventory and at lower cost while, at the same time, providing better customer service.

Demand for steel in North America was exceptionally high in 1997. We expect demand conditions to remain favourable in 1998, although it remains to be seen what impact the current economic crisis in Asia will have on the economies of Canada and the U.S. On the supply side, increased output from new steelmaking facilities combined with a continuation of record import levels will exert pressure on selling prices. Energy-sector demand for pipe and tubular products is exceptionally strong and the large-diameter pipe mills at Welland Pipe Ltd. and the Camrose Pipe Company joint venture are expected to operate at high capacity utilization levels in 1998.

In 1998, we will remain focused on our business improvement strategy, including the completion of current capital investment projects and delivering the identified improvements. We will also review additional opportunities for growth and improvement of our businesses and enhancement of shareholder value.

We would like to take this opportunity to thank our employees, customers, and suppliers for contributing so much to our achievements in 1997. Above all, we thank our shareholders for their continuing support, patience, and loyalty and assure them that we will bring to bear all our ingenuity, vigour, and commitment to our key strategic objective of enhancing shareholder value.

James C. Alfano
President and Chief Executive Officer

Hamilton, Canada
February 2, 1998

Priorities and Objectives

At the Stelco Group of Businesses, we believe that the goal of enhanced shareholder value through improved financial performance is pursued most effectively through observing the following priorities:

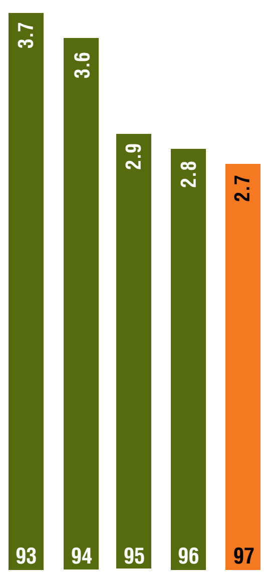
- Create and maintain healthy and safe workplaces for our people.
- Preserve and enhance the environment in communities where we have plants through responsible and environmentally oriented operating practices.
- Maintain our asset base by keeping our operating facilities productive and up to date.
- Deliver continually improving levels of quality and service to our customers.
- Maintain close control of costs to ensure our competitiveness.
- Achieve superior levels of output and productivity.

Health and Safety

At Stelco, our number one priority is the workplace health and safety of our employees. Besides the obvious moral imperative, a focus on health and safety is also good business. Fewer accidents mean fewer days lost to injury, leading to better productivity and improved operational performance.

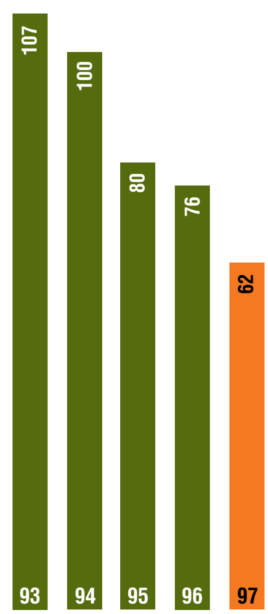
Stelco's commitment to health and safety is paying off. In 1997, safety measurables – the number of lost-time accidents and workdays lost, expressed as accident frequency and severity – continued to trend favourably.

In 1997, Ontario's Workplace Safety and Insurance Board revised its formula for determining assessment rates to a system placing stronger emphasis on safety performance. Because of their safety records, Stelco's Ontario-based Business Units will all benefit from reduced assessment rates in 1998. Business Units in Quebec and Alberta will also enjoy reduced assessment rates.



Frequency

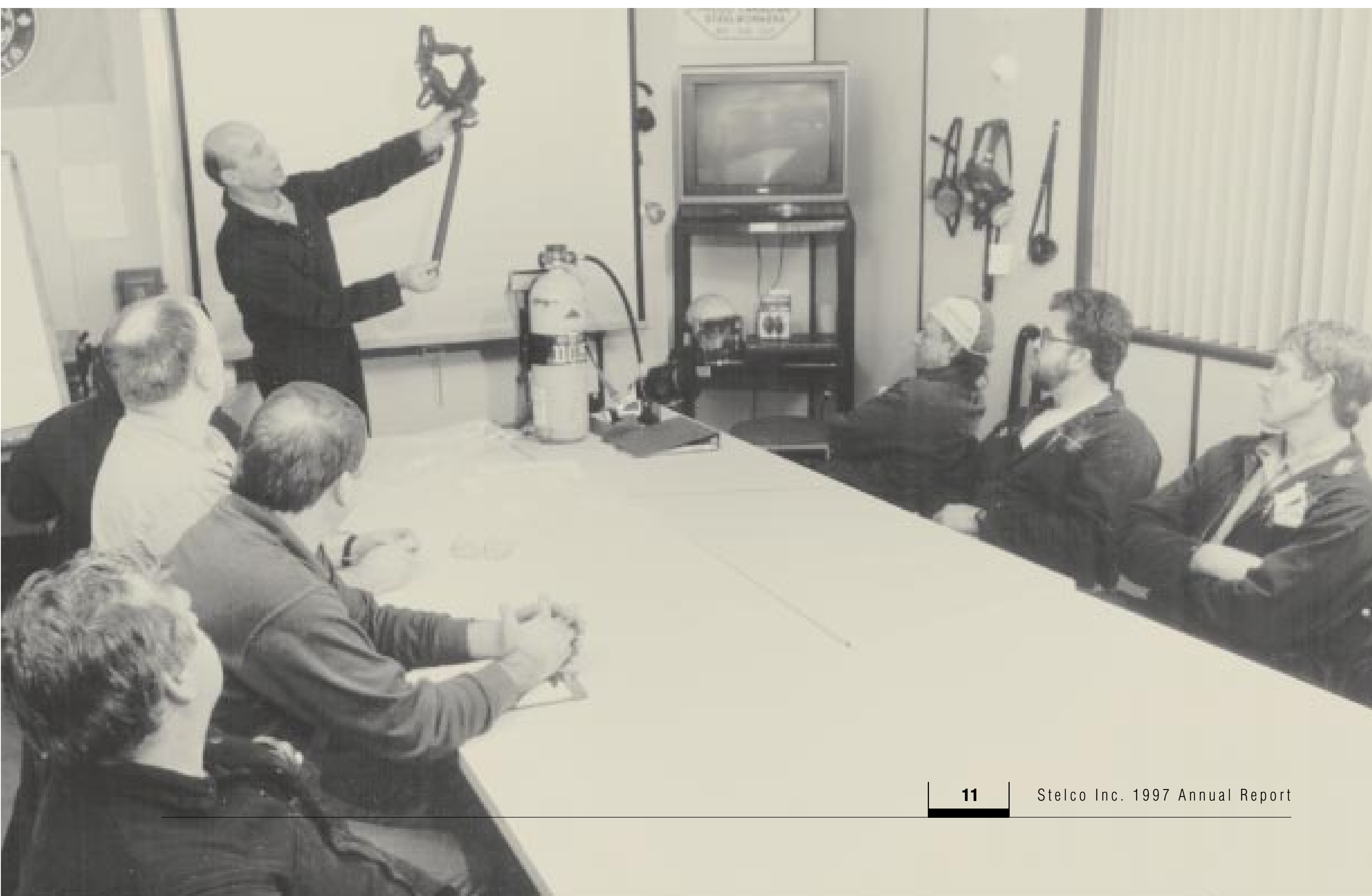
(lost-time accidents per 200,000 person-hours worked)



Severity

(days lost per 200,000 person-hours worked)

Health and safety is our number one priority. A major part of our overall employee training programme is devoted to raising safety awareness and increasing knowledge of appropriate job procedures with the aim of avoiding workplace injuries.



Environment

Iron oxide dust, captured in the steelmaking environmental controls at Hilton Works, being used in a new septic system. Researchers at the University of Waterloo discovered that this by-product is effective in removing phosphate from domestic wastewater in septic systems. Finding uses for our waste is one of our key environmental initiatives.

Resource recovery
(pounds per ton of steel shipped)

This graph shows the amounts of by-product materials being shipped from Stelco plants for reuse in the economy.

Stelco is committed, through responsible and environmentally oriented operating practices, to preserving and enhancing the environment in communities in which our facilities are located. Achieving such a goal is not without cost but there are positive economic spin-offs. For example, the new Pulverized Coal Injection (PCI) facility installed at Hilton Works in 1995, by allowing direct injection of coal into the blast furnaces, reduces the need for coke as fuel. The result is not only a substantial reduction in various emissions into the environment but also a significant reduction in energy costs.

Through water conservation efforts at our various facilities, the volume of water used per ton of steel shipped has declined steadily in recent years. These efforts, while improving the quality of water discharged from our facilities, also produce substantial savings in reduced treatment costs and water purchases.

Stelco is also determined to reduce the amount of energy needed to produce a ton of steel and has set a target of a 1% energy-efficiency improvement per annum during the 1990s. By meeting this target, the Corporation will not only cut costs but also help Canada meet its commitment on lower greenhouse gas emissions.

Waste reduction is another key environmental initiative. By substantially increasing the volume of by-products of steel manufacturing being sold and recycled, less material is being directed to landfill or final treatment facilities. In addition to the obvious environmental advantages, the Corporation also benefits from these programmes by reducing expensive disposal fees.

To further its environmental abatement efforts, the Corporation's various Business Units are involved in a wide range of voluntary activities, including the Accelerated Reduction and Elimination of Toxics (ARET) programme; the Canadian Benzene Challenge; the Canadian Chemical Producers Association's National Emission Reduction Masterplan and Responsible Care® Activity; and the Industrial Energy Innovator Programme under the Canadian Industrial Programme for Energy Conservation (CIPEC) for inclusion in the Voluntary Challenge Registry.

Upgrading of cokemaking facilities at Hilton Works is the cornerstone of this Unit's Accelerated Reduction and Elimination of Toxics programme to reduce benzene and poly-aromatic hydrocarbon (PAH) emissions.

As a first step, Hilton Works undertook to find world-class technology to reduce overall dependence on coke. This ultimately resulted in the construction of the Pulverized Coal Injection facility at a cost of $60 million. Starting up in December 1995, this facility allowed Hilton Works to idle three of its five coke oven batteries and reduce its dependence on coke for blast furnace ironmaking. The idling of Nos. 3, 4, and 5 Coke Oven Batteries resulted in a 40% decrease in particulate, volatile organic compounds, and PAH emissions from the coking operations.

The next phase, begun in 1995, led to the decision to refurbish No. 7 Coke Oven Battery at a cost of $108 million. This will provide Hilton Works with a quality facility from both an operational and environmental standpoint. This phase of the programme is presently underway and will be completed by the fourth quarter of 1998.

The final stage of the upgrade strategy is now focused on the remaining No. 6 Coke Oven Battery. A full review of its future viability from an operational, environmental, and economic perspective is now underway.

Asset Base

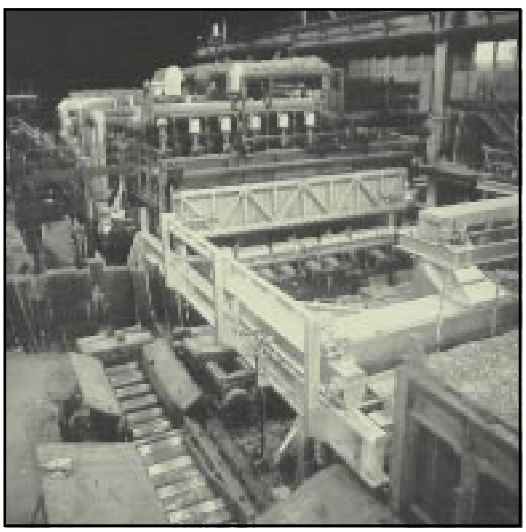
Capital spending
(millions of dollars)

The $105 million upgrade and expansion at Lake Erie Steel is essentially complete. Construction and commissioning of the slab caster, the major undertaking in the project, was completed in November 1997. Slab quality and productivity from the upgraded caster are excellent. Installation of a second casthouse at the Blast Furnace was completed in January 1998. This project will expand steelmaking capacity at Lake Erie Steel by 20%.

A number of priority projects, with an estimated capital cost of $350 million, are underway at various Business Units. These investments will assist our people in improving financial performance through gains in operational performance, upgrading the mix of products we sell, and securing access to markets.

Among the projects undertaken are:

- an expansion and upgrade at Lake Erie Steel Company Ltd.
- an upgrade of No. 7 Coke Oven Battery at Hilton Works
- an expansion and upgrade of the Plate Mill at Hilton Works
- installation of a new reheat furnace at Hilton Works Bloom and Billet Mill
- installation of a high-velocity, water-cooled oxygen lance, an electromagnetic stirring machine on the billet caster, and a high-power transformer at Stelco-McMaster Ltée
- a programme at AltaSteel Ltd. to provide automatic bar bundling, computer-controlled roll turning, computer controls for reheating, oxy-fuel burner assist for the electric furnace, and a ladle furnace
- installation of new take-up blocks and turntables on No.1 Oil-Temper Line at Stelwire Ltd.



Installation of a walking beam bloom reheat furnace at the No. 3 Bloom and Billet Mill at Hilton Works is progressing on schedule. This $23 million project will significantly improve both productivity and the quality of rod and bar products, and reduce operating costs.

Work is underway on the $85 million expansion and upgrade of the Plate Mill at Hilton Works. Upgrading the mill provides access to sizeable and attractive markets in which we cannot currently participate. In addition, product quality will be improved and operating costs reduced.

Quality and Service

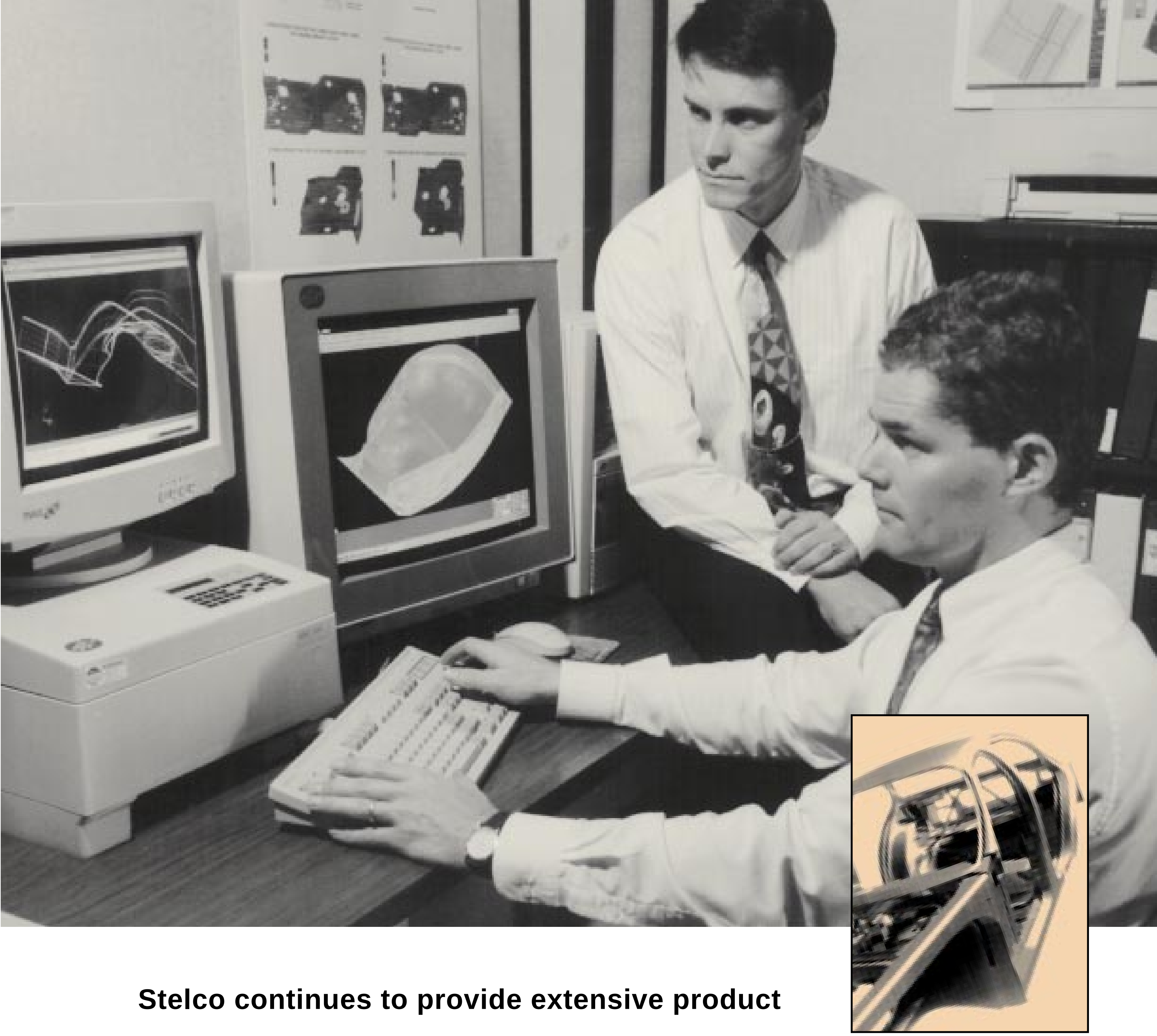
Ensuring access to markets underlies our drive for quality. Each of our Business Units has adopted a Quality Policy, which commits them to satisfying customers' needs "through continuous improvement of our processes, products, and services."

The Quality Policy is implemented through planning, development, and application of quality systems that meet the ISO 9002 quality standard. All Units were registered to this standard by the end of 1996. In addition, Units shipping directly to automotive customers are now registered to that industry's QS-9000 quality standard.

In 1997, our Quality Index – an internal measure of customer satisfaction – stood at 99.5%. A good score, but our goal is to raise this performance through participation in advanced quality planning initiatives, quality-driven facility upgrades, and international technology programmes.

Chrysler Corporation's Gold Pentastar Award received by Hilton Works for outstanding supplier performance.

In January 1998, the No.1 Bar Mill at Hilton Works was selected to receive the Ford Q1 Award, signifying exemplary quality performance.



Stelco is an active participant in the UltraLight Steel Auto Body (ULSAB) consortium – a group of the world's leading steelmakers. The ULSAB programme's aim is to demonstrate steel's capability in the manufacture of vehicle body shells that will be lighter, more rigid, and safer.

Stelco continues to provide extensive product support to our customers. For example, for automotive customers, we provide advanced computer simulation analysis of steel forming operations and structural performance.

Output and Productivity

Shipments per employee
(thousands of net tons)

There have been some remarkable gains in productivity at Stelco in recent years. Mainly through natural attrition, the workforce at our wholly owned Business Units declined from 11,951 people in 1993 to 10,763 in 1997. During this time frame shipments have increased. Consequently, shipments per employee – a useful measure of productivity – has shown a marked improvement.

These impressive productivity gains have been achieved through carefully managed reorganization, employee training, shifts in product mix, and small, quick-payback capital projects. Simply put, Stelco is a leaner, flatter organization, with better-trained employees, than it has ever been.

Take, as evidence, some of the achievements of our Business Units in 1997:

- Lake Erie Steel Company Ltd. set annual production records in its Blast Furnace, Steelmaking, and Hot Strip Mill operations
- Stelco-McMaster Ltée established record annual outputs in both Steelmaking and the Bar Mill
- at Hilton Works, production of cold rolled and coated products was at a record high
- Stelwire Ltd. and Stelfil Ltée both recorded highest-ever output.

W•I•N training is designed to provide our employees with skills they can use to better manage their Businesses. W•I•N III aims at improved financial results by increasing throughput, reducing inventories, and lowering operating costs. When complete, some 400 employees will have attended this one-week segment of the W•I•N process. W•I•N has been in place since 1988.

Automation of operations at the Hot Strip Mill at Hilton Works is a typical productivity improvement project. By revamping operator controls on the mill, output and productivity have increased and product quality has improved.

Management's Statement of Responsibility

Management of Stelco Inc. is responsible for the preparation of the accompanying consolidated financial statements and related information contained in this Annual Report. The financial statements have been prepared in accordance with generally accepted accounting principles. Where alternative accounting methods exist, management has chosen methods which management believes to be appropriate in the circumstances. Where estimates or judgments have been required, management has determined such amounts on a reasonable basis in conformity with generally accepted accounting principles.

In meeting its reporting responsibility, management has established and followed policies and procedures and systems of internal control designed to (i) provide reasonable assurance that assets were safeguarded from loss or unauthorized use and (ii) produce reliable financial information. These internal control systems were periodically tested and evaluated by both the internal auditors and the external auditors, and management took any action necessary to respond appropriately to their recommendations. Management recognizes the limits inherent in all systems of internal control but believes that Stelco has established effective and responsive systems of internal control through the careful selection of employees, the division of responsibilities, and the application of formal policies and procedures.

The Board of Directors oversees management's preparation of the consolidated financial statements and ultimately approves the financial statements and related disclosure based on a recommendation from the Audit Committee of the Board of Directors. As a basis for recommending approval of the consolidated financial statements to the Board of Directors, the Audit Committee reviews with management the Corporation's internal controls over financial reporting and the accounting policies and procedures employed by the Corporation for financial reporting purposes and, as well, meets independently with internal and external auditors to consider the results of their audits.

Stelco's management believes that the systems of internal control, review procedures, and established policies provide reasonable assurance that the Corporation's operations have been carried out in conformity with the high business standards of the Corporation's Code of Conduct & Ethics.

The Audit Committee recommended the appointment of the Corporation's external auditors, KPMG, to examine the 1997 and 1996 consolidated financial statements of the Corporation in accordance with auditing standards generally accepted in Canada. The appointment of the external auditors was confirmed by the Corporation's shareholders. The external auditors' report as to the fairness of presentation of these financial statements and their conformity with generally accepted accounting principles is included in this Annual Report.

J C Alfano

J. C. Alfano
President
and Chief Executive Officer

R. E. Rogan

R. Eric Rogan
Executive Vice President
and Chief Financial Officer

Hamilton, Canada
February 2, 1998

Consolidated Statement of Income and Retained Earnings

Years ended December 31, (in millions)	**1997**	1996
Net sales	**$ 3,149**	$ 2,941
Operating expenses		
Cost of sales, exclusive of the following items	**2,739**	2,615
Amortization	**129**	132
Corporate services	**21**	23
	2,889	2,770
Income from operations	**260**	171
Financial expense		
Interest on long-term debt	**(43)**	(46)
Other interest – net	**7**	6
Income before income taxes	**224**	131
Income taxes (Note 3) – current	**35**	49
– deferred	**52**	3
Net income	**137**	79
Retained earnings		
Balance at beginning of year	**340**	274
Dividends (Note 10)	**(22)**	(13)
Balance at end of year	**$ 455**	$ 340
Income per common share		
Basic	**$ 1.17**	$ 0.63
Fully diluted	**$ 1.14**	N/A
Weighted average common shares outstanding – millions	**106.2**	105.1

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statement of Financial Position

At December 31, (in millions)	**1997**	1996
Current assets		
Cash and short-term investments	**$ 322**	$ 165
Accounts receivable	**488**	426
Inventories (Note 4)	**579**	582
Prepaid expenses	**19**	13
	1,408	1,186
Current liabilities		
Bank indebtedness (Note 5)	**22**	17
Accounts payable and accrued	**522**	457
Income and other taxes	**22**	41
Cash dividends payable	**6**	3
Long-term debt due within one year (Note 8)	**57**	48
	629	566
Working capital	**779**	620
Other assets		
Capital assets (Note 6)	**1,236**	1,129
Deferred pension cost	**125**	99
Other	**64**	74
	1,425	1,302
Total investment	**2,204**	1,922
Other liabilities		
Provision for blast furnace relines – beyond one year	**89**	80
Long-term debt (Note 8)	**486**	393
Deferred income taxes	**175**	123
	750	596
Shareholders' equity	**$ 1,454**	$ 1,326
Derived from:		
Capital stock (Note 10)	**$ 986**	$ 973
Contributed surplus	**13**	13
Retained earnings	**455**	340
	$ 1,454	$ 1,326

See accompanying Notes to the Consolidated Financial Statements.

On behalf of the Board:

James C. Alfano
Director

J.D. Muncaster
Director

Consolidated Statement of Cash Flow

Years ended December 31, (in millions)	**1997**	1996
Cash provided by (used for)		
Operating activities		
Net income	**$ 137**	$ 79
Charges (credits) to income not affecting cash		
Amortization	**129**	132
Deferred income taxes	**52**	3
Provision for blast furnace relines	**14**	7
Gain on sale of assets	**(4)**	(5)
Other – net	**17**	2
	345	218
Net change in deferred pension cost	**(26)**	(3)
Changes in operating elements of working capital (see below)	**(19)**	(30)
Other – net	**(9)**	6
	291	191
Investment activities		
Repayment from (advance to) joint venture (Note 11)	**17**	(62)
Proceeds from sale of assets	**5**	21
Expenditures for capital assets	**(252)**	(53)
	(230)	(94)
Financing activities		
Net proceeds from issue of long-term debt	**153**	11
Reduction of long-term debt	**(57)**	(65)
Net proceeds from issue of common shares	**14**	1
Purchase of preferred shares	**–**	(6)
	110	(59)
Cash dividends paid	**(19)**	(13)
Net increase in cash	**152**	25
Cash position*		
Balance at beginning of year	**148**	123
Balance at end of year	**$ 300**	$ 148

** Cash and short-term investments less Bank indebtedness*

Changes in operating elements of working capital		
Accounts receivable	**$ (62)**	$ (20)
Inventories	**3**	–
Prepaid expenses	**(6)**	(1)
Accounts payable and accrued	**65**	(9)
Income and other taxes	**(19)**	–
	$ (19)	$ (30)

See accompanying Notes to the Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

December 31, 1997

1. Summary of significant accounting policies

Principles of consolidation

The consolidated financial statements include the accounts of Stelco Inc., its wholly owned subsidiaries, and its proportionate share of the accounts of its joint ventures. Corporate investments in which the Corporation does not have joint control are accounted for by the equity method.

Foreign currencies

Monetary assets and liabilities originating in foreign currencies are translated at year-end exchange rates. All other assets and liabilities originating in foreign currencies are translated at historic rates prevailing when the assets were acquired or the liabilities incurred. Income and expense items, other than those related to assets and liabilities translated at historic rates, are translated at the average rates for the year.

Unrealized gains or losses resulting from the translation of long-term debt at year-end exchange rates are deferred and amortized on a straight-line basis over the remaining life of the debt. All other gains or losses resulting from foreign currency translations are reflected in the Consolidated Statement of Income and Retained Earnings.

Inventories

Inventories are valued at the lowest of cost, replacement cost, and net realizable value. Physical quantities are normally confirmed once a year.

Capital assets and amortization

Capital assets are recorded at historical cost less investment tax credits realized and include construction in progress. Amortization is provided using the straight-line method applied to the cost of the assets at rates based on their estimated useful life and beginning from the point when production commences. The following annual amortization rates are in effect:

Buildings	2 1/2 to 5%
Equipment	6 to 7 1/2%
Automotive and mobile equipment	10 to 20%
Raw material plants and properties	4 1/2 to 5%

Blast furnace relines

The Corporation's blast furnaces periodically require extensive relining. The estimated future costs of such relines are charged to income on a unit-of-iron-production basis over the period to the next anticipated reline date and are accumulated as a Provision for blast furnace relines – beyond one year. The actual costs of relines are charged against the accumulated provision as incurred.

Research and development

Expenditures for research are expensed as incurred. Expenditures for development are capitalized when applicable; otherwise they are expensed as incurred. No development expense has been capitalized in 1997 or 1996.

Interest

Interest costs are expensed as incurred.

Pension costs, obligations and post-retirement benefits

The Corporation, its wholly owned Business Unit, wholly owned subsidiaries, and joint ventures maintain a number of defined benefit pension plans which cover substantially all employees. Pension expenses are determined using the projected benefit method, prorated on service, together with adjustments arising from (i) plan initiation or amendment, (ii) changes in assumptions, (iii) experience gains and losses, and (iv) the difference between the actuarial present value of accrued pension benefits and the value of pension fund assets determined at January 1, 1987, all such adjustments being amortized on a straight-line basis over the expected average remaining service life of the participants in the plans. The pension fund assets are based on values which are adjusted to market over a period of five years.

In addition to the pension plans, the Corporation, its wholly owned Business Unit, wholly owned subsidiaries, and joint ventures also provide other benefits for retired employees. These benefits are essentially the same as those given to active employees with the exception of life insurance and income protection coverage. Post-retirement benefit costs are expensed when paid.

Income taxes

The Corporation provides for income taxes under the tax allocation basis of accounting whereby income taxes are provided for in the year in which the related income is reflected in the financial statements. Deferred income tax provisions result from timing differences in the recognition of income and expense for income tax and financial statement purposes. Investment tax credits are recorded, using the cost-reduction approach, when there is reasonable assurance that such credits ultimately will be realized. Current and future income is affected to the extent that expenses or the cost of certain assets for amortization purposes have been reduced by such investment tax credits.

2. Segmented information

The Corporation operates, primarily within the North American market, as a group of Business Units producing and marketing a wide range of steel products, the only business segment.

3. Components of consolidated income taxes

(in millions)	**1997**	1996
Provision based on combined basic Canadian federal and provincial income tax rates (1997 – 44%, 1996 – 44%)	**$ 99**	$ 58
Manufacturing and processing profits deduction	**(20)**	(11)
Mining incentives	**(4)**	(4)
Recognition of tax benefits not previously recognized	**(8)**	(4)
Non-recognition of tax benefits from current losses	**10**	9
Corporate minimum tax	**7**	–
Large corporations tax	**3**	5
Other	**–**	(1)
Income tax expense	**$ 87**	$ 52

Approximately $60 million of federal and provincial tax losses are available to reduce future income for tax purposes.

4. Inventories

(in millions)	**1997**	1996
Raw materials and supplies	**$ 267**	$ 264
Finished and semi-finished products	**312**	318
	$ 579	$ 582

5. Bank indebtedness

Bank indebtedness is secured by accounts receivable and inventories.

6. Capital assets

(in millions)	**1997**	1996
Raw material plants and properties	**$ 399**	$ 393
Manufacturing plants and properties	**3,355**	3,343
	3,754	3,736
Less accumulated amortization	**(2,750)**	(2,635)
	1,004	1,101
Construction in progress	**232**	28
	$ 1,236	$1,129

7. Proportionately consolidated joint ventures and related commitments

The joint ventures are an integral part of steel operations and exist to provide raw materials and certain manufacturing, finishing, and sales functions.

The following is a summary of the Corporation's proportionate share of the financial position, operating results, and cash flows of the joint ventures:

(in millions)	**1997**	1996
Current assets	**$ 149**	$ 138
Non-current assets	**275**	281
Total assets	**424**	419
Current liabilities	**130**	115
Long-term liabilities	**71**	88
Equity	**$ 223**	$ 216

(in millions)	**1997**	1996
Revenue	**$ 142**	$ 118
Expenses	**108**	98
Net income	**$ 34**	$ 20

(in millions)	**1997**	1996
Cash provided by (used for)		
Operating activities	**$ 47**	$ 22
Investment activities	**(39)**	(17)
Financing activities	**(12)**	3
Net increase (decrease) in cash	**$ (4)**	$ 8

Included in the liabilities of the joint ventures is $100 million of debt against which certain assets relating to those entities have been pledged ($107 million in 1996).

Commitments

The Corporation is committed to pay its share of the costs, including minimum charges for principal and interest to cover servicing of long-term debt, of certain joint ventures. The Corporation's share of such minimum charges averages $23 million annually to 2003.

8. Long-term debt

(in millions)	1997	1996
10.40% retractable debentures due November 30, 2009 (see (a) below)	**$ 125**	$ 125
Notes payable (see (b) below)	**165**	195
Construction loans (see (c) below)	**159**	2
Debentures at prime plus 1% floating rate due September 30, 2000	**7**	20
Term loan at Bankers' Acceptances Rate plus 2.75% or Government of Canada Bond Rate plus 3.55% maturing on January 31, 2003	**59**	62
Proportionately consolidated joint venture term loan at Bankers' Acceptances Rate plus 0.5% due July 31, 2001	**27**	36
Other	**1**	1
	543	441
Less amount due within one year, net of prepayments	**57**	48
	$ 486	$ 393

The estimated fair value of the Corporation's long-term debt net of amount due within one year was approximately $546 million at December 31, 1997 ($443 million at December 31, 1996). (See Note 13 on page 33.)

(a) On November 30, 1989, the Corporation issued $125,000,000 principal amount of Retractable Debentures bearing interest at the rate of 10.40% payable semi-annually commencing May 31, 1990. The Debentures mature on November 30, 2009 but are redeemable after November 30, 1999 at the option of the Corporation at a redemption price equal to the greater of the Canada Yield Price and par. Canada Yield Price means, in effect, a price for the Debentures calculated on the business day preceding the date on which the Corporation gives notice of redemption, to provide a yield to maturity equal to the yield on a non-callable Government of Canada bond, issued at 100% of its principal amount with a term to maturity equal to the remaining term to maturity of the Debentures, plus 0.40%.

A holder of the Debentures may elect that all or any portion of such holder's Debentures mature on November 30, 1999. Such election may be made only after August 31, 1999 and prior to the close of business on September 30, 1999. The Corporation may increase the rate of interest payable on the Debentures after November 30, 1999 over the 10.40% rate otherwise payable, provided that notice of any such increase is given on or before August 31, 1999.

Throughout the life of the Debentures, upon the occurrence of both a designated event and a rating decline, a holder of Debentures may require the Corporation to purchase all or any portion of such holder's Debentures unless a rating recovery has occurred. For these purposes, designated event includes significant changes in ownership, control or structure of the Corporation or membership of the Board of Directors or certain distributions of cash, property or securities excluding regular dividends and distributions of non-redeemable and non-retractable shares of the Corporation.

(b) The Corporation issued notes payable to finance the slab and bloom caster facilities at Hilton Works in the aggregate amount of $270 million bearing a weighted average interest rate of 10.2% per annum. Repayment of these notes commenced in 1994 and will be completed in 2003. Under certain circumstances, which include changes in ownership of the Corporation, the lender can require immediate repayment of principal and accrued interest of this indebtedness.

(c) The construction loans bear interest at various rates based on Canadian Prime Rate, Bankers' Acceptances Rates, or Government of Canada Bond Rates plus premiums ranging from 0.625% to 2.25%. On completion of the related construction projects, or by certain dates between January 31, 1998 and June 10, 1999, the construction loans may be converted into term loans at interest rates based on Bankers' Acceptances Rates or Government of Canada Bond Rates plus premiums ranging from 0.625% to 2.5% and with maturities of from five to ten years.

After allowing for prepayments, annual sinking fund and other repayments of debt over the next five years amount to $57 million in 1998, $182 million in 1999, $61 million in 2000, $73 million in 2001, and $62 million in 2002.

9. Commitments

(A) Capital programmes

The estimated cost to complete capital programmes is $176 million which will be spent over a period of two years.

(B) Operating leases

Future minimum rental payments required under operating leases that have initial or remaining lease terms in excess of one year at December 31, 1997 are:

	(in millions)
1998	$ 37
1999	36
2000	33
2001	29
2002	24
Subsequent to 2002	35
	$ 194

10. Capital stock and dividends

(A) Authorized shares

Under the Canada Business Corporations Act, the Corporation is authorized to issue in series, unlimited numbers of Preferred Shares and Common Shares without nominal or par value.

Capital stock

(in millions)	**1997**	1996
Preferred Shares (see (B) below)	**$ 166**	$ 167
Common Shares – stated capital (see (C) below)	**820**	806
	$ 986	$ 973

(B) Preferred shares

	Number of Shares	**1997 (millions)**	Number of Shares	1996 (millions)
Outstanding				
– *SERIES A*–	**$**	–8,000	$	–
– *SERIES B*	**1,240,430**	**30**	1,247,450	31
– *SERIES C*	**5,406,629**	**136**	5,406,629	136
	6,647,059	**$ 166**	6,662,079	$ 167

SERIES A

On May 1, 1997, 8,000 shares with a stated capital of $200,000 were tendered and purchased for a total consideration of $200,000 and were cancelled.

SERIES B

These shares are entitled to a fixed cumulative dividend at the rate of $1.94 per share annually, payable in equal quarterly instalments.

The shares are redeemable at $25.00 per share. In 1997 and 1996, no shares were redeemed.

On November 1 each year, the Corporation is required to purchase, at $25.00 per share, 61,350 Series B Preferred Shares, if tendered. On November 1, 1997, 7,020 shares with a stated capital of $175,500 were tendered and purchased for a total consideration of $175,500 and were cancelled. On November 1, 1996, 61,350 shares with stated capital of $1,533,750 were tendered and purchased for a total consideration of $1,533,750 and were cancelled. (See Note 16, page 34, for subsequent events affecting Series B shares.)

SERIES C

These shares are entitled to a fixed cumulative dividend at the rate of $1.94 per share annually, payable in equal quarterly instalments.

The shares are redeemable at $25.00 per share. In 1997 and 1996, no shares were redeemed.

The Corporation is required to make all reasonable efforts to purchase during each calendar quarter, at a price not exceeding $25.00 per share plus unpaid dividends and costs of purchase, 1% of the number of these shares outstanding on April 30, 1990. During 1997, no Series C Preferred Shares were purchased. During 1996, 170,200 shares with a stated capital of $4,255,000 were purchased for a total consideration of $4,121,950 and were cancelled. The resulting difference of $133,050 is included in contributed surplus. The resulting annual obligation expires December 31 in each year. (See Note 16, page 34, for subsequent events affecting Series C shares.)

(C) Convertible common shares

(C) Convertible common shares

	1997			1996		
	Number of shares			Number of shares		
	Series A	Series B	(millions)	Series A	Series B	(millions)
Opening balance	**105,183,924**	**61,258**	**$ 806**	105,011,753	65,932	$ 805
Transfers between series (see below)	**22,290**	**(22,290)**	**–**	4,671	(4,671)	–
Stock dividends	**–**	**317**	**–**	–	–	–
Exercise of stock options (see below)	**2,054,000**	**–**	**14**	167,500	–	1
Fractional shares purchased and cancelled	**–**	**(7)**	**–**	–	(3)	–
Outstanding	**107,260,214**	**39,278**	**$ 820**	105,183,924	61,258	$ 806

The Convertible Common Shares of each series are voting, convertible into one another on a share-for-share basis and rank equally in all respects except that the dividends on the Series B Convertible Common Shares may be paid by way of a stock dividend in Series B Convertible Common Shares in accordance with the conditions attaching to such shares, and dividends on the Series A Convertible Common Shares are normally payable in cash.

Stock options

The Corporation has a Key Employee Stock Option Plan under which the aggregate number of Convertible Common Shares reserved for issuance is 8,000,000 of which 1,863,000 shares remain available at December 31, 1997.

Options outstanding at December 31, 1997 are as follows:

Shares	Price per share	Expiry date
44,000	$ 5.875	December 16, 1998
30,100	$ 1.220	December 21, 1999
195,000	$ 7.875	December 20, 2000
263,000	$ 7.500	February 10, 2002
276,000	$ 6.500	February 8, 2003
360,000	$ 6.300	June 24, 2003
661,000	$ 7.750	February 6, 2004
150,000	$ 10.350	June 26, 2004
1,979,100		

A summary of option activity during 1997 and 1996 is as follows:

	1997	1996
Outstanding at beginning of year	**3,222,100**	2,293,600
Granted	**811,000**	1,137,000
Exercised	**(2,054,000)**	(167,500)
Expired or cancelled	**–**	(41,000)
Outstanding at end of year	**1,979,100**	3,222,100

(D) Dividends

Dividends declared were as follows:

	1997		1996	
	Per share	**(thousands)**	Per share	(thousands)
Preferred shares				
SERIES A	**$ 0.22200**	**$ 2**	$ 1.15322	$ 9
SERIES B	**1.94000**	**2,417**	1.94000	2,509
SERIES C	**1.94000**	**10,489**	1.94000	10,569
		12,908		13,087
Common shares				
SERIES A	**0.09000**	**9,607**	–	–
SERIES B (stock)	**0.06000**	**4**	–	–
SERIES B (cash)	**0.03000**	**1**	–	–
		9,612		–
		$ 22,520		$ 13,087

11. Advance to joint venture

During 1996, Stelco Inc. advanced an amount to the Z-Line Company, a joint venture, replacing a consortium of banks as the long-term lender to the Z-Line. The advance ($45 million at December 31, 1997; $62 million at December 31, 1996) is included in Other assets on the Consolidated Statement of Financial Position and bears interest at the average rate for bankers acceptances for the applicable period.

12. Pension plans

The Corporation, its wholly owned Business Unit, wholly owned subsidiaries, and joint ventures maintain a number of defined benefit pension plans which cover substantially all employees. Pension expenses have been determined as follows:

(in millions)	**1997**	1996
Current service costs	**$ 33**	$ 31
Interest cost on projected benefit obligations	**155**	153
Projected return on plan assets	**(154)**	(150)
Net amortization of gains, losses, and plan improvements	**14**	33
Net pension expense of proportionately consolidated joint ventures	**1**	–
Net expense for pension plans	**$ 49**	$ 67

The discount rate used in determining the interest cost on projected benefit obligations and the assumed rate of return on pension fund assets was 8.0% in 1997 and 1996.

Status of the pension plans at December 31 was as follows:

(in millions)	**1997**	1996
Pension fund assets	**$ 2,155**	$ 1,969
Estimated present value of accrued pension benefits attributed to services rendered	**2,022**	1,961
Surplus	**133**	8
Net surplus of proportionately consolidated joint ventures	**19**	17
Total surplus	**$ 152**	$ 25

13. Financial instruments and risk management

Derivative financial instruments

The Corporation utilizes interest rate agreements and foreign exchange contracts to manage interest rate and foreign currency exposures. The principal objective of such contracts is to minimize the risks and/or costs associated with financial and operating activities. The Corporation does not trade in financial instruments for speculative purposes.

The Corporation's theoretical risk in the derivative financial instruments based on default of counterparties is minimal since it transacts only with major Canadian banks.

As at December 31, 1997 and December 31, 1996, there were no potential material gains or losses associated with the Corporation's derivative financial instruments.

Concentrations of credit risk

The Corporation does not have significant exposure to any individual customer or counterparties. Stelco is a group of businesses comprising integrated and mini-mill steelmaking, and fabrication of a wide range of primary and value-added steel products mainly serving the integrated North American steel market. The major markets for the Corporation’s products are the automotive sector, steel service centres, the construction industry, pipeline systems, various industries that utilize pipe and tube products, and wire and wire products. Except in a few situations where the risk warrants it, the Corporation does not require collateral on trade receivables. The Corporation reviews its customers’ credit histories before extending credit and conducts regular reviews of its existing customers’ credit performances. Overall, credit risk related to the Corporation’s trade receivables is limited due to the large number of customers in differing industries and geographic areas.

Fair value of financial instruments

The fair value of long-term debt is based on quoted market prices where applicable or on discounted future cash flows, including interest payments, using rates currently available for debt of similar terms and maturities. The carrying value of other financial instruments approximates fair value due to the short maturities or the terms and conditions attached to these instruments.

14. Contingency

The union local at Hilton Works has complained to the Ontario Labour Relations Board (the Board) that representations were made to it in the course of bargaining that solvency deficiency payments would be made to the bargaining unit pension plan over the course of the six-year labour agreement reached in 1996. The union complaint is seeking various remedies including a reopening of the 1996 labour agreement or an order that solvency deficiency payments be made. Should the Board order solvency deficiency funding to be made to the plan on a continuing basis, the special employer contribution on account of solvency deficiency payments would be in the range of $60 million for 1997 and $20 million for 1996. In subsequent years, such contributions would depend on a variety of factors such as interest rates and workforce retirement age. Making such payments to the pension plan for 1996 and 1997 would be a timing consideration, affecting the Corporation's cash resources but not its pension plan expense amount. A hearing is expected in mid-1998. The Corporation believes the complaint to be without merit and intends to defend its position vigorously.

15. Comparative figures

Certain 1996 comparative figures have been reclassified to conform with the disclosure adopted for 1997.

16. Subsequent events

Sale of Stelco Fasteners Ltd.

On January 21, 1998, the Corporation concluded negotiations, commenced late in 1997, whereby the assets and business of Stelco Fasteners Ltd., a wholly owned subsidiary located in Brantford, Ontario, were sold for net proceeds of $11 million. A provision for loss, adjusted for income taxes, of $10 million has been recorded against 1997 results.

Redemption and purchase of shares

On February 2, 1998, the Corporation announced that it has exercised its right to redeem all its issued and outstanding Series B Preferred Shares, and 2,703,314 (being 50%) of its issued and outstanding Series C Preferred Shares. The shares will be redeemed May 1, 1998 at a price of $25 per share for a total cost of approximately $100 million.

At the same time, the Corporation announced that it intends to seek regulatory approval to purchase up to 5,364,975 of its Series A and B Convertible Common Shares, representing 5% of the 107,299,492 Series A and B Convertible Common Shares outstanding as of January 31, 1998, pursuant to a normal course issuer bid. Purchases may only commence upon receipt of all required regulatory approvals and will terminate no later than one year from that date. The price the Corporation will pay for any such Common Shares will be the market price of such shares at the time of purchase.

Auditors' Report

To the Shareholders of Stelco Inc.

We have audited the consolidated statements of financial position of Stelco Inc. as at December 31, 1997 and 1996 and the consolidated statements of income and retained earnings and cash flow for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1997 and 1996 and the results of its operations and the changes in its cash flow for the years then ended in accordance with generally accepted accounting principles.

KPMG

Hamilton, Canada
February 2, 1998

Management's Discussion and Analysis of Results of Operations and Financial Condition

Overview

The purpose of this Management Discussion and Analysis is to provide Stelco management's commentary on the Corporation's financial situation and future prospects. Included in this discussion is a review of this year's financial results in comparison with the previous year – and of the economic and business issues which affect the Corporation's performance in the marketplace.

This discussion should be read in conjunction with the financial statements contained within this annual report. Financial information provided relates to the period ended December 31, 1997.

The Stelco Group of Businesses

In recent years Stelco Inc. has been organized into a group of steelmaking and steel-related businesses. By transforming the operations into a series of separate economic entities – one unincorporated Business Unit, eleven incorporated subsidiaries, six steel-related joint ventures, and a number of mining joint ventures – Stelco has become more responsive to rapidly changing market conditions and more economically efficient. The integrated steel businesses – Hilton Works, in Hamilton, and the Lake Erie Steel Company Ltd., in Nanticoke, Ontario – generate 75% of the Corporation's revenues. Two mini-mills – Stelco-McMaster Ltée, in Contrecoeur, Quebec, and AltaSteel Ltd., in Edmonton, Alberta – account for a further 10% of total revenues and afford valuable exposure to regional markets. Stelco's remaining operations (15% of total revenues) consist of a group of steel-fabricating businesses which transform quality steel into higher value-added products.

Strategy

Since the downturn in the steel business in the early 1990s the principal focus of management's efforts was to strengthen the Corporation's financial position. This has been substantially accomplished. Over the last five years the Corporation has dramatically reduced debt levels and at December 31, 1997, the debt-to-equity ratio was 27:73 and the net cash position was $300 million. Dividends on both preferred and common shares, which were suspended in the early 1990s, have been reinstituted.

Looking to the future, the key objectives are to maintain this solid financial foundation and to enhance shareholder value through improved financial performance.

Strategies in place to accomplish these objectives are: continuous improvement in operational performance, particularly in productivity, product yields, and energy usage; growing our profitability by expanding the value-added mix of products sold; and securing access to markets through improved quality, customer service, and supply dependability. Selective facility investment and continued workforce training will be used to equip our people with the technology and skills required to carry out our strategies.

Innovation, research, and development

To remain viable the Corporation must be at the forefront of change and innovation. In addition to research and product and process development activities undertaken at the individual businesses, significant research was undertaken through membership in industry-based consortia. These included:

UltraLight Steel Auto Body (ULSAB) – Phase II

This programme, sponsored by 33 of the world's leading steel companies, is designed to demonstrate a lightweight steel auto body structure that meets a wide range of performance targets. Phase II – Validation includes an economic analysis of ULSAB versus conventional steel auto bodies; development of a final engineering design, including crash simulation; and demonstration of ULSAB's manufacturability using state-of-the-art steels and existing manufacturing equipment to produce demonstration body-in-white prototypes.

Formtech – Phase II

This programme has been undertaken by a consortium consisting of two Canadian steel companies, four metal stampers, and a European automaker, and is aimed at developing advanced Computer-Aided Engineering (CAE) software that incorporates metal forming science. This software has the ability to provide rapid simulation at early stages of styling, product design, and tool development. It is also capable of optimizing process plans and overcoming part production problems, including identifying forming problems and predicting key factors such as part springback and press load requirements.

Projet Bessemer

Phase V of this project has continued the development of process and product technology for the direct casting of thin (5mm) carbon steel strip using a pilot caster of the Industrial Materials Institute (IMI) of the National Research Council. This project is sponsored by a consortium of Canadian steel companies, in cooperation with IMI. During 1997, IMI successfully commissioned a new one-ton furnace, an in-line rolling mill, a strip shear, a strip downcoiler, and roll-powder spray equipment. Also, IMI continued development of casting procedures to produce acceptable commercial-quality thin strip.

AISI Advanced Process Control

This multi-project programme is sponsored by 14 member companies of the American Iron and Steel Institute and is aimed at developing advanced process sensors and software to maintain the competitive advantage of North American steel producers. Significant progress was achieved in several project areas, including Microstructural Engineering of Hot Strip Mills, Optical Sensors and Controls for Improved Basic Oxygen Furnace Operation, and On-Line Measurement of Mechanical Properties.

The**Steel**Alliance

As a member of The**Steel**Alliance, Stelco is part of an innovative North American public awareness campaign designed to educate consumers on the true value of steel in their lives by emphasizing steel's attributes of safety, security, durability, and recyclability.

Income and expense

Overview

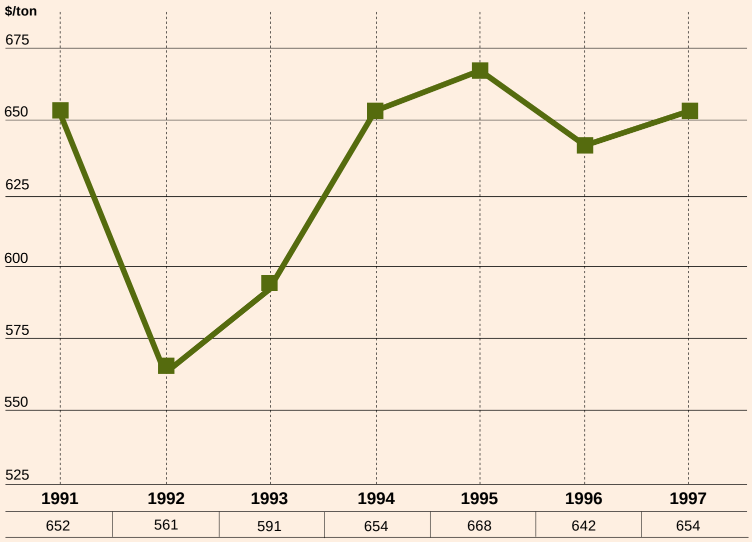
The steel industry in North America has benefited from strong demand during 1996 and 1997. Underlying Stelco's sustained sales growth in 1997 – the fourth year in a row – were buoyant steel demand and improved steelmaking output. The effects of favourable market conditions were somewhat tempered by the rising level of low-priced offshore imports.

The major markets for the Corporation's products are the automotive industry, steel service centres, the construction industry, pipeline systems, various industries that utilize pipe and tubular products, and wire and wire products.

Net sales

Sales reached $3.1 billion in 1997, an increase of $208 million from 1996. This growth was due to a combination of higher shipments and an increase in the average selling price per ton. It also marked the first time in the Corporation's history that sales exceeded the $3 billion level.

Average selling prices per ton 1991 to 1997



At $654 a ton, the average selling price per ton shipped increased by $12 a ton (approximately 2%) from the $642 per ton recorded in 1996. The increase in selling prices during 1997 re-established the positive trend that has been evident from the severely depressed levels of 1992. Augmented by about 200,000 tons of purchased steel, this year's steel shipments rose 5% to 4,818,000 tons from 4,577,000 tons in 1996.

Sales by Business Unit

(in millions)	**1997**	1996
Hilton Works	**$ 1,951**	$ 1,881
Lake Erie Steel Company Ltd.	**969**	802
Stelco-McMaster Ltée	**197**	177
AltaSteel Ltd.	**124**	124
Stelwire Ltd.	**206**	178
Frost Wire Products Ltd.	**34**	34
Stelco Fasteners Ltd.	**65**	57
Stelfil Ltée	**75**	66
Stelpipe Ltd.	**31**	146
Welland Pipe Ltd.	**92**	58
CHT Steel Company Inc.	**7**	8
Stelco USA, Inc.	**84**	62
Proportionately consolidated joint ventures (net) (Note 7, page 27)	**142**	118
Deduct inter-Unit sales	**(828)**	(770)
Total Sales	**$ 3,149**	$ 2,941

Sales in 1997 met or exceeded 1996 levels at most Units and decreased significantly only at Stelpipe Ltd., which did not operate during the first seven months of 1997 due to a work stoppage.

Sales by product group

(Dollars in millions)	**1997**	**% of total**	1996	% of total
Hot Rolled Sheet	**$ 848**	**27**	$ 691	24
Cold Rolled Sheet	**351**	**11**	327	11
Coated Sheet	**677**	**22**	630	22
Plate	**182**	**6**	189	6
Bars and Wire Rod	**507**	**16**	502	17
Wire and Wire Products	**330**	**10**	291	10
Pipe and Tubular Products	**197**	**6**	246	8
Other	**57**	**2**	65	2
Total	**$ 3,149**	**100%**	$ 2,941	100%

Sheet

Driven by a strong automotive sector and the strength of the North American economies, shipments of hot rolled, cold rolled, and coated sheet increased in 1997 over 1996. The substantial increase in hot rolled sheet shipments was also due, in part, to the work stoppage at Stelpipe Ltd.; hot rolled sheet tonnages normally converted by this Unit into pipe were sold to external customers. Despite the strong demand, prices improved only modestly through the year due to pricing pressure from new North American capacity and imports. Total sheet sales increased to $1,876 million in 1997, up $228 million over 1996, and as a result, sheet comprised 60% of the Corporation's total sales (up from 57% last year).

Plate

Plate sales to customers declined moderately in 1997. Plate production increased; the additional tonnage was consumed by the affiliated large-diameter pipe operations and sold as pipe. Overall, the plate market was reasonably strong in 1997, although low-priced imports precluded price increases until the latter part of 1997.

Bar and Wire Rod

Solid demand for bar and wire products during 1997 kept prices firm. Both production and shipments at Stelco Units were up from the previous year. Sales totalled $507 million, up by $5 million from 1996. The proportion of total sales was 16% in 1997 compared with 17% in 1996.

Wire and Wire Products

Demand for wire and wire products strengthened in 1997. While price increases were restrained by competitive factors, shipments and market participation increased during the year. Sales rose to $330 million from $291 million in 1996 (10% of consolidated sales in both years).

Pipe and Tubular Products

Demand for pipe and tubular products varied widely according to market sector in 1997. The ongoing buoyancy of the Canadian oil and gas industry ensured healthy demand for all oil-country goods including large-diameter pipe. Demand in the construction, distribution, and manufacturing sectors was less robust. Stelpipe Ltd. did not operate for the first seven months of 1997 due to a work stoppage. This resulted in overall pipe and tubular product sales declining to $197 million, down 20% from the $246 million recorded in 1996.

Operating expenses

Good operating performance in 1997 resulted in new records being set for steel production and shipments since steelmaking assets assumed their current configuration. Semi-finished steel output reached 5,108,000 tons, up 99,000 tons from 1996.

Although operations generally ran well in 1997, a number of events had a negative impact on the year's financial results. Among them:

- a planned shutdown at Lake Erie Steel Company Ltd. to accommodate the caster upgrade programme
- planned outages at AltaSteel Ltd. and Stelco-McMaster Ltée to accommodate construction and commissioning work on capital programmes
- unplanned outages at "E" and "D" Blast Furnaces at Hilton Works in February and November, respectively
- a work stoppage at Stelpipe Ltd. that continued from October 31, 1996 to July 7, 1997
- a $10 million after-tax charge related to the sale of Stelco Fasteners Ltd. in January 1998

During 1996, a number of events also occurred that affected financial performance. Among them:

- the five-week interim repair of the Lake Erie Steel Company Ltd. Blast Furnace
- a brief work stoppage at Stelwire Ltd. (Parkdale Works)
- the work stoppage at Stelpipe Ltd. that began on October 31, 1996 was unresolved at 1996 year-end
- an unexpected failure at its Central Boiler Station caused production interruptions at Hilton Works in June
- a failure of a 6000 hp motor at Lake Erie Steel Company Ltd. in December

In both years, some of the cost impact was mitigated by insurance coverage.

Keeping costs under control has always been an important corporate initiative. Reflecting higher output, total operating expenses in fiscal 1997 edged up 4% to $2.9 billion from $2.8 billion in 1996. However, 1997 operating expense per ton shipped decreased $5 to $600.

Major elements of Cost of sales

(Dollars in millions)	**1997**	1996
Employment costs	**$ 867**	$ 885
Raw materials	**834**	824
Purchased materials and services	**1,038**	906
Total	**$ 2,739**	$ 2,615

Employment costs

Employment costs in 1997 were $867 million (28% of net sales) compared with $885 million (30% of net sales) last year. Throughout 1997, the average number of employees declined to 11,732 from 12,076, because of work force attrition. The average employment cost per employee increased to $73,864 from $73,282 the previous year. Details are provided in the following table.

(Dollars in millions)	**1997**	1996
Wages and salaries		
For time worked	**$ 620**	$ 605
For vacations and statutory holidays not worked	**71**	76
	691	681
Supplementary employment benefits		
Pension costs – company and government	**65**	83
Group insurance plans and other benefits	**73**	78
Employment insurance and workers' compensation	**38**	43
	176	204
Total employment costs	**$ 867**	$ 885
Average number of employees	**11,732**	12,076
Additional employment cost data		
Number of pensioners at year-end	**11,993**	11,961
Pensions paid during the year	**$ 147**	$ 142
Total life insurance in force at year-end	**$ 747**	$ 713

The increase in the wages and salaries component of employment costs reflects, in part, the higher wage rates inherent in the new collective agreements signed, in 1996, with the locals of the United Steelworkers at nine of our Business Units. At Hilton Works, Stelco-McMaster Ltée, and Stelwire Ltd. (Burlington Works), the contracts run for an unprecedented six years. Others vary in length from two to four years. These new arrangements provide labour stability and more predictable labour costs.

The reduction in the cost for employment insurance and workers' compensation is an encouraging sign that the regulatory component of employment costs is beginning to ease.

A safe and secure workplace leads to major benefits such as fewer days lost to injury and improved health of employees. During 1997, both accident frequency and severity were down from the previous year, building on what has been a favourable, multi-year trend.

Raw materials

Coal and iron ore are the principal raw materials used by the Corporation's integrated steelmaking facilities. Scrap iron and steel is the main raw material used by the Corporation's electric furnace operations and is also used in the integrated steelmaking process.

The Kentucky-based Chisholm Coal Company, a wholly owned subsidiary, provides a significant portion of the Corporation's total metallurgical coal needs and all the coal required by the state-of-the-art Pulverized Coal Injection facility at Hilton Works. The remainder is sold commerically. At current mining rates, Chisholm's coal reserves are estimated to be between five and six years. The unit cost of coal produced at Chisholm Coal showed a minor decline in 1997 compared with 1996. The balance of Stelco's coal requirements is purchased from independent producers. Supplies are readily available at prices which in 1997 were virtually unchanged from 1996. In addition to coal, purchases of coke are made to supplement coke production. Prices of purchased coke can vary significantly in the spot market and are generally trending upwards.

To ensure secure sources of iron ore, Stelco Inc. has substantial interests in iron ore mining properties and production facilties across North America. The estimated reserves guarantee about a 30-year supply of iron ore. The Corporation has also entered into flexible, long-term contractual arrangements with outside producers to purchase iron ore pellets during periods of supply interruption at ownership sources.

The cost of iron ore pellets increased slightly in 1997 over the previous year. Wabush Mines reduced output due to lower international sales; the Hibbing Mine experienced some temporary difficulties with its ore grade; at the Eveleth Mines, above-normal maintenance outages resulted in somewhat lower production; and the Tilden Mine cut back operations to adjust inventory levels. The combination of these events caused a moderate rise in the cost of iron ore. The overall average cost of iron ore produced at the Corporation's facilities is below currently quoted world market prices.

Scrap is obtained from outside suppliers and internally, as a by-product, from production processes. Stelco-McMaster Ltée has a 50% interest in Fers et Métaux Recyclés Ltée, a processor of scrap derived primarily from obsolete vehicles. Fers et Métaux supplies steel scrap to Stelco-McMaster Ltée for use in its steelmaking furnace. AltaSteel Ltd. operates a scrap-preparation facility which includes an auto-hulk shredder. The average price of purchased scrap was approximately 7% higher in 1997 than in 1996.

Purchased materials and services

In 1997, electricity and natural gas comprised about 4% and 3%, respectively, of total manufacturing costs. Although the Corporation is a large consumer of these commodities, it believes current sources are sufficiently stable and adequate for the maintenance of operations. Prices were generally stable during the past year.

Unlike the previous year, prices for other commodities such as ferro-silicon, manganese, cobalt, and titanium, were generally stable in 1997. The major exception was zinc, the price of which fluctuated widely during the year; after rising in value for the first three quarters – it was up 50% by September – it plummeted in the fourth quarter, finishing 1997 at 1996 year-end levels.

Amortization

Amortization for fiscal 1997 was $129 million compared with $132 million in 1996. The main reason for decreased amortization was the relatively modest level of capital spending of recent years.

Corporate services

The cost for head office functions such as executive management, legal, information systems, raw material management and strategic purchasing (which support the activities of the subsidiaries and joint ventures), including a $4 million gain on the sale of surplus real estate, was $21 million. The comparative number for 1996 was $23 million.

Income from operations

In 1997, Income from operations totalled $260 million, a marked improvement over $171 million in 1996. As previously noted, better prices contributed to this increase, as well as the higher output and some increased efficiencies in operations. Also, comparative numbers for 1996 were negatively impacted by unusually large major maintenance expenditures at Lake Erie Steel Company Ltd.

Financial expense

Over the last five years the Corporation has aggressively reduced debt levels. Our debt-to-equity ratio is now 27:73, and the consolidated cash balance has grown to $300 million. These levels were achieved during a year when the Corporation invested $252 million in a number of major capital improvements at Hilton Works, Lake Erie Steel Company Ltd., and our other facilities. The financing of these projects was obtained from outside lenders and internally generated capital. Long-term debt outstanding increased by $93 million. This will result in higher interest expense in the future.

Reduction in average long-term debt and lower interest rates resulted in the Interest on long-term debt falling to $43 million from $46 million in 1996.

The income recorded under Other interest, at $7 million, was up slightly from last year. Although the balances invested in short-term investments were substantially higher, interest rates were lower.

Income taxes

Income tax expense in 1997 increased by $35 million to $87 million as a result of higher pretax profit. This item includes Canadian federal and provincial income taxes as well as Canadian Large Corporations Tax and the U.S. federal and state income taxes from the Corporation's activities in the United States.

Net income

Net income in 1997 was $137 million, up $58 million from the previous year's earnings of $79 million. Net income per common share rose to $1.17 from $0.63 last year. Both years were calculated using the weighted average number of common shares outstanding (approximately 106 million in 1997 and 105 million in 1996). As previously noted, better selling prices and increased output were the main reasons for the improved net income.

Dividends

Dividends declared on common shares totalled $9 million or $0.09 per common share in 1997. No common share dividends were declared in 1996. Regular quarterly dividends on all series of preferred shares were paid in the amount of $13 million in both 1996 and 1997.

Liquidity and capital resources

In 1997, the Corporation's financial position improved considerably, generating sufficient cash to fund its ongoing operations and to meet sinking fund and dividend payment schedules. In addition, a number of construction loans were arranged at favourable interest rates to undertake a number of important capital investments. As of December 31, 1997, the Corporation's net cash position totalled $300 million, up from $148 million on December 31, 1996, and its debt-to-equity ratio was 27:73. The Corporation's aim is to maintain adequate cash balances and preserve a conservative debt-to-equity position.

A key aim of the Corporation has been to increase financial accountablity at the Business Units. During 1997, most subsidiaries were responsible for their own lines of credit, cash management, and borrowings without guarantees from Stelco Inc. At December 31, 1997, total lines of credit available were $302 million, about $22 million of which had been drawn down.

Operating activities

Cash generated from Operating activities increased to $291 million in 1997 from $191 million in 1996. The higher level of Net income in 1997, $137 million compared with $79 million in 1996, was one of the major factors in the improvement. Another significant factor was the higher amount of Deferred income taxes of $52 million in 1997 compared with $3 million in 1996. The amount for 1996 was low due to the impact of corporate restructuring, mainly the incorporation of Lake Erie Steel Company Ltd. The adjustment for Amortization in 1997 fell slightly to $129 million from the $132 million in 1996.

The Provision for blast furnace relines, a non-cash charge to cost of sales in the year, was $14 million in 1997, twice last year's amount; an ongoing review ensures the adequacy of reline provisions in light of changing technology and operating practices. Included under Other is the 1997 impact of the $16 million pretax loss related to the January 1998 sale of Stelco Fasteners Ltd. This was a non-cash effect in 1997 since the actual cash transaction did not take place until early in 1998.

During 1997, the Operating elements of working capital used $19 million. Accounts receivable increased by $62 million reflecting the growth in sales and shipments in 1997. This use of cash was offset by a $65 million increase in Accounts payable and accrued due mainly to heavy capital spending towards year-end. In 1996, Operating elements of working capital used $30 million.

When cash funding of the pension plans differs from pension costs calculated under Generally Accepted Accounting Principles, deferred or accrued pension costs arise. The cash flow impact of Deferred pension costs was a use of cash of $26 million compared with $3 million in 1996. At December 31, 1997, Deferred pension costs totalled $125 million compared with $99 million at the previous year-end.

Other – net includes a $6 million use for blast furnace spending. In 1996, the main item was a favourable impact of $11 million relating to investment tax credits.

Investment activities

This past year, expenditures for capital assets increased to $252 million, from $53 million in 1996.

Major capital expenditures in 1997 were incurred for:

- Slab-caster modifications and installation of a second Blast Furnace casthouse at Lake Erie Steel Company Ltd. Spending on this project in 1997 was $88 million ($2 million in 1996). The aims of this project are improved product quality and a 20% increase in steelmaking capacity at this facility.
- Improvements to the Plate Mill at Hilton Works. Spending in 1997 was $43 million. Benefits of this undertaking are improved mill productivity, product quality and product range, increased capacity, and reduced operating costs.
- Installation of a new reheat furnace at Hilton Works Bloom and Billet Mill. Spending in 1997 was $18 million ($2 million in 1996). The project will significantly improve mill productivity and product quality, reduce environmental emissions, and reduce operating costs.
- Upgrading No. 7 Coke Oven Battery at Hilton Works. Spending on this project in 1997 was $54 million. This complete rebuild will extend the life of the facility by 15 years, improve coke output and quality, and reduce air emissions.

A number of more modest capital projects at Hilton Works, the subsidiaries and the joint ventures were focused on important improvements to health and safety, environmental protection, product quality, and enhancement and revitalization of the existing asset base.

In June 1996, $69 million was advanced to the Z-Line Company, a 60%-owned partnership, allowing it to eliminate its debt to a consortium of banks. During 1997, a total of $17 million of the advance was repaid for an outstanding balance of $45 million at the end of 1997 ($7 million was repaid in 1996).

Proceeds of $21 million were received in 1996 from the sale of the Corporation's 40.3% investment in Bliss & Laughlin Industries Inc. of Harvey, Illinois. A gain of $5 million was recorded on this transaction. In 1997, the surplus property at the former R&D Centre in Burlington, Ontario was sold for $5 million and a gain of $4 million was realized.

After negotiations during the latter half of 1997, the sale of the business of Stelco Fasteners Ltd. was concluded in January 1998. Net proceeds totalling $11 million are to be received early in 1998.

Financing activities

During 1997, Stelco issued $153 million of Long-term debt, all of it representing drawdowns of previously arranged financing for major capital projects. The only project financing in 1996 was the $11 million allocated for the Corporation's 89% share of the Pulverized Coal Injection facility.

Repayments of Long-term debt totalled $57 million in 1997 ($65 million in 1996). Of this amount, payments of $30 million were made on the Notes payable, $13 million on the Stelco-McMaster Ltée term loan, and $14 million against amounts owing by proportionately consolidated joint ventures.

The Corporation has a Key Employee Stock Option Plan. At the Annual Meeting May 3, 1996, the number of Series A Convertible Common Shares reserved for issuance under the Plan was increased from 5 million to 8 million. During 1997, 661,000 options at $7.75 and 150,000 options at $10.35 were granted, and 2,054,000 options were exercised, generating $14 million. (In 1996, 167,500 options were exercised, generating $1 million.) No options expired in 1997 (41,000 in 1996). As of December 31, 1997, 1,979,100 options remained outstanding (3,222,100 at December 31, 1996) at exercise prices ranging from $1.22 to $10.35.

As required by the terms of the issues, the repurchase of preferred shares continued. In 1997, 7,020 Series B Preferred Shares were repurchased at par for $175,500 and were cancelled. In 1996, 61,350 Series B Preferred Shares were repurchased at par for $1,533,750 and were cancelled. In 1997, no Series C Preferred Shares were purchased. In 1996, 170,200 shares with stated capital of $4,255,000 were purchased for a cost of $4,121,950. The resulting excess was recorded in Contributed surplus.

Risks and uncertainties

Steel supply and prices

Significant risk factors facing the steel industry and the Stelco Group of Businesses pivot around pricing and trade. While steel demand is usually a fairly reliable indicator of general economic conditions, issues such as global supply and demand, and expanding new capacity also affect steel prices. Both factors explain, in part, why prices remained relatively flat in 1997 despite a very strong North American steel demand.

Like all steel companies, the Stelco Group is alert to general competitive issues in its own business and to trade risk. The Corporation vigilantly monitors unfair trade while supporting an integrated North American steel market.

Among the most important issues facing the North American steel industry is global oversupply caused by both new domestic capacity and a glut of steel imports from abroad. In 1997 alone, imports surged by an estimated 50% to comprise 37% of the total Canadian market. The single greatest contributor to this import growth is the dumping of cheap steel from Russia, China, and a number of former Soviet republics. In just three years, Russia has become one of the largest steel exporters into the U.S. and Canadian markets, a fact which has resulted in all three North American Free Trade Agreement (NAFTA) governments (the U.S., Canada, Mexico) flagging the issue. The current economic crisis in Asia, the effects of which are as yet not clear, may result in increased exports from that region.

Unfair trade complaints have been filed by domestic producers in both Ottawa and Washington. On October 27, the Canadian International Trade Tribunal (CITT) ruled that dumped plate from Russia, China, South Africa, and Mexico threatened future domestic production. The U.S. International Trade Commission (ITC) reached similar conclusions to complaints filed by American steel producers.

Because of the vital importance of the U.S. market, Stelco executes its bilateral trade obligations carefully and continues to vigorously support a level playing field in the North American steel business. Direct sales to the U.S. are conducted in strict accordance with current trade rules. The Corporation firmly believes in an integrated continental steel market and the need for common trade rules within the NAFTA.

In the meantime, Stelco services its U.S. customers in a competitive manner and the Corporation's ongoing access to this market is a direct reflection of the success of such efforts.

Currency

The Corporation both buys and sells in the U.S. market and has no direct material currency risk. A rising Canadian dollar, however, reduces the revenue realizations from the U.S. exports of the Corporation's Canadian customers, thus affecting their ability to compete. The average value of the Canadian dollar in U.S. terms declined from $0.739 in 1996 to $0.722 in 1997.

Interest rates

North American interest rates have been declining over the last few years and appear to be stabilizing at relatively low levels and inflation seems to be under control. Stelco's debt load, while increasing in 1997, is relatively low by historical standards. With adequate cash balances and low interest rates, there is no abnormal interest rate risk at Stelco. However, if the Bank of Canada raises interest rates significantly to defend the value of the Canadian dollar, there could be a negative impact on general economic activity and steel consumption.

Year 2000

The Corporation has a programme which is well underway to examine and resolve Year 2000 issues. Late in 1995, the Stelco Group of Businesses began assessing the impact of the Year 2000 on its computer and process control systems. As a consequence, measures were taken, and resources allocated, to make necessary changes to our computer and process-control systems by December 31, 1998.

The impact analysis on our systems is now finished and the necessary conversion programmes and coordination with third parties where electronic interaction is present, are underway. Integration testing of the systems is scheduled to begin in the first quarter of 1998.

Based on information currently available, the cost of remediation and coordination is not expected to have a material adverse effect on the Corporation's financial condition.

Should Year 2000 issues not be resolved in a timely fashion, the Corporation could face business interruptions or delays. The Corporation is therefore dedicating significant resources to Year 2000 issues with the objective of effecting a smooth transition to the new millennium.

Labour issue

The union local at Hilton Works has complained to the Ontario Labour Relations Board regarding certain pension matters. The issue is set forth in the Note 14 to the Financial Statements (see page 34).

Changes in accounting rules

Post-retirement benefits

The accounting method used by most Canadian companies to calculate the annual expense for post-employment benefits is expected to undergo major changes by the year 2000. These benefits will be accounted for on an accrual basis rather than on the “pay-as-you-go” basis currently used by Stelco and most other employers. The Corporation is reviewing its options and will determine its course of action in due time. The changes are likely to result in a material charge to retained earnings.

Income taxes

Effective for fiscal years commencing on or after January 1, 2000, new rules will apply for corporate income tax accounting which will require Stelco to move to the “liability” method from the "deferral" method. Under the new standard, tax assets and liabilities must be measured using income tax rates and applying tax laws which are expected to apply to taxable income in periods in which the tax assets or liabilities are expected to be realized or settled. The impact of this change on the Corporation is expected to be somewhat favourable, either with respect to tax rates or on retained earnings, when these requirements are adopted.

Environment

Among the most important responsibilities of the Corporation's Business Units is complying with an evolving body of environmental laws and regulations concerned with, among other things, emissions into the air, discharges to surface ground water, noise control, and the generation, handling, storage, transportation and disposal of toxic and hazardous substances. These laws and regulations vary depending on the location of the facility and can fall within federal, provincial, or municipal jurisdictions.

In meeting its overall environmental goals and government-imposed standards in 1997; the Corporation incurred operating costs of $64 million ($64 million in 1996) and spent $38 million on capital improvements ($11 million in 1996).

At the present time, Hilton Works is required to meet certain water emission standards established by the Ontario Government under its Municipal/Industrial Strategy for Abatement (MISA). The Corporation has earmarked adequate funds and is confident that this Unit will satisfy these water-emission control standards.

Another environmental issue facing the Stelco Group of Businesses is the federal government's Toxic Substances Management Plan (TSMP), which is identifying and characterizing toxic substances. On occasion, the TSMP also adds substances to a list of toxins which require management.

Stelco's Corporate Health, Safety, and Environment Department regularly reviews and audits each Business Unit's operating practices to monitor compliance with the Corporation's environmental policies and legal requirements.

The Corporation believes that future costs relating to environmental compliance will not have a material adverse effect on the Corporation's financial position. There is always the possibility, however, that unforeseen changes, such as new laws or enforcement policies, or a crisis at one of our properties or operations, could result in material adverse costs.

Technology and competition

The expansion in North America of electric arc furnace steel mills (also referred to as mini-mills), which produce steel from scrap, has contributed to the competitive pressures faced by integrated producers. Although the participation of mini-mills in steel markets has traditionally been limited to structural, bar, and rod products, this is rapidly changing. Thin-slab-casting technologies are allowing such mills to participate in sheet and plate markets that were largely served by integrated plants.

Stelco Inc. is unable to predict the extent and severity of future competition but the Corporation will continue to focus its resources and capital expenditures on maintaining its status as a strong and capable competitor in North American steel markets.

Outlook

As noted earlier, demand for steel in North America was high in 1997 and through the early part of 1998. Management expects demand conditions to remain favourable through 1998, although it remains to be seen what impact the current economic crisis in Asia will have on the economies of Canada and the U.S. On the supply side, increased output from new steelmaking facilities combined with a continuation of high import levels will continue to exert downward pressure on steel prices. Energy sector demand for pipe and tubular products is exceptionally strong and the large-diameter pipe mill at Welland Pipe Ltd. and the Camrose Pipe Company joint venture are expected to operate at high capacity levels in 1998.

Directors and Officers *At December 31, 1997*

Directors

John N. Abell
Corporate Director
A director since 1992.
Marlborough, Wilts., UK.

James C. Alfano
President and
Chief Executive Officer
Stelco Inc.
A director since 1996.
Hamilton, Ontario

John E. Caldwell
President and
Chief Executive Officer
CAE Inc.
A director since 1997.
Toronto, Ontario

William P. Cooper
President and
Chief Executive Officer
Cooper Construction Limited
A director since 1989.
Toronto, Ontario

Richard Drouin
Corporate Director
A director since 1996.
Quebec City, Quebec

George Lethbridge
Corporate Director
A director since 1993.
Hamilton, Ontario

Douglas W. Mahaffy
President and
Chief Executive Officer
McLean Budden Limited
A director since 1993.
Toronto, Ontario

J. Dean Muncaster
Corporate Director
A director since 1985.
Collingwood, Ontario

J. Fraser Mustard
Bell Canada Fellow and
Founding President
The Canadian Institute for
Advanced Research
A director since 1986.
Toronto, Ontario

Peter J. Nicholson
Executive Vice President,
Corporate Strategy
BCE Inc.
A director since 1997.
Montreal, Quebec

Helen K. Sinclair
Chief Executive Officer
BankWorks Trading Inc.
A director since 1995.
Toronto, Ontario

Frederick H. Telmer
Chairman
Stelco Inc.
A director since 1989.
Burlington, Ontario

Officers

Frederick H. Telmer
Chairman

James C. Alfano
President and
Chief Executive Officer

R. Eric Rogan
Executive Vice President
and Chief Financial Officer

G. Blair Cowper-Smith
Corporate Secretary and
Special Counsel

Paul J. Paciocco
Vice President and
General Manager –
Hilton Works

Karl H. Reitz
Vice President –
Manufactured Products
Group

Gordon W. Rich
Vice President and
General Manager –
Lake Erie Steel Company
Ltd.

Brian W. Warry
Vice President –
Purchasing, Raw Materials,
and Transportation

Matti Tuvikene
Assistant Secretary

Historical Summary [1]

*Dollars in millions except as indicated **		**1997**	1996	1995	1994	1993
Operations *(Thousands of net tons)*						
Production of semi-finished steel		**5,108**	5,009	4,970	4,841	4,924
Steel shipments		**4,818**	4,577	4,380	4,460	4,492
Income and expense						
Net sales	$	**3,149**	2,941	2,926	2,916	2,491
Cost of sales	$	**2,760**	2,638	2,521	2,553	2,314
Amortization	$	**129**	132	130	138	122
Income from operations	$	**260**	171	275	225	55
Financial expense						
Interest on long-term debt	$	**43**	46	63	75	78
Other interest (income) expense – net	$	**(7)**	(6)	(12)	(2)	7
Income before income taxes	$	**224**	131	224	152	(30)
Income taxes - recovery (expense)	$	**(87)**	(52)	(68)	(37)	(6)
Net income (loss)	$	**137**	79	156	115	(36)
Net income per common share [2]	*$	**1.17**	0.63	1.35	1.01	(0.62)
– Fully diluted	*$	**1.14**	N/A	N/A	N/A	N/A
Financial position						
Cash and short-term investments	$	**322**	165	190	267	111
Other current assets	$	**1,086**	1,021	1,000	962	816
Total current assets	$	**1,408**	1,186	1,190	1,229	927
Bank indebtedness	$	**22**	17	67	156	176
Other current liabilities	$	**607**	549	548	550	452
Total current liabilities	$	**629**	566	615	706	628
Working capital	$	**779**	620	575	523	299
Capital assets (net)	$	**1,236**	1,129	1,223	1,277	1,194
Other non-current assets	$	**189**	173	121	81	243
Total investment	$	**2,204**	1,922	1,919	1,881	1,736
Long-term debt	$	**486**	393	457	581	695
Other non-current liabilities	$	**264**	203	198	140	112
Shareholders' equity	$	**1,454**	1,326	1,264	1,160	929
Preferred shareholders' equity	$	**166**	167	172	178	178
Common shareholders' equity	$	**1,288**	1,159	1,092	982	751
	$	**1,454**	1,326	1,264	1,160	929
Common shareholders' equity per common share	*$	**12.00**	11.02	10.39	9.04 [6]	8.80
Cash flow						
Net cash provided by (used for):						
Operating activities	$	**291**	191	266	253	125
Investment activities						
Expenditures for capital assets	$	**(252)**	(53)	(79)	(23)	(8)
Proceeds from sale of assets	$	**5**	21	5	46	–
Other investment activities (net)	$	**17**	(62)	–	–	(10)
Financing activities						
Net proceeds from issue of long-term debt	$	**153**	11	80	–	–
Reduction of long-term debt	$	**(57)**	(65)	(207)	(202)	(52)
Net proceeds from issue of common shares	$	**14**	1	1	134	2
Purchase of preferred shares	$	**–**	(6)	(6)	–	–
Cash dividends paid	$	**(19)**	(13)	(48)	(17)	–
Net increase (decrease) in cash position	$	**152**	25	12	191	57
Cash position at end of year	$	**300**	148	123	111	(65)
Other data						
Return on average capital employed [3]	%	**7.8**	5.5	10.2	8.7	0.5
Return on average common shareholders equity [2]	%	**10.2**	5.9	13.9	12.2	(6.8)
Debt-to-equity ratios	%	**27:73**	25:75	28:72	35:65	50:50
Dividends declared – preferred [5]	$	**13**	13	47	17	4
– common	$	**9**	–	–	–	–
Per common share	*$	**0.09**	–	–	–	–
Average number of employees		**11,732** [4]	12,076 [4]	12,356 [4]	13,120 [4]	11,951
Number of registered common shareholders at year-end		**11,803**	10,988	12,034	12,710	13,853

1992	1991	1990(8)	1989	1988	1987
4,680	3,705	2,785	4,729	4,503	4,528
4,176	3,252	3,390	4,254	4,245	4,257
2,203	1,983	2,101	2,749	2,712	2,546
2,176	1,967	2,199	2,405	2,374	2,291
128	130	133	130	125	110
(101)	(114)	(231)	214	213	145
82	86	92	85	80	75
8	20	19	2	(3)	(8)
(191)	(220)	(342)	127	136	78
64	84	145	(33)	(39)	(15)
(127)	(136)	(197)	94	97	63
(1.76)	(3.05)	(5.96)	2.25	1.95	0.66
N/A	N/A	N/A	2.13	1.91	N/A
68	11	7	13	21	36
799	811	727	1,222	1,009	924
867	822	734	1,235	1,030	960
190	75	138	68	48	21
398	377	383	581	421	416
588	452	521	649	469	437
279	370	213	586	561	523
1,309	1,424	1,532	1,624	1,612	1,635
247	235	255	219	214	208
1,835	2,029	2,000	2,429	2,387	2,366
767	796	826	855	822	691
101	135	182	345	386	341
967	1,098	992	1,229	1,179	1,334
178	183	185	189	191	382
789	915	807	1,040	988	952
967	1,098	992	1,229	1,179	1,334
9.46	11.25(7)	22.74	29.46	28.28	27.53
(53)	(102)	186	85	205	293
(12)	(30)	(48)	(141)	(116)	(149)
47	–	–	–	–	–
(9)	(5)	(82)	(19)	(7)	(95)
–	–	–	124	169	89
(27)	(27)	(87)	(34)	(35)	(36)
1	239	2	6	5	5
(5)	(1)	(3)	(1)	(197)	(196)
–	(7)	(44)	(48)	(66)	(77)
(58)	67	(76)	(28)	(42)	(166)
(122)	(64)	(131)	(55)	(27)	15
(4.2)	(4.4)	(6.5)	6.0	5.9	4.1
(17.0)	(17.6)	(22.9)	7.8	7.2	2.4
50:50	51:49	50:50	43:57	42:58	35:65
–	–	15	15	29	41
–	–	26	35	35	35
–	–	0.75	1.00	1.00	1.00
12,753	12,890	14,348	16,147	16,207	16,960
14,264	13,892	14,447	15,154	16,109	17,191

1. Effective January 1, 1995, Accounting Standards require that the Corporation proportionately consolidate all joint venture investments. 1994 figures have been restated; 1993 and prior years have not been restated since the financial information required is not reasonably determinable.

2. After preferred dividends.

3. After adding back interest on long-term debt (net of tax) to net income (loss).

4. The average number of employees of Stelco Inc., its wholly owned Business Units, and wholly owned subsidiaries was 11,768 in 1994, 11,437 in 1995, 11,141 in 1996, and 10,763 in 1997.

5. No dividends were declared in the first three quarters of 1993, or in the years 1992 or 1991. Dividends declared – preferred in 1995, 1994, and 1993 include payment of arrears.

6. Reflects the exercise of 22,200,000 Common Share Purchase Warrants.

7. Reflects the issue of 44,500,000 units.

8. 1990 operations were interrupted by strikes: 106 days at Hilton Works and for various periods at other locations.

Corporate Directory*

Corporate Office

Stelco Inc.
P.O. Box 2030
Hamilton, Ontario L8N 3T1
Tel: (905) 528-2511
Fax: (905) 577-4412
Internet address: www.stelco.ca *or* www.stelco.com

Courier address:
100 King Street West
Hamilton, Ontario L8P 1A2

Business Unit

Hilton Works
P.O. Box 2030
Hamilton, Ontario L8N 3T1

P. J. Paciocco
Vice President and General Manager
Tel: (905) 527-8335
Fax: (905) 308-7002

Subsidiary Companies, Wholly Owned

Lake Erie Steel Company Ltd.
General Delivery
Nanticoke, Ontario N0A 1L0

G. W. Rich
Vice President and General Manager
Tel: (519) 587-4541
Fax: (519) 577-7705

Stelco-McMaster Ltée
P.O. Box 249
Contrecoeur, Quebec J0L 1C0

M. Francoeur
President and Chief Executive Officer
Tel: (514) 652-1100
Fax: (514) 652-1101

AltaSteel Ltd.
P.O. Box 2348
Edmonton, Alberta T6B 2X6

H. J. Lepp
President and Chief Executive Officer
Tel: (403) 468-1133
Fax: (403) 468-7335

Stelwire Ltd.
P.O. Box 2030
Hamilton, Ontario L8N 3T1

J. K. Prikryl
General Manager
Tel: (905) 528-9473
Fax: (905) 577-4409

Frost Wire Products Ltd.
P.O. Box 1000 LCD-1
Hamilton, Ontario L8N 3R1

N. D. Clark
General Manager
Tel: (905) 528-8895
Fax: (905) 577-4509

Stelfil Ltée
303 St. Joseph Blvd.
Lachine, Quebec H8S 2K9

B. M. Guay
General Manager
Tel: (514) 367-2424
Fax: (514) 367-2408

Stelpipe Ltd.
P.O. Box 1010
Welland, Ontario L3B 5Y6

J. E. Fry
General Manager
Tel: (905) 735-7473
Fax: (905) 735-9069

Welland Pipe Ltd.
P.O. Box 99
Welland, Ontario L3B 5P2

D. S. Hunter
General Manager
Tel: (905) 735-8338
Fax: (905) 735-4387

CHT Steel Company Inc.
300 Newkirk Road
Richmond Hill, Ontario L4C 4Y8

R. E. Taylor
Vice President and General Manager
Tel: (905) 884-5000
Fax: (905) 884-7956

Stelco USA, Inc.
2855 Coolidge Hwy., Suite 203
Troy, Michigan
U.S.A. 48084

L. S. Simpson
Vice President and General Manager
Tel: (248) 649-3460
Fax: (248) 649-1104

Chisholm Coal Company
32601 State Highway 194 E
Jamboree, Kentucky
U.S.A. 41536

R. C. Miser
Vice President and General Manager
Tel: (606) 456-3432
Fax: (606) 456-8565

Ontario Coal Company, Delaware
Ontario Eveleth Company, Minnesota
Ontario Hibbing Company, Minnesota
Ontario Tilden Company, Michigan
Stelco Holding Company, Delaware
Stelco Coal Company, Pennsylvania

Other Offices

Longueuil Sales Office
110, rue de la Barre, Bureau 224
Longueuil, Quebec J4K 1A3
Tel: (514) 442-3555
Fax: (514) 442-0364

Toronto Office
P.O. Box 205
Toronto-Dominion Centre
Toronto, Ontario M5K 1J4
Tel: (416) 362-2161
Fax: (416) 362-2167

Courier address:
Royal Trust Tower, Suite 2202
77 King Street West
Toronto, Ontario M5K 1J4

Windsor Sales Office
4520 Rhodes Drive, Unit 100
Windsor, Ontario N8W 5C2
Tel: (519) 251-1050
Fax: (519) 251-1650

Joint Ventures

	% owned
Iron Ore	
Wabush Mines, Nfld. & Que.	37.9
Hibbing Development Company, Minn.	24.1
Eveleth Mines L.L.C., Minn.	15.0
Tilden Mining Company L.C., Mich.	15.0
Ontario Iron Company, Minn.	10.0
Hibbing Taconite Company, Minn.	6.7
Other	
PCI-Hilton Corporation, Ont.	89.0
Z-Line Company, Ont.	60.0
Baycoat, Ont.	50.0
Fers et Métaux Recyclés Ltée, Que. (A Corporate Joint Venture of Stelco-McMaster Ltée)	50.0
MOLY-COP Canada, B.C. (A Partnership of AltaSteel Ltd.)	50.0
Torcad Limited, Ont.	50.0
Camrose Pipe Company, Alta.	40.0
Arnaud Railway Company, Que.	37.9
Wabush Lake Railway Company, Limited, Nfld.	37.9
Knoll Lake Minerals Limited, Nfld.	22.1
Northern Land Company Limited, Nfld.	18.9
Twin Falls Power Corporation Limited, Nfld.	6.5

** Excludes inactive companies*

Investor Information

Shares

The Series A and Series B Convertible Common Shares and the Preferred Shares Series C are listed on The Toronto Stock Exchange and The Montreal Exchange. The Preferred Shares Series B are listed on The Toronto Stock Exchange. The rights and privileges of each class of shares are set out in the financial statement section of this Annual Report.

At December 31, 1997, there were 11,803 registered holders of common shares. Approximately 96% of the Corporation's issued common shares were held by shareholders with Canadian addresses.

Quarterly comparison *(in millions except as indicated*)*

Quarter		1		2		3		4	
		1997	1996	**1997**	1996	**1997**	1996	**1997**	1996
Net sales	$	**772**	709	**819**	793	**763**	712	**795**	727
Income from operations	$	**66**	41	**81**	65	**76**	16	**37**	49
Net income	$	**32**	17	**43**	34	**41**	5	**21**	23
Income per common share	*$	**0.27**	0.13	**0.38**	0.29	**0.35**	0.02	**0.17**	0.19
– fully diluted	*$	**0.27**	N/A	**0.37**	N/A	**0.34**	N/A	**0.17**	N/A
Series A common shares									
High	*$	**8.60**	6.88	**10.80**	6.95	**13.35**	6.80	**12.05**	8.75
Low	*$	**7.20**	5.50	**7.25**	6.00	**10.30**	5.80	**8.75**	6.25
Trading volume		**18**	16	**27**	11	**36**	14	**40**	23

Dividends

Dividends on preferred shares were paid quarterly on February 1, May 1, August 1, and November 1 of 1997 and 1996. Dividends on common shares were paid on August 1 and November 1 of 1997. No dividends were paid on common shares in 1996.

Transfer agent

The Preferred Shares Series B and C, and the Convertible Common Shares Series A and B are transferable through the Corporation's Transfer Agent, CIBC Mellon Trust Company, at their offices in Toronto, Montreal, and Vancouver.

Investor inquiries

Questions and comments regarding Stelco Inc. or any information appearing in the Annual Report, Quarterly Reports, or any other corporate publication may be directed to:

Stelco Inc.
Office of the Secretary,
P.O. Box 2030
Hamilton, Ontario L8N 3T1
Telephone: (905) 528-2511 Ext. 4985
Fax: (905) 577-4575
Internet address: www.stelco.ca or www.stelco.com

Pour obtenir un exemplaire de la version française de ce rapport, veuillez écrire à :
Stelco Inc.
Bureau du Secrétaire
C.P. 2030
Hamilton, Ontario L8N 3T1

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Stelco Inc.
P.O. Box 2030, Hamilton, Ontario L8N 3T1