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A Season of Change for Canadian Steel

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By Scott Robertson

PITTSBURGH -- Denis Turcotte took over as president and chief executive officer of Algoma Steel Inc., Sault Ste. Marie, Ontario, in September 2002 after more than a decade working in the forest products industry. That experience gave Turcotte the vision to see both the forest and its trees, a perspective that views the Canadian integrated steel industry branching out in new directions.

The Canadian industry is at something of a crossroads, with its three major integrated steel producers all facing challenges both similar and different in many important ways. For example:

· Creditors of Stelco Inc., Hamilton, Ontario, have just approved a restructuring plan that might finally allow the company to emerge from bankruptcy protection after almost two years.

· After a joint takeover offer by Luxembourg-based Arcelor SA and Charlotte, N.C.,-based Nucor Corp., was rejected by Dofasco Inc.'s board of directors, shareholders of the Hamilton steelmaker are being asked to support a takeover attempt by ThyssenKrupp AG, Düsseldorf, Germany, which has offered about $4.1 billion for the company.

· One of Algoma Steel's largest investors is pushing to revamp its board of directors. U.S. hedge fund Paulson & Co. Inc., New York, has asked a court to advance a scheduled March 22 meeting of shareholders in which it will move to replace Algoma's current board with its own nominees.

Many see the moves involving the three Canadian integrated steelmakers as steps toward further global consolidation. They say the time has come for companies the size of the three Canadian producers-Stelco produced 5.4 million tons of steel in 2004, Dofasco about 5.3 million tons and Algoma around 2.5 million tons-to be consolidated into larger operations.

"Consolidation really started six or seven yeas ago in Europe, and maybe four years ago in the U.S.," Turcotte said in a recent interview. "I think you are starting to see things come together, but I don't think you can say it is strictly a Canadian thing or a U.S. thing. I think it is a North American phenomenon at this point.

"There will be consolidation going forward. We saw the same things in the forest products industry. What has happened in North America is that the investors now are turning their attention to the stronger, more well-managed companies. This is different than what ISG did. The bottom-feeding companies are gone and now companies who want to consolidate are realizing that they are going to have to pay up to do it."

ISG, the former International Steel Group Inc. founded by Wall Street financier Wilbur Ross, in the early part of this decade acquired

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bankrupt or ailing steel assets for, essentially, pennies on the dollar, cobbling together LTV Corp., Bethlehem Steel Corp., Acme Steel Inc. and Weirton Steel Co. under one corporate flag. Once free of the huge legacy costs that those companies shed through the Chapter 11 bankruptcy process, Ross was able to revive the companies into money-makers as steel fortunes turned around. He sold the assets of ISG to Mittal Steel Co. NV earlier this year in a deal that was valued at some $17 billion.

John Anton, a longtime steel industry analyst, economist and director of steel service at Waltham, Mass.,-based Global Insight Inc., said the Canadian integrated steel industry now appears poised to become part of the consolidation game.

Anton believes the stage is set for the Canadian companies to become involved in a global transformation currently under way in steel. "It's not just Canada," he said. "But Canada is the next step in the process. There aren't many of those 1-million- or 1.5-million-ton-per-year companies around any more, with the exception of China. Even on the electric furnace side, there has been a lot of change. The term mini-mill almost does not apply any more. On the blast furnace side, you have these 4-million- or 5-million-ton companies in Canada . . . in a position now where they stand to be next (to be consolidated)."

Barry LaCombe, president of the Canadian Steel Producers' Association, Ottawa, said it is the right time to invest in the Canadian steel industry.

"When you look at the industry, it is very productive and the companies themselves are investing to improve their operations. There are improvements being made, or scheduled to be made, at all three companies that will allow them to move into more high-value-added products," LaCombe said. "But there are challenges, too. Natural gas prices in North America are higher than they are anywhere in the world. Canada right now is below the (air emissions) levels of the Kyoto protocols, but we are challenged to go lower. We do not want to see our customers being negatively affected by these things.

"The climate (for consolidation in Canada) is beginning to change a bit, but those other challenges will still be there," LaCombe added. "We want to be sure the industry remains in position to meet those challenges."

The United Steelworkers union will have a large say in the changing face of the Canadian industry and, in some respects, already has. The union signed on to the recapitalization plan for Stelco proposed by Tricap Management LLC. That plan at first was rejected by Stelco, but major elements of it are part of the restructuring plan approved by creditors earlier this month. The Ontario Superior Court of Justice will conduct a hearing Jan. 17 to consider the plan.

The potential purchase of Dofasco by ThyssenKrupp might open new doors for the union. Dofasco is not a union shop, but Wayne Fraser, Ontario/Atlantic director for the USW, said that an organizing drive already is under way at the steelmaker, with the union selling the point that it can protect more jobs during a takeover than a non-union operation would be able to preserve.

Leo Gerard, international president of the USW and a native of Sudbury, Ontario, has been involved in organizing efforts and contract negotiations with Canadian steel producers many times throughout the years. He said the recent spate of activity surrounding Canadian producers is symptomatic of the lingering effects of the ills that hit the North American steel industry in the late 1990s.

"I think these are clear examples of what happened with the Asian financial crisis and the problems of global oversupply of steel," Gerard said. "Let's not forget that companies in Canada-like Ivaco, Slater and Atlas-were among the first to fall. Now you've got the situation at Algoma, which is a clear example of what is wrong in North American manufacturing. You've got these fast-money people in Paulson who don't give a damn about the long-term health of the company. All they want to do is line their pockets."

Gerard said he also is skeptical of ThyssenKrupp's plans for Dofasco. The German steel producer long has been interested in getting a foothold in the North American market to supply U.S. auto manufacturers. The company has been rumored several times to be interested in AK Steel Corp., Middletown, Ohio, for the same reason.

"Dofasco is a reasonably healthy company that got a competitive bid for its shares," Gerard said. "But I am skeptical of this kind of investment. It reminds me of when the Japanese came over and invested in National Steel Corp. There was no long-term benefit to National Steel in that deal. The Japanese took care of themselves first and of National Steel and its employees second. I think it could be the same thing here."

Michael Locker, a steel industry consultant and founder of Locker Associates Inc., New York, said the Canadian steel industry has been relatively stable in recent years when viewed in the context of the North American industry as a whole.

"The Canadian industry has not grown much. The industry there is in a strong position with regard to raw materials such as iron ore. They are well-situated in that market," Locker said. "But I think what is happening there now with the activity surrounding the integrated mills is reflective of what is happening in the rest of the world. I think people in the industry are continuing to feel pressure to merge, and the assets in Canada are good-they are ready to be had. Stelco, I think, eventually will get bought by someone else. Algoma will get bought. The midsize players are now in the (consolidation) game."

Turcotte said that Algoma, which earlier this year considered buying Stelco but later pulled its hat out of the ring and then became a takeover target itself, remains a healthy and viable company. He said that Algoma is looking over Paulson's proposals and awaiting a tax ruling from Revenue Canada as to whether the arrangements Paulson proposes can legally go forward.

"I think there is some logic to (the notion that midsize companies are next to be consolidated)," Turcotte said. "But, as I said, I view the market as North America and not just Canada. I think there are two camps: the consolidators and those who will be consolidated. One of the factors (in who falls into which camp) is size, but profitability and return on capital are important as well. Dofasco has been a strong company with strong management and a strong return on capital invested. I think if people look closely at Algoma they will see that we are the same. This company is solid and generates great returns on capital. The value of these companies is higher than it was.

"I think you are seeing the same things in (mergers in) eastern Europe and in Mexico with the Techint deal, and now with ThyssenKrupp and Dofasco," he said. "Companies now are in a position where, if people want to acquire them, they (potential acquirers) are going to have to pay more."

Global Insight's Anton shares Turcotte's view. "The assets that were in bankruptcy have, for the most part, been consolidated," he said. "The next step is for these smaller or midsize assets that are not in bankruptcy to become part of larger entities. You've seen it on the raw materials side where you have, essentially, three companies who control iron ore.

"I think we are at the point where we are seeing the same things develop in steel, and these small to midsize companies represent the next step in the process. It's already started to happen. You could see in, say, 20 years, where we could be down to 15 or 20 carbon steel companies in the world. We are at a point where some of these companies want to grow, and North America is a place where that can happen right now.

"Companies are becoming multinational and that is something that will continue. If you can deal with one company that can get you your steel from just about any area, that's a more efficient way of doing business than having to deal with seven or eight different suppliers from different parts of the world," Anton said. "I think what's happening in Canada is the next step in that process."

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