Algoma shareholders watch for news of possible sale, acquisition

02:13 PM EDT Jun 29

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TORONTO (CP) - Shareholders of Algoma Steel Inc. will be watching more than the company's first-quarter results Tuesday, as Canada's third-largest steelmaker ponders a sale, acquisition or merger.

"We emerged from 2004 in a position of strength," said spokeswoman Brenda Stenta. "And so we're in the process of undertaking a comprehensive strategic review of all of our opportunities. That may very well include a sale or acquisition, mergers, internal growth." Algoma posted a cash balance of $453 million at the end of 2004, the company's most profitable year in more than a century of operations.

Industry observers have spent many hours since wondering what the Sault Ste. Marie, Ont.-based steelmaker will do with the funds.

"I'm waiting to hear also what they're going to do," John Paulson, president of Algoma's largest shareholder, New York-based Paulson & Co. Inc., said Monday.

Algoma hunted around Hamilton's Stelco Inc. in December, but backed out of the bidding war for the restructuring steel giant two months later, saying the risks outweighed the potential benefits.

One Toronto-based analyst, who did not wish to be identified, said a picture on Algoma's strategy and future will become more clear this week.

"How much they could spend on acquisitions will be determined by how much they're going to pay out to shareholders," he said. "And I would think that the priority is to pay money out to shareholders, either through a special dividend, normal dividend, stock buy-back, or all of the above."

Algoma is bringing the company's Wednesday annual meeting to Toronto from its traditional location in Sault Ste. Marie.

"It's the first time in a while that we've hosted the meeting there," Stenta said. "We felt that it was important to be more accessible to shareholders, and a growing percentage of our shareholder base are Americans."

Stockholders will be asked to ratify the new shareholders' rights plan, a defence against unwanted takeover bids. It kicks in if any holder intends to acquire 20 per cent of Algoma's stock without board approval, and delays the transaction for 60 days.

Paulson & Co., which manages about $2.9 billion US in assets, holds nearly 15 per cent of Algoma's stock.

In December, Paulson said he did not intend to acquire 20 per cent.

He also predicted that due to Algoma's small size and low valuation, "a long list of potential acquirers would be interested in Algoma at values significantly higher than current market prices, should Algoma decide to explore these possibilities."

Algoma, which emerged from another round of bankruptcy protection in 2002, is now "virtually debt free," DBRS said in an April rating note.

No significant capital spending on its operations is required until at least 2010, the credit rating agency said, adding special dividends and niche acquisitions "are possible uses of free cash flow."

Michael Locker, president of New York-based steel consultants Locker Associates, said Algoma's cash balance increases the company's attractiveness as an acquisition target.

"The viability of small independent steel companies in this day and age is limited," Locker said. "Their days are numbered. They are looking for and would like to find a happy home."

Steel industry observers are forecasting that consolidation will produce a handful of massive players who control the market.

In a recent research report, TD Newcrest analyst Paul D'Amico said he doubted foreign steelmakers would be interested "in buying North American mills in the near-term, especially Algoma."

TD's target price for Algoma is $29 per share, with the analyst noting that "almost half of the current share price in our view is attributable to the company's present value net cash excess."

Algoma's remote location and its focus on commodity-grade steel work against it, said one analyst.

"Strategically, they just don't fit with a lot of other companies."

Canada's two largest steelmakers, Stelco and its Hamilton neighbour Dofasco Inc., produce higher-value specialty products for key customers like the automotive market.

Algoma's reliance on commodity-grade steel makes it highly sensitive to price fluctuations, DBRS said. Last year's dramatic rise in steel prices, fuelled by demand from China, took the steelmaker's sales from $1.1 billion in 2003 to $1.8 billion in 2004. Net income rose from $8 million to $344 million. But steel prices have been softening since the fall.

Last week Don Pether, chief executive of Dofasco, said the third quarter will determine future steel prices. As prices soared last year, customers bought early and built up large inventories.

"The general feeling is it's probably going to be the third quarter before that works off," Pether said. "If the market conditions are still relatively good, theoretically you could continue to see things strengthen from that point on," he said.

Algoma's stock finished 2004 at $29.30 per share, up 416 per cent from the end of 2003.

On Monday, the shares traded at $29.90 on the Toronto Stock Exchange, up 45 cents.