

## **Consolidated Financial Statements**

For the three months and six months ended June 30, 2009

**Consolidated Balance Sheets**

As at June 30, 2009 and December 31, 2008  
(Unaudited)

| (in thousands of dollars)                          | June 30,<br>2009<br>\$ | December 31,<br>2008<br>\$ |
|--|------------------------|----------------------------|
| <b>ASSETS</b>                                      |                        |                            |
| <b>Current</b>                                     |                        |                            |
| Cash and cash equivalents                          | 2,974                  | 2,607                      |
| Accounts receivable                                | 16,019                 | 20,828                     |
| Inventories [notes 2 and 10]                       | 27,347                 | 21,315                     |
| Income taxes recoverable                           | 3,223                  | 1,926                      |
| Prepaid expenses                                   | 1,169                  | 899                        |
| Future tax assets                                  | 723                    | 270                        |
|  | <b>51,455</b>          | <b>47,845</b>              |
| Property, plant and equipment [note 4]             | 24,115                 | 24,580                     |
| Intangible assets [note 4]                         | 9,479                  | 9,882                      |
| Goodwill   | 31,740                 | 33,459                     |
| Restricted cash [note 8]                           | 289                    | 306                        |
| Other assets                                       | 472                    | 472                        |
|  | <b>117,550</b>         | <b>116,544</b>             |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>        |                        |                            |
| <b>Current</b>                                     |                        |                            |
| Bank indebtedness [note 6]                         | 10,302                 | 573                        |
| Accounts payable and accrued liabilities [note 10] | 12,507                 | 14,653                     |
| Accrued pension liability                          | 255                    | 270                        |
| Income taxes payable                               | 424                    | 110                        |
| Deferred revenue                                   | 1,526                  | 1,340                      |
| Current portion of long term debt                  | 2,290                  | 1,994                      |
|  | <b>27,304</b>          | <b>18,940</b>              |
| Future tax liabilities                             | 5,759                  | 5,586                      |
| Long term debt [note 7]                            | 4,164                  | 4,500                      |
|  | <b>37,227</b>          | <b>29,026</b>              |
| Commitments [note 8]                               |                        |                            |
| <b>Shareholders' equity</b>                        |                        |                            |
| Share capital                                      | 62,395                 | 62,210                     |
| Contributed surplus                                | 683                    | 552                        |
| Accumulated other comprehensive (loss) income      | (549)                  | 2,989                      |
| Retained earnings                                  | 17,794                 | 21,767                     |
|  | <b>80,323</b>          | <b>87,518</b>              |
|  | <b>117,550</b>         | <b>116,544</b>             |

See accompanying notes

**Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss)**

For the six months ended June 30, 2009 and 2008

(Unaudited)

| (in thousands)  | Common<br>Shares | Share<br>Capital<br>\$ | Contributed<br>Surplus<br>\$ | Accumulated Other                    | Retained<br>Earnings<br>\$ | Total<br>\$   | Comprehensive<br>Income (Loss)<br>\$ |
|---|------------------|------------------------|------------------------------|--------------------------------------|----------------------------|---------------|--------------------------------------|
|   |                  |                        |                              | Comprehensive<br>(Income) Loss<br>\$ |                            |               |                                      |
| <b>Balance, December 31, 2008</b>   | <b>26,455</b>    | <b>62,210</b>          | <b>552</b>                   | <b>2,989</b>                         | <b>21,767</b>              | <b>87,518</b> | <b>—</b>                             |
| Shares issued on exercise of<br>options [note 9a]                                   | 90               | 126                    | —                            | —                                    | —                          | 126           | —                                    |
| Stock-based compensation<br>[note 9b]   | —                | —                      | 190                          | —                                    | —                          | 190           | —                                    |
| Reclassification of fair value of<br>stock options previously<br>expensed [note 9a] | —                | 59                     | (59)                         | —                                    | —                          | —             | —                                    |
| Translation of self-sustaining<br>foreign operations                                | —                | —                      | —                            | (3,538)                              | —                          | (3,538)       | (3,538)                              |
| Dividends [note 5]  | —                | —                      | —                            | —                                    | (3,176)                    | (3,176)       | —                                    |
| Net loss  | —                | —                      | —                            | —                                    | (797)                      | (797)         | (797)                                |
| <b>Balance, June 30, 2009</b>   | <b>26,545</b>    | <b>62,395</b>          | <b>683</b>                   | <b>(549)</b>                         | <b>17,794</b>              | <b>80,323</b> | <b>(4,335)</b>                       |
| <b>Balance, December 31, 2007</b>   | <b>26,445</b>    | <b>62,190</b>          | <b>449</b>                   | <b>(8,729)</b>                       | <b>13,576</b>              | <b>67,486</b> | <b>—</b>                             |
| Shares issued on exercise of<br>options [note 9a]                                   | —                | —                      | —                            | —                                    | —                          | —             | —                                    |
| Stock-based compensation<br>[note 9b]   | —                | —                      | 42                           | —                                    | —                          | 42            | —                                    |
| Reclassification of fair value of<br>stock options previously<br>expensed [note 9a] | —                | —                      | —                            | —                                    | —                          | —             | —                                    |
| Translation of self-sustaining<br>foreign operations                                | —                | —                      | —                            | 1,193                                | —                          | 1,193         | 1,193                                |
| Dividends [note 5]  | —                | —                      | —                            | —                                    | (3,173)                    | (3,173)       | —                                    |
| Net income  | —                | —                      | —                            | —                                    | 4,555                      | 4,555         | 4,555                                |
| <b>Balance, June 30, 2008</b>   | <b>26,445</b>    | <b>62,190</b>          | <b>491</b>                   | <b>(7,536)</b>                       | <b>14,958</b>              | <b>70,103</b> | <b>5,748</b>                         |

See accompanying notes

**Consolidated Statements of Income (Loss)**

For the periods ended June 30  
(Unaudited)

|   | Three months  |        | Six months      |        |
|---|---------------|--------|-----------------|--------|
|   | 2009          | 2008   | 2009            | 2008   |
| (in thousands of dollars, except per share amounts) | \$            | \$     | \$              | \$     |
| <b>Revenue</b>                                      | <b>28,810</b> | 33,014 | <b>48,491</b>   | 56,811 |
| Manufacturing and selling costs <i>[note 3]</i>     | <b>24,561</b> | 25,165 | <b>43,237</b>   | 44,403 |
|   | <b>4,249</b>  | 7,849  | <b>5,254</b>    | 12,408 |
| General and administration                          | <b>2,361</b>  | 2,311  | <b>4,088</b>    | 4,017  |
| Amortization <i>[note 4]</i>                        | <b>983</b>    | 919    | <b>2,008</b>    | 1,736  |
| Interest expense <i>[note 11]</i>                   | <b>134</b>    | 150    | <b>257</b>      | 372    |
|   | <b>3,478</b>  | 3,380  | <b>6,353</b>    | 6,125  |
| Income (loss) before income taxes                   | <b>771</b>    | 4,469  | <b>(1,099)</b>  | 6,283  |
| <b>Income tax expense (recovery)</b>                |               |        |                 |        |
| Current   | <b>61</b>     | 1,208  | <b>(234)</b>    | 1,708  |
| Future  | <b>151</b>    | 59     | <b>(68)</b>     | 20     |
|   | <b>212</b>    | 1,267  | <b>(302)</b>    | 1,728  |
| Net income (loss)                                   | <b>559</b>    | 3,202  | <b>(797)</b>    | 4,555  |
| <b>Earnings (loss) per share <i>[note 12]</i></b>   |               |        |                 |        |
| Basic   | <b>\$0.02</b> | \$0.12 | <b>(\$0.03)</b> | \$0.17 |
| Diluted   | <b>\$0.02</b> | \$0.12 | <b>(\$0.03)</b> | \$0.17 |

See accompanying notes

**Consolidated Statements of Cash Flows**

For the periods ended June 30

(Unaudited)

| (in thousands of dollars)  | Three months   |         | Six months     |         |
|--|----------------|---------|----------------|---------|
|  | 2009           | 2008    | 2009           | 2008    |
|  | \$             | \$      | \$             | \$      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                        |                |         |                |         |
| Net income (loss)  | 559            | 3,202   | (797)          | 4,555   |
| Add items not affecting cash:                                      |                |         |                |         |
| Amortization expense [note 4]                                      | 983            | 919     | 2,008          | 1,736   |
| Future tax (recovery) expense                                      | 151            | 59      | (68)           | 20      |
| Stock-based compensation expense [note 9b and c]                   | 65             | 32      | 196            | 57      |
| Expense related to debt transaction                                | —              | —       | 7              | —       |
|  | <b>1,758</b>   | 4,212   | <b>1,346</b>   | 6,368   |
| Changes in non-cash working capital:                               |                |         |                |         |
| (Increase) decrease in accounts receivable                         | (2,612)        | (2,819) | 4,252          | (2,696) |
| Increase in inventories  | (287)          | (340)   | (7,018)        | (3,636) |
| Increase in prepaid expenses                                       | (199)          | (679)   | (284)          | (461)   |
| (Decrease) increase in accounts payable<br>and accrued liabilities | (1,564)        | 487     | (1,672)        | 1,858   |
| Increase (decrease) in deferred revenue                            | 263            | 93      | 375            | 253     |
| (Decrease) increase in income taxes payable                        | (414)          | 587     | (946)          | (1,506) |
| <b>Cash flows (used in) from operating activities</b>              | <b>(3,055)</b> | 1,541   | <b>(3,947)</b> | 180     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                        |                |         |                |         |
| Issue of common shares on the exercise of options [note 9a]        | 126            | —       | 126            | —       |
| Net advance of bank indebtedness                                   | 5,326          | 2,619   | 9,720          | 6,584   |
| Dividends paid [note 5]  | (3,176)        | (3,173) | (3,176)        | (3,173) |
| Net advance on long term debt                                      | 318            | —       | 318            | —       |
| Repayment of long term debt  | (500)          | (500)   | (1,000)        | (1,500) |
| <b>Cash flows from (used in) financing activities</b>              | <b>2,094</b>   | (1,054) | <b>5,988</b>   | 1,911   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                        |                |         |                |         |
| Purchase of property, plant and equipment                          | (595)          | (577)   | (934)          | (1,705) |
| Purchase of intangibles  | (393)          | —       | (393)          | —       |
| <b>Cash flows used in investing activities</b>                     | <b>(988)</b>   | (577)   | <b>(1,327)</b> | (1,705) |
| Foreign exchange (loss) gain on cash held in foreign currency      | (286)          | (51)    | (347)          | 20      |
| <b>(Decrease) increase in cash and cash equivalents</b>            | <b>(2,235)</b> | (141)   | <b>367</b>     | 406     |
| Cash and cash equivalents, beginning of the period                 | 5,209          | 2,580   | 2,607          | 2,033   |
| <b>Cash and cash equivalents, end of the period</b>                | <b>2,974</b>   | 2,439   | <b>2,974</b>   | 2,439   |

See accompanying notes

## Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2009

(Unaudited)

### 1. FINANCIAL STATEMENT PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

These unaudited interim consolidated financial statements for ZCL Composites Inc. ("ZCL" or the "Company") have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") on a basis consistent with those used in the preparation of the most recent annual consolidated financial statements except as further explained below. These unaudited interim consolidated financial statements do not include all the information and disclosures required for annual financial statements and should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2008. In management's opinion, these interim consolidated financial statements include all adjustments necessary to present fairly such interim financial information.

The consolidated statements of income (loss), shareholders' equity and comprehensive income (loss) and cash flows for interim periods are not necessarily indicative of results on an annual basis due to seasonal and short-term variations as well as the effects and timing of business acquisitions. Historically, the Company has been affected by seasonality and experiences its lowest levels of activity in the first and second quarters of the Company's fiscal year, corresponding to the seasonality of the installation of underground liquid storage systems in Canada and the northern US.

#### a) Changes in Significant Accounting Policies

Effective January 1, 2009, the Company adopted the following new accounting standards:

##### *Goodwill and Intangible Assets*

The Company adopted prospectively Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064 "Goodwill and Intangible Assets" that replaced Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs" effective January 1, 2009. The new pronouncement establishes standards for the recognition, measurement, presentation, and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. There was no significant impact as a result of the Company adopting this standard.

#### b) Recent Accounting Pronouncements

##### *International Financial Reporting Standards*

In February 2008, Canada's Accounting Standards Board confirmed January 1, 2011 as the official changeover date for publicly listed Canadian companies to start reporting under International Financial Reporting Standards ("IFRS"). IFRS uses a conceptual framework that is similar to Canadian GAAP, but there are differences in recognition, measurement and disclosure. The International Accounting Standards Board also currently has projects underway that should result in new pronouncements and the Canadian convergence initiative is on-going as of the date of these statements.

The Company, with the assistance of external advisors, commenced its conversion project in 2008. An IFRS project team has been established and a detailed conversion project plan has been prepared for 2009 and 2010 that will enable the Company to begin reporting its consolidated financial statements in accordance with IFRS on a comparative basis beginning January 1, 2011. The IFRS conversion project consists of three phases: scoping and diagnostic; analysis and development; and implementation and review. The first phase, which has been completed, involved project planning, a high level review of key accounting policy differences between Canadian GAAP and IFRS, as well as determining policy choices and elections allowed under IFRS. The areas identified to have the highest potential to significantly impact the Company are business combinations, property, plant and equipment, intangible assets, the process for testing impairment of assets, and initial adoption of IFRS under the provisions of IFRS 1 "First-Time Adoption of IFRS".

The second phase, which involves detailed analysis and evaluation of options available under IFRS and the financial impact of these options, is currently in progress. Information system requirements are also in the process of being evaluated as part of the conversion project.

Until the policy choices are made and analysis completed, the impact on the Company's future results of operation and financial position is not determinable. The Company does anticipate that there will be a significant increase in disclosure resulting from the adoption of IFRS. The Company also expects the transition to IFRS to impact financial reporting, business processes, internal controls and information systems.

#### *Business Combinations and Consolidated Financial Statements*

In January 2009, the CICA issued Section 1582 "Business Combinations", Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-Controlling Interests", which supersede 1581 "Business Combinations" and Section 1600 "Consolidated Financial Statements". The standards apply to annual and interim financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1582 establishes standards for the accounting for a business combination. It provides the Canadian GAAP equivalent to IFRS 3, "Business Combinations" (January 2008) and applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Section 1601, together with Section 1602, establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS 27, "Consolidated and Separate Financial Statements" (January 2008). Earlier application of the standards is permitted. If an entity applies the Sections before January 1, 2011, it shall disclose that fact and apply Sections 1582, 1601 and 1602 at the same time. The Company is currently evaluating the impact of adopting the standards as part of its IFRS conversion plan.

## 2. INVENTORIES

| As at                     | June 30,<br>2009 | December 31,<br>2008 |
|---------------------------|------------------|----------------------|
| (in thousands of dollars) | \$               | \$                   |
| Raw materials             | 9,635            | 9,899                |
| Work in progress          | 5,459            | 3,666                |
| Finished goods            | 12,253           | 7,750                |
|                           | <b>27,347</b>    | 21,315               |

As at June 30, 2009, inventories included raw materials and finished goods written down to their net realizable value of \$18,000 and \$nil respectively (December 31, 2008: raw materials - \$133,000, finished goods - \$65,000). During the three months ended June 30, 2009, a write down of inventory of \$62,500 (2008 - \$64,000) to net realizable value was recorded and an \$88,000 (2008 - \$63,000) write down was recorded for the six month period then ended.

## 3. MANUFACTURING AND SELLING COSTS

For the periods ended June 30,

| (in thousands of dollars)  | Three months  |        | Six months    |         |
|--|---------------|--------|---------------|---------|
|  | 2009          | 2008   | 2009          | 2008    |
|  | \$            | \$     | \$            | \$      |
| Raw materials and consumables used                               | 9,044         | 11,185 | 18,725        | 19,478  |
| Labour costs   | 6,694         | 6,552  | 13,339        | 13,749  |
| Other costs  | 7,919         | 8,259  | 17,470        | 14,616  |
| Net change in inventories of finished goods and work in progress | 904           | (831)  | (6,297)       | (3,440) |
|  | <b>24,561</b> | 25,165 | <b>43,237</b> | 44,403  |

**4. AMORTIZATION EXPENSE**

For the periods ended June 30,

| (in thousands of dollars)     | Three months |      | Six months |       |
|-------------------------------|--------------|------|------------|-------|
|                               | 2009         | 2008 | 2009       | 2008  |
|                               | \$           | \$   | \$         | \$    |
| Property, plant and equipment | 513          | 508  | 1,036      | 892   |
| Intangible assets             | 470          | 411  | 972        | 844   |
|                               | 983          | 919  | 2,008      | 1,736 |

Included in property, plant and equipment is capital work-in-process of \$130,500 (December 31, 2008 – \$71,000) that is not subject to amortization. Included in intangible assets is \$1,028,100 related to an intangible asset under development that is not subject to amortization (December 31, 2008 – \$nil). The intangible asset under development is related to an enterprise resource planning system and includes capitalized interest.

**5. DIVIDENDS PAID**

During the three and six month periods ended June 30, 2009, dividends in the amount of \$3,176,000 were paid on April 20, 2009 (\$0.12 per common share for all shareholders of record on April 6, 2009). In the three and six month periods ended June 30, 2008, dividends in the amount of \$3,173,000 were paid on April 17, 2008 (\$0.12 per common share for all shareholders of record on April 3, 2008).

**6. BANK INDEBTEDNESS**

During the three and six month periods ended June 30, 2009, the Company amended its credit facility agreement to increase the revolving operating credit facility to a maximum \$20,000,000 (2008 - \$15,000,000). The credit facility is payable on demand and matures on May 15, 2010. Depending on the form under which the credit facility is assessed, rates of interest vary between Canadian bank prime plus 50 or 100 basis points, US base rate plus 50 or 100 basis points and Canadian bankers acceptances with terms of 1, 2, 3, or 6 months, subject to availability plus 175 or 225 basis points. Interest rates are adjusted quarterly based on certain financial performance indicators of the Company.

**7. LONG TERM DEBT**

During the three and six month periods ended June 30, 2009, the Company amended its credit facility agreement to increase the committed revolving term loan to \$10,000,000 (\$5,500,000 drawn at June 30, 2009). The maturity date of the revolving term loan has been extended from May 2, 2010 to May 31, 2011. The revolving term loan continues to require payment of interest monthly and quarterly repayments of \$500,000. Depending on the form under which the term loan is assessed, rates of interest vary between Canadian bank prime plus 75 or 125 basis points, US base rate plus 75 or 125 basis points and Canadian bankers acceptances with terms of 1, 2, 3, or 6 months, subject to availability plus 200 or 250 basis points. Interest rates are adjusted quarterly based on certain financial performance indicators of the Company.

Also during the six month period ended June 30, 2009, the Company entered into a financing agreement with a fair market value of \$954,300 involving software license fees, services and equipment relating to an intangible asset under development that is not yet available for use. The finance agreement requires repayments of \$30,300 (including interest where applicable) monthly effective September 2009, with the balance due on maturity in May 2012. Depending on the nature of the amounts financed, rates of interest vary between 0 and 7.15% per annum. The amount of the debt will be accreted to its face value over the term of the instrument with the offsetting charge to interest expense or intangible assets as appropriate.

**8. COMMITMENTS & RESTRICTED CASH****a) Restricted Cash:**

A contract performance guarantee of \$250,000 US is secured by cash of the same amount held by the captive insurance company and is recorded as restricted cash.

**b) New Lease Commitment:**

The Company has entered into a leasing arrangement for new head office facilities. The lease term is for 10 years and provides for two additional renewable terms of five years each. Under the lease agreement, the Company is committed to pay \$431,000 of lease payments annually commencing upon completion of the facilities. Construction is expected to be completed in the spring of 2010.

**9. STOCK-BASED COMPENSATION****a) Stock Options**

For the six months ended June 30,

|                          | 2009<br># | 2008<br># |
|--------------------------|-----------|-----------|
| Balance, as at January 1 | 1,078,168 | 254,068   |
| Granted                  | -         | 1,600     |
| Cancelled                | (20,000)  | -         |
| Balance, as at March 31  | 1,058,168 | 255,668   |
| Exercised                | (90,001)  | -         |
| Cancelled                | (7,500)   | -         |
| Balance, as at June 30   | 960,667   | 255,668   |

During the six month period ended June 30, 2009, the Company cancelled 27,500 stock options (7,500 stock options for the three month period ended June 30, 2009) that had an exercise price of \$3.75. There were 90,001 stock options exercised that had an exercise price of \$1.40 resulting in cash proceeds to the Company of \$126,000 for the three and six month periods ended June 30, 2009.

During the three and six month periods ended June 30, 2009, \$58,500 (2008 -\$nil) was credited to share capital related to options exercised in respect of compensation expense previously included in contributed surplus.

As at June 30, 2009, 129,667 (2008 – 183,334) of the outstanding options were vested and exercisable into common shares.

**b) Stock-based Compensation**

The Company uses the fair value method of accounting for all stock options granted to employees. During the six month period ended June 30, 2009, no options were granted (2008 – 1,600 issued at market price). Stock-based compensation expense of \$95,000 (2008 - \$21,000) in the three month period and \$189,900 (2008 – \$42,000) in the six month period was recorded in manufacturing and selling costs and general and administration expenses in the consolidated statements of income (loss).

## Notes to the Consolidated Financial Statements

The estimated fair values of stock options granted at market are determined, at the date of the grant, using the Black-Scholes option pricing model with the following weighted-average assumptions resulting in a fair value per option of \$2.83 during the six months ended June 30, 2008:

|   | 2009 | 2008   |
|---|------|--------|
| Fair value  | -    | \$2.83 |
| Risk-free interest rate (%)                         | -    | 3.88   |
| Expected hold period to exercise (years)            | -    | 4.0    |
| Volatility in the price of the Company's shares (%) | -    | 50.0   |
| Dividend yield (%)                                  | -    | 1.0    |

### c) Stock Appreciation Rights (SARs) and Restricted Share Units (RSUs)

|                                 | 2009           |               | 2008      |           |
|---------------------------------|----------------|---------------|-----------|-----------|
|                                 | SARs<br>#      | RSUs<br>#     | SARs<br># | RSUs<br># |
| <b>Balance, as at January 1</b> | <b>230,000</b> | <b>93,125</b> | 230,250   | 21,160    |
| Granted                         | -              | -             | 14,750    | 1,840     |
| <b>Balance, as at March 31</b>  | <b>230,000</b> | <b>93,125</b> | 245,000   | 23,000    |
| Cancelled                       | <b>(4,000)</b> | -             | -         | -         |
| <b>Balance, as at June 30</b>   | <b>226,000</b> | <b>93,125</b> | 245,000   | 23,000    |

The Company granted no SARs and RSUs during the three and six month periods ended June 30, 2009. During the six months ended June 30, 2008, the Company granted 14,750 SARs with an exercise price of \$7.67, the market share price on the grant date, and 1,840 RSUs to employees. During the three and six month periods ended June 30, 2009, the Company cancelled 4,000 SARs (2008 - nil) that had an exercise price of \$10.14.

Included in manufacturing and selling costs and general and administration expenses in the consolidated statements of income (loss) during the three month period ended June 30, 2009 was a net recovery of \$29,500 relating to RSUs (2008 – an expense of \$10,000) and a net expense of \$6,000 (2008 – \$18,100) for the six month period then ended. During the three month period ended June 30, 2009 an expense of \$nil (2008 – \$1,000) and a net recovery of \$nil (2008 – \$3,000) for the six month period then ended was recorded relating to the SARs.

### 10. RELATED PARTY TRANSACTIONS

Certain manufacturing components purchased for \$6,200 (2008 - \$11,500) for the three months ended and \$16,400 (2008 - \$46,200) for the six months ended June 30, 2009, included in manufacturing and selling costs in the consolidated statements of income (loss) or inventories were provided by a corporation whose Chairman and CEO is an individual who became a director of the Company on May 15, 2007. The transactions were recorded at the exchange amount being normal commercial rates for the products. Accounts payable and accrued liabilities at June 30, 2009 included \$1,600 (December 31, 2008 - \$nil) owing to the corporation. There are no ongoing contractual or other commitments resulting from these transactions.

The Company paid fees to a law firm in which an officer of the Company is a partner in the amount of \$89,700 (2008 - \$97,600) for the three months ended and \$145,500 for the six months ended June 30, 2009 (2008 - \$188,400) included in general and administration expenses in the consolidated statements of income (loss). The transactions were recorded at the exchange amount being normal commercial terms for the services. Accounts payable and accrued liabilities at June 30, 2009 included \$58,300 (December 31, 2008 - \$9,200) owing to the law firm. There are no ongoing contractual or other commitments resulting from these transactions.

**11. OTHER EXPENSES****a) Interest Expense**

For the periods ended June 30,

|   | Three months |      | Six months |      |
|---|--------------|------|------------|------|
|   | 2009         | 2008 | 2009       | 2008 |
| (in thousands of dollars)                   | \$           | \$   | \$         | \$   |
| Short term interest, net of interest income | 106          | 61   | 180        | 136  |
| Interest, long term obligations             | 28           | 89   | 77         | 236  |
|   | 134          | 150  | 257        | 372  |

**b) Foreign Exchange Loss (Gain)**

General and administration expenses include a foreign exchange loss of \$234,600 for the three months ended June 30, 2009 (2008 – \$65,000) and \$43,300 for the six months ended June 30, 2009 (2008 – gain of \$24,000).

**12. EARNINGS (LOSS) PER SHARE**

The following table sets forth the net income (loss) available to common shareholders and weighted-average number of common shares outstanding for the computation of basic and diluted earnings (loss) per share:

For the periods ended June 30,

|   | Three months |        | Six months |        |
|---|--------------|--------|------------|--------|
|   | 2009         | 2008   | 2009       | 2008   |
| <b>Numerator</b> (in thousands of dollars)    |              |        |            |        |
| Net income (loss)                             | 559          | 3,202  | (797)      | 4,555  |
| <b>Denominator</b> (in thousands)             |              |        |            |        |
| Weighted-average shares outstanding - basic   | 26,498       | 26,445 | 26,481     | 26,445 |
| Effect of dilutive securities                 |              |        |            |        |
| Stock options                                 | 21           | 150    | -          | 150    |
| Weighted-average shares outstanding - diluted | 26,519       | 26,595 | 26,481     | 26,595 |

**13. STATEMENT OF CASH FLOWS**

Supplementary disclosures required in respect of the Statement of Cash Flows are as follows:

For the periods ended June 30,

|                           | Three months |      | Six months |       |
|---------------------------|--------------|------|------------|-------|
|                           | 2009         | 2008 | 2009       | 2008  |
| (in thousands of dollars) | \$           | \$   | \$         | \$    |
| Net interest paid         | 118          | 122  | 225        | 351   |
| Income taxes paid         | 392          | 239  | 564        | 2,697 |

#### 14. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, other assets, restricted cash, bank indebtedness, accounts payable and accrued liabilities, and long term debt.

The Company has classified cash and cash equivalents and restricted cash as held for trading measured at fair value with any gains and losses identified during periodic evaluations recorded in net income. The carrying value of these financial assets approximates their fair value due to the relatively short period to maturity.

Accounts receivable and other assets are classified as loans and receivables and are measured at amortized cost using the effective interest rate method.

Accounts payable and accrued liabilities, bank indebtedness and long term debt are classified as other financial liabilities and measured at amortized cost. The carrying value of accounts payable and accrued liabilities approximates fair value due to the relatively short period to maturity. The carrying value of bank indebtedness and long term debt may vary from their face value due to higher premiums charged by the banks. Using an interest rate that is 25 basis points higher than it was at year end would result in a nominal difference between the carrying value and the fair value of bank indebtedness.

The Company has pledged as general collateral for advances under the operating credit facility and the term loan a general security agreement on present and future assets, guarantees from each present and future direct and indirect subsidiary of the Company supported by a first registered security over all present and future assets, and pledge of shares. The Company is not permitted to sell or re-pledge significant assets held under collateral without consent from the lenders.

##### Financial Risk Management

The Company's activities expose it to a variety of financial risks including market risk (foreign exchange risk and interest rate risk), credit risk and liquidity risk. Management reviews these risks on an ongoing basis to ensure that the risks are appropriately managed. The Company may use foreign exchange forward contracts to manage exposure to fluctuations in foreign exchange from time to time. The Company does not have a practice of trading derivatives. The Company had no derivative instruments outstanding at June 30, 2009.

##### *Interest Rate Risk*

The Company's objective in managing interest rate risk is to monitor expected volatility in interest rates while also minimizing the Company's financing expense levels. Interest rate risk mainly arises from fluctuations of interest rates and the related impact on the return earned on cash and cash equivalents, restricted cash and other assets and the expense on floating rate debt. On an ongoing basis, management monitors changes in short term interest rates and considers long term forecasts to assess the potential cash flow impact to the Company. The Company does not currently hold any financial instruments to mitigate its interest rate risk. Cash and cash equivalents, restricted cash and other assets earn interest based on market interest rates. Bank indebtedness balances and long term debt bear interest at the bank prime rate, which is variable.

The spread between the interest rate at which the bank can borrow funds and the interest rate they charge on loans has compressed with the decline in the Canadian bank prime interest rate and the general deterioration in credit quality around the world. As the debt balances were renegotiated during 2009, the premiums above prime rate increased between 25 and 75 basis points. The effective interest rate on the bank indebtedness balance at June 30, 2009 was Canadian bank prime interest rate plus 50 or 100 basis points (2.75% or 3.25%), adjusted quarterly based on certain financial indicators of the Company. The term loan bears interest at bank prime plus 75 or 125 basis points (3.00% or 3.50%), adjusted quarterly based on certain financial indicators of the Company. As at June 30, 2009, with other variables unchanged, an increase or decrease of 100 basis points in the prime interest rate would have impacted net income for the three months then ended by approximately \$29,000. There would be no effect on other comprehensive income.

The finance agreement entered into during the three months ended June 30, 2009 has a fixed rate of interest and therefore no market interest rate risk.

#### *Foreign Exchange Risk*

The Company operates on an international basis and is subject to foreign exchange risk exposures arising from transactions denominated in foreign currencies. The Company's objective with respect to foreign exchange risk is to minimize the impact of the volatility related to financial assets and liabilities denominated in a foreign currency where possible through effective cash flow management. Foreign currency exchange risk is limited to the portion of the Company's business transactions denominated in currencies other than Canadian dollars. The Company's most significant foreign exchange risk arises primarily with respect to the US dollar. The revenues and expenses of the Company's US operations are denominated in US dollars. Certain of the revenue and expenses of the Canadian operations are also denominated in US dollars. The Company is also exposed to foreign exchange risk associated with the Euro due to its operations in the Netherlands, however these exposures are not significant to the Company's consolidated financial results. On an ongoing basis, management monitors changes in foreign currency exchange rates and considers long term forecasts to assess the potential cash flow impact to the Company. The Company has elected not to actively manage foreign exchange exposures at this time.

The tables that follow provide an indication of the Company's exposure to changes in the value of the US dollar relative to the Canadian dollar as at and for the six months ended June 30, 2009. The analysis is based on financial assets and liabilities denominated in US dollars at the end of the period ("balance sheet exposure") separated by subsidiaries classified as self-sustaining and other operations, which include the Canadian operations and subsidiaries classified as integrated operations, and US dollar denominated revenue and operating expenses during the period ("operating exposure").

#### **Balance sheet exposure as at June 30, 2009**

| (in thousands of dollars)                | Self-sustaining<br>Operations<br>\$ | Other<br>Operations<br>\$ | Total<br>\$  |
|--|-------------------------------------|---------------------------|--------------|
| Cash and cash equivalents                | 797                                 | 2,258                     | 3,055        |
| Accounts receivable                      | 8,757                               | 822                       | 9,579        |
| Restricted cash                          | -                                   | 250                       | 250          |
| Accounts payable and accrued liabilities | (4,748)                             | (1,142)                   | (5,890)      |
| Accrued pension liability                | (221)                               | -                         | (221)        |
| Deferred revenue                         | (937)                               | -                         | (937)        |
| <b>Net balance sheet exposure</b>        | <b>3,648</b>                        | <b>2,188</b>              | <b>5,836</b> |

#### **Operating exposure for the six months ended June 30, 2009**

| (in thousands of dollars)     | \$           |
|-------------------------------|--------------|
| Sales                         | 27,320       |
| Operating expenses            | 25,379       |
| <b>Net operating exposure</b> | <b>1,941</b> |

The weighted average US to Canadian dollar translation rate was 1.20168 for the six month period ended June 30, 2009. The translation rate as at June 30, 2009 was 1.1560 (December 31, 2008 – 1.2228).

Based on the Company's foreign currency exposures noted above, with other variables unchanged, a twenty percent decline in the Canadian dollar would have impacted net income (loss) as follows:

**For the six months ended June 30, 2009**

| (in thousands of dollars)                      | \$         |
|--|------------|
| Net balance sheet exposure of other operations | <b>280</b> |
| Net operating exposure of other operations     | <b>248</b> |
| Increase in net income (loss)                  | <b>528</b> |

Other comprehensive income would have also increased an additional \$467,000 due to the net balance sheet exposure of self-sustaining operations.

An increase or strengthening of twenty percent in the Canadian dollar would have had an equal but opposite impact on net income and other comprehensive income.

*Credit Risk*

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company is exposed to credit risk through its cash and cash equivalents, restricted cash, other assets, and accounts receivable. The Company manages the credit risk associated with its cash and cash equivalents by holding its funds with reputable financial institutions and investing only in highly rated securities that are traded on active markets and are capable of prompt liquidation. Credit risk for other assets and trade and other accounts receivables are managed through established credit monitoring activities. The Company also mitigates its credit risk on trade accounts receivable by obtaining a cash deposit from certain customers with no prior order history with the Company or where the Company perceives the customer has a higher level of risk.

The Company has a concentration of customers in the oil and gas sector. The concentration risk is mitigated by the number of customers and by a significant portion of the customers being large international organizations. As at June 30, 2009 and 2008 no single customer exceeded 10% of the consolidated trade accounts receivable balance. Losses under trade accounts receivable have not historically been significant. The credit worthiness of new and existing customers is subject to review by management by considering such items as the type of customer, prior order history and the size of the order. Decisions to extend credit to new customers are approved by management and the credit worthiness of existing customers is monitored. The recent volatility in the global capital markets and the economic slowdown in Canada and the US could cause the credit worthiness of some of the Company's customers to decline.

The Company reviews its trade receivable accounts regularly and amounts are written down to their expected realizable value when the account is determined not to be fully collectible. This generally occurs when the customer has indicated an inability to pay, the Company is unable to communicate with the customer over an extended period of time, and other methods to obtain payment have been considered and have not been successful. The bad debt expense is charged to net income in the period that the account is determined to be doubtful. Estimates for the allowance for doubtful accounts are determined on a customer-by-customer evaluation of collectability at each reporting date, taking into account the amounts which are past due and any available relevant information on the customers' liquidity and going concern status. After all efforts of collection have failed, the accounts receivable balance not collected is written off with an offset to the allowance for doubtful accounts, with no impact on net income.

The Company's maximum exposure to credit risk for trade accounts receivable is the carrying value of \$16,019,000 as at June 30, 2009 (December 31, 2008 - \$20,828,000). On a geographic basis as at June 30, 2009, approximately 49% (December 31, 2008 - 43%) of the balance of trade accounts receivable was due from Canadian and non-US customers and 51% (December 31, 2008 - 57%) was due from US customers.

Payment terms are generally net 30 days. As at June 30, 2009, the percentages of past due trade accounts receivable were as follows: 27% past due 1 to 30 days (December 31, 2008 – 19%), 6% past due 31 to 60 days (December 31, 2008 – 9%), 2% past due 61 to 90 days (December 31, 2008 – 10%) and 4% past due greater than 90 days (December 31, 2008 – 6%). Despite the established payment terms, customers in the oil and gas industry, who represent a significant portion of the customer base for the Company, typically pay amounts within 60 days of the invoice date. Accordingly, it is management's view that amounts outstanding from these customers up to 60 days from the invoice date have a low risk of not being collected.

As at June 30, 2009, the Company had recorded an allowance for doubtful accounts of \$171,700 (December 31, 2008 - \$200,300). The allowance is an estimate of the June 30, 2009 trade receivable balances that are considered uncollectible. The allowance increased for bad debt expense of \$86,300 and a translation adjustment of \$7,800, offset by payments of \$69,700, accounts written off of \$37,400 for the six months ended June 30, 2009.

#### *Liquidity Risk*

The Company's objective related to liquidity risk is to effectively manage cash flows to minimize the exposure that the Company will not be able to meet its obligations associated with financial liabilities. On an ongoing basis, Management manages liquidity risk by maintaining adequate cash and cash equivalent balances and appropriately utilizing available lines of credit. Management believes that forecasted cash flows from operating activities, along with the available lines of credit, will provide sufficient cash requirements to cover the Company's forecasted normal operating activities and budgeted capital expenditures.

The following are the undiscounted contractual maturities of financial liabilities excluding future interest:

| (in thousands of dollars)                | Carrying<br>Amount<br>\$ | Remainder<br>of 2009<br>\$ | 2010<br>\$   | 2011<br>\$   | 2012<br>\$ |
|--|--------------------------|----------------------------|--------------|--------------|------------|
| Bank indebtedness                        | 10,302                   | 10,302                     | —            | —            | —          |
| Accounts payable and accrued liabilities | 12,507                   | 12,507                     | —            | —            | —          |
| Long term debt                           | 6,454                    | 1,108                      | 2,348        | 2,859        | 139        |
| <b>Total</b>                             | <b>29,263</b>            | <b>23,917</b>              | <b>2,348</b> | <b>2,859</b> | <b>139</b> |

#### **15. CAPITAL RISK MANAGEMENT**

Management's objectives when managing capital are to safeguard the Company's ability to continue as a going concern, to provide an adequate return to shareholders, to meet external capital requirements on the Company's debt and credit facilities and preserve financial flexibility in order to benefit from potential opportunities that may arise. The Company maintained \$50 million of shareholders' equity to meet its external capital requirement as at June 30, 2009. Management considers changes in economic conditions, risks that impact the consolidated operations and future significant capital investment opportunities in managing its capital and considers adjustments to its ratio of long term debt to adjusted capital employed when significant changes in these factors are expected. Management considers the ratio of long term debt to adjusted capital employed of 8% as at June 30, 2009 (December 31, 2008 – 8%) to be low. Adjusted capital employed is defined by the Company as long term debt plus total shareholders' equity plus accumulated other comprehensive income.

**16. SEGMENTED INFORMATION**

Operating segments are defined as components of the Company for which separate financial information is available that is evaluated regularly by the chief operating decision maker in allocating resources and assessing performance. The chief operating decision maker of the Company is the Chief Executive Officer. The Company operates substantially all of its activities in one reportable segment, liquid containment storage systems, which include the manufacture and distribution of liquid storage systems including fibreglass underground and aboveground storage tanks and related products and accessories.

**Information about geographic areas****Revenue for the periods ended June 30,**

| (in thousands of dollars) | Three months  |               | Six months    |               |
|---------------------------|---------------|---------------|---------------|---------------|
|                           | 2009          | 2008          | 2009          | 2008          |
|                           | \$            | \$            | \$            | \$            |
| Canada and Foreign        | 11,656        | 12,382        | 17,959        | 22,718        |
| United States             | 17,154        | 20,632        | 30,532        | 34,093        |
|                           | <b>28,810</b> | <b>33,014</b> | <b>48,491</b> | <b>56,811</b> |

| (in thousands of dollars) | Total assets   |                   | Property, plant and equipment and goodwill |                   |
|---------------------------|----------------|-------------------|--|-------------------|
|                           | June 30, 2009  | December 31, 2008 | June 30, 2009                              | December 31, 2008 |
|                           | \$             | \$                | \$   | \$                |
| Canada and Foreign        | 44,834         | 42,592            | 19,726                                     | 19,717            |
| United States             | 72,716         | 73,952            | 36,129                                     | 38,322            |
|                           | <b>117,550</b> | <b>116,544</b>    | <b>55,855</b>                              | <b>58,039</b>     |

Information on geographic location was allocated based on the primary location of the Company's customers. Revenue, total assets, property, plant and equipment, and goodwill related to foreign operations were not significant and therefore have been included in the Canadian and Foreign results.

**Information about major customers**

The Company has long-term contracts and alliance arrangements with many of the major oil and gas companies in Canada and provides products for distributors and retail oil and gas companies in the US. For the three and six month periods ended June 30, 2009 and 2008, no single customer exceeded 10% of total revenue.

**17. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to conform to the presentation of the current period's consolidated financial statements.