

# **ZCL Composites Inc.**

## **Interim Consolidated Financial Statements**

For the three and six months ended June 30, 2008  
(Unaudited)

**ZCL Composites Inc.**  
**Consolidated Balance Sheets**

As at June 30, 2008 and December 31, 2007

(Unaudited)

(in thousands of dollars)	June 30, 2008 \$	December 31, 2007 \$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	2,439	2,033
Accounts receivable	19,502	16,595
Inventories <i>[notes 2 and 8]</i>	20,020	16,218
Income taxes recoverable	1,038	—
Prepaid expenses	1,139	661
Future tax assets	163	416
	<b>44,301</b>	35,923
Property, plant and equipment <i>[note 4]</i>	22,046	20,749
Deferred development costs	687	819
Intangible assets	8,257	8,995
Goodwill	28,011	27,327
Other assets	555	555
	<b>103,857</b>	94,368
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank indebtedness	6,734	150
Accounts payable and accrued liabilities <i>[note 8]</i>	12,925	10,886
Accrued pension liability	292	284
Income taxes payable	70	511
Deferred revenue	1,774	1,490
Current portion of long term debt	1,960	1,960
	<b>23,755</b>	15,281
Future tax liabilities	4,499	4,623
Long term debt <i>[note 6]</i>	5,500	6,978
	<b>33,754</b>	26,882
Commitments and contingencies		
<b>Shareholders' equity</b>		
Share capital	62,190	62,190
Contributed surplus	491	449
Accumulated other comprehensive loss	(7,536)	(8,729)
Retained earnings	14,958	13,576
	<b>70,103</b>	67,486
	<b>103,857</b>	94,368

*See accompanying notes*

## ZCL Composites Inc.

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

For the six months ended June 30, 2008 and 2007

(Unaudited)

(in thousands)	Common Shares	Share Capital \$	Contributed Surplus \$	Accumulated Other Comprehensive Loss \$	Retained Earnings \$	Total \$	Comprehensive Income (Loss) \$
<b>Balance, December 31, 2007</b>	26,445	62,190	449	(8,729)	13,576	67,486	—
Stock-based compensation [note 7b]	—	—	42	—	—	42	—
Translation of self-sustaining 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>
<b>Balance, December 31, 2006</b>	21,681	23,135	452	—	8,661	32,248	—
Common shares issued for cash	4,000	38,179	—	—	—	38,179	—
Shares issued on exercise of options [note 7a]	221	220	—	—	—	220	—
Warrants exercised for cash [note 7a]	210	199	—	—	—	199	—
Stock-based compensation [note 7b]	—	—	109	—	—	109	—
Reclassification of fair value of stock options and warrants previously expensed	—	112	(112)	—	—	—	—
Translation of self-sustaining foreign operations	—	—	—	(5,160)	—	(5,160)	(5,160)
Dividends [note 5]	—	—	—	—	(2,600)	(2,600)	—
Net income	—	—	—	—	2,203	2,203	2,203
<b>Balance, June 30, 2007</b>	<b>26,112</b>	<b>61,845</b>	<b>449</b>	<b>(5,160)</b>	<b>8,264</b>	<b>65,398</b>	<b>(2,957)</b>

See accompanying notes

**ZCL Composites Inc.**  
**Consolidated Statements of Income**

For the periods ended June 30

(Unaudited)

	Three months		Six months	
	2008	2007	2008	2007
(in thousands of dollars, except per share amounts)	\$	\$	\$	\$
<b>Revenue</b>	<b>33,014</b>	28,532	<b>56,811</b>	43,477
Manufacturing and selling costs <i>[note 3]</i>	<b>25,165</b>	22,813	<b>44,403</b>	35,373
	<b>7,849</b>	5,719	<b>12,408</b>	8,104
General and administration	<b>2,246</b>	1,765	<b>4,041</b>	2,987
Amortization <i>[note 4]</i>	<b>919</b>	926	<b>1,736</b>	1,678
Financing expense <i>[note 9]</i>	<b>215</b>	223	<b>348</b>	568
	<b>3,380</b>	2,914	<b>6,125</b>	5,233
Income before income taxes	<b>4,469</b>	2,805	<b>6,283</b>	2,871
<b>Income tax expense (recovery)</b>				
Current	<b>1,208</b>	1,016	<b>1,708</b>	1,107
Future	<b>59</b>	(337)	<b>20</b>	(439)
	<b>1,267</b>	679	<b>1,728</b>	668
<b>Net income</b>	<b>3,202</b>	2,126	<b>4,555</b>	2,203
<b>Earnings per share <i>[note 10]</i></b>				
Basic	<b>\$0.12</b>	\$0.08	<b>\$0.17</b>	\$0.09
Diluted	<b>\$0.12</b>	\$0.08	<b>\$0.17</b>	\$0.09

See accompanying notes

**ZCL Composites Inc.**  
**Consolidated Statements of Cash Flows**

For the periods ended June 30

(Unaudited)

(in thousands of dollars)	Three months		Six months	
	2008	2007	2008	2007
	\$	\$	\$	\$
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Net income	3,202	2,126	4,555	2,203
Add items not affecting cash:				
Amortization expense [note 4]	919	926	1,736	1,678
Future tax expense (recovery)	59	(337)	20	(439)
Stock-based compensation expense [note 7b]	21	54	42	109
	4,201	2,769	6,353	3,551
Changes in non-cash working capital:				
Decrease (increase) in accounts receivable	(2,819)	2,558	(2,696)	16
Increase in inventories	(340)	(633)	(3,636)	(2,043)
(Increase) decrease in prepaid expenses	(679)	23	(461)	(82)
(Decrease) increase in accounts payable and accrued liabilities	487	(1,152)	1,858	(1,047)
(Decrease) increase in deferred revenue	93	(179)	253	67
(Decrease) increase in income taxes payable	587	1,053	(1,506)	(593)
<b>Cash flows from (used in) operating activities</b>	<b>1,530</b>	<b>4,439</b>	<b>165</b>	<b>(131)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Issue of common shares	—	117	—	37,813
Net advances of bank indebtedness	2,619	2,265	6,584	5,963
Dividends paid	(3,173)	(2,600)	(3,173)	(2,600)
Net cash received on long term debt	—	—	—	20,000
Repayment of long term debt	(500)	(500)	(1,500)	(10,500)
<b>Cash flows from (used in) financing activities</b>	<b>(1,054)</b>	<b>(718)</b>	<b>1,911</b>	<b>50,676</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Business acquisition, including bank indebtedness assumed and repaid [note 1]	—	—	—	(52,648)
Purchase of property, plant and equipment	(577)	(801)	(1,705)	(1,464)
Other	—	—	—	(74)
<b>Cash flows used in investing activities</b>	<b>(577)</b>	<b>(801)</b>	<b>(1,705)</b>	<b>(54,186)</b>
Foreign exchange gain (loss) on cash held in foreign currency	(40)	(223)	35	(237)
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(141)</b>	<b>2,697</b>	<b>406</b>	<b>(3,878)</b>
Cash and cash equivalents, beginning of the period	2,580	1,227	2,033	7,802
<b>Cash and cash equivalents, end of the period</b>	<b>2,439</b>	<b>3,924</b>	<b>2,439</b>	<b>3,924</b>

See accompanying notes

# **ZCL Composites Inc.**

## **Notes to the Interim Consolidated Financial Statements**

For the three and six months ended June 30, 2008

(Unaudited)

### **1. Financial Statement Presentation and Significant Accounting Policies**

These unaudited interim consolidated financial statements 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, 2007. 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, 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.

The Company's comparative financial results include the operations of Xerxes Corporation ("Xerxes") from the date of acquisition on February 22, 2007. The purchase price of \$46.3 million was funded from the net proceeds of a "bought deal" private placement and commercial debt financing. The acquisition of Xerxes substantially increased the Company's revenues and operations as Xerxes was a similar size to the Company.

#### **a) Changes in Significant Accounting Policies**

Effective January 1, 2008, the Company adopted the following new accounting standards:

##### ***Capital Disclosures***

The Company adopted prospectively CICA Handbook Section 1535 "Capital Disclosures", which requires disclosure of qualitative and quantitative information that enables users to evaluate the Company's objectives, policies and process for managing capital. See note 13.

##### ***Financial Instruments – Disclosure and Presentation***

The Company adopted prospectively without restatement, CICA Handbook Sections 3862 "Financial Instruments - Disclosure" and 3863 "Financial Instruments – Presentation", which requires additional disclosures to enable users to evaluate the significance of financial instruments to the Company's financial position and performance. Qualitative and quantitative disclosures are also provided to enable users to evaluate the nature and extent of risks arising from the Company's financial instruments. See note 12.

##### ***Inventories***

The Company adopted retrospectively CICA Handbook Section 3031 "Inventories", which requires inventories to be measured at the lower of cost and net realizable value and provides guidance on the determination of cost, including the allocation of overheads and other costs to inventories. The adoption of this standard had no impact on the current or previous operating results of the Company.

Raw materials are valued at the lower of cost, determined on an average cost basis, and net realizable value. Work in progress and finished goods are valued at the lower of manufacturing cost and net realizable value

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

on a specific item basis. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale. Manufacturing costs include the costs of raw materials and consumables, direct labour costs, and applicable production overheads based on normal operating capacity. Prior to the adoption, raw materials were valued at the lower of average cost and replacement cost, which approximated net realizable value.

#### b) Recent Accounting Pronouncements

In February 2008, the CICA issued Section 3064 "Goodwill and Intangible Assets", replacing Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs", effective for interim and annual reporting periods beginning on or after October 1, 2008. 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. The Company is currently evaluating the impact of adopting the standard.

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"). The International Accounting Standards Board 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 is currently in the process of developing a conversion plan and assessing the impact of the ultimate adoption of IFRS.

## 2. Inventories

As at	June 30, 2008	December 31, 2007
(in thousands of dollars)	\$	\$
Raw materials	8,941	7,865
Work in progress	3,288	2,483
Finished goods	7,791	5,870
	<b>20,020</b>	<b>16,218</b>

As at June 30, 2008, inventories included raw materials and finished goods carried at net realizable value of \$135,000 and \$3,000 respectively (December 31, 2007: raw materials - \$147,000, finished goods - \$3,000). During the three and six months ended June 30, 2008, there was a write down of \$64,000 of inventory to net realizable value.

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

#### 3. Manufacturing and Selling Costs

For the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2008	2007	2008	2007
	\$	\$	\$	\$
Raw materials and consumables used	<b>11,185</b>	14,386	<b>19,478</b>	18,744
Labour costs	<b>6,552</b>	3,003	<b>13,749</b>	7,994
Other costs	<b>8,259</b>	5,549	<b>14,616</b>	11,059
Net change in inventories of finished goods and work in progress	<b>(831)</b>	(125)	<b>(3,440)</b>	(2,424)
	<b>25,165</b>	22,813	<b>44,403</b>	35,373

#### 4. Amortization Expense

For the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2008	2007	2008	2007
	\$	\$	\$	\$
Property, plant and equipment	<b>508</b>	351	<b>892</b>	661
Deferred development costs	<b>72</b>	63	<b>133</b>	127
Intangible assets	<b>339</b>	512	<b>711</b>	890
	<b>919</b>	926	<b>1,736</b>	1,678

Included in property, plant and equipment is capital work-in-process of \$629,000 (December 31, 2007 – \$990,000) that is not subject to amortization.

#### 5. Dividends Paid

During the three month period 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). In the six month period ended June 30, 2007, dividends in the amount of \$2,600,000 were paid on April 4, 2007 (\$0.10 per common share for all shareholders of record on March 28, 2007).

#### 6. Long Term Debt

During the six months ended June 30, 2008, the Company amended its credit facility agreement extending the maturity date of the term loan from February 28, 2009 to May 2, 2010. No other terms and conditions of the credit facility agreement were amended.

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

#### 7. Share Capital and Stock-Based Compensation

##### a) Share Options and Warrants

	2008		2007	
	Share options #	Warrants #	Share options #	Warrants #
<b>Balance, as at January 1</b>	<b>254,068</b>	—	498,002	482,750
Granted	<b>1,600</b>	—	—	—
Exercised	—	—	(125,000)	(192,500)
<b>Balance, as at March 31</b>	<b>255,668</b>	—	373,002	290,250
Granted	—	—	—	—
Exercised	—	—	(96,334)	(17,100)
<b>Balance, as at June 30</b>	<b>255,668</b>	—	276,668	273,150

The Company granted 1,600 options at an exercise price of \$7.67 to employees during the six month period ended June 30, 2008. There were no share options or warrants exercised during the three and six month periods ended June 30, 2008. The share options and warrants exercised during the six month period ended June 30, 2007 had an exercise price of \$0.95 or \$1.40 resulting in cash proceeds to the Company of \$101,118 for the three month period and \$219,868 for the six month period ended June 30, 2007 in respect of the share options, and \$16,245 and \$199,120 respectively for the warrants.

##### b) Stock-based Compensation

The Company uses the fair value method of accounting for all share options granted and warrants transferred to employees. During the six month period ended June 30, 2008, 1,600 options were granted at market price (2007 – no options granted). Stock-based compensation expense of \$21,000 (2007 - \$54,000) in the three month period and \$42,000 (2007 – \$109,000) in the six month period was recorded in manufacturing and selling costs and general and administration expenses in the consolidated statements of income.

The following estimated fair values of stock options granted at market during the six month period ended June 30, 2008 were determined, at the date of the grant, using the Black-Scholes option pricing model with the following weighted-average assumptions:

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

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

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

	2008		2007	
	SARs #	RSUs #	SARs #	RSUs #
<b>Balance, as at January 1</b>	<b>230,250</b>	<b>21,160</b>	—	—
Granted	14,750	1,840	—	—
<b>Balance, as at March 31</b>	<b>245,000</b>	<b>23,000</b>	—	—
Granted	—	—	—	—
<b>Balance, as at June 30</b>	<b>245,000</b>	<b>23,000</b>	—	—

The Company granted no SARs and RSUs during the three month period ended June 30, 2008 (2007 – nil). The Company granted 14,750 SARs (2007 – nil) with an exercise price of \$7.67, the market share price on the grant date, and 1,840 RSUs (2007 – nil) to employees during the six month period ended June 30, 2008.

Included in manufacturing and selling costs and general and administration expenses in the consolidated statements of income during the three month period ended June 30, 2008 was an expense of \$1,000 (2007 – nil) relating to the SARs and a net recovery of \$3,000 (2007 – nil) for the six month period then ended. During the three month period ended June 30, 2008 an expense of \$9,000 (2007 – nil) and an expense of \$18,000 (2007 – nil) for the six month period then ended was recorded relating to the RSUs.

#### 8. Related Party Transactions

Certain manufacturing components purchased for \$11,500 (2007 - \$24,500) for the three months ended and \$46,200 (2007 - \$60,000) for the six months ended June 30, 2008, included in manufacturing and selling costs in the consolidated statements of income 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, 2008 included \$nil (December 31, 2007 - \$1,000) 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 \$97,600 (2007 - \$180,500) for the three months ended and \$188,400 for the six months ended June 30, 2008 (2007 - \$656,100) included in general and administration expenses in the consolidated statements of income. The majority of the fees charged in 2007 related to the acquisition of Xerxes and the related private placement. The transactions were recorded at the exchange amount being normal commercial terms for the services. Accounts payable and accrued liabilities at June 30, 2008 included \$9,200 (December 31, 2007 - \$101,900) owing to the law firm. There are no ongoing contractual or other commitments resulting from these transactions.

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

#### 9. Financing Expense (Income)

For the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2008	2007	2008	2007
	\$	\$	\$	\$
Short term interest, net of interest income	61	(50)	136	(114)
Interest, long term obligations	89	156	236	252
Foreign exchange (gains) losses	65	117	(24)	430
	215	223	348	568

#### 10. Earnings Per Share

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

For the periods ended June 30,

	Three months		Six months	
	2008	2007	2008	2007
<b>Numerator</b> (in thousands of dollars)				
Net income	3,202	2,126	4,555	2,203
<b>Denominator</b> (in thousands)				
Weighted-average shares outstanding - basic	26,445	26,032	26,445	24,714
Effect of dilutive securities				
Stock options	150	251	150	250
Warrants	—	265	—	449
<b>Weighted-average shares outstanding - diluted</b>	<b>26,595</b>	26,548	<b>26,595</b>	25,413

#### 11. Statement of Cash Flows

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

For the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2008	2007	2008	2007
	\$	\$	\$	\$
Net interest paid	122	206	351	238
Income taxes paid	239	109	2,697	1,422

## **ZCL Composites Inc.**

### **Notes to the Interim Consolidated Financial Statements**

For the three and six months ended June 30, 2008

(Unaudited)

#### **12. Financial Instruments**

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

The Company has classified cash and cash equivalents and bank indebtedness 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 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 the debt approximates its fair value as the interest rate on this debt is variable.

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.

##### **a) 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, 2008.

##### ***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 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 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 effective interest rate on the bank indebtedness balance at June 30, 2008 was Canadian bank prime interest rate plus 25 basis points (5.00%). The term loan bears interest at bank prime plus 25 or 50 basis points, adjusted quarterly based on certain financial indicators of the Company. As at June 30, 2008, with other variables unchanged, an increase or decrease of 25 basis points in the prime interest rate would have impacted net income for the six months then ended by approximately \$15,000. There would be no effect on other comprehensive income (loss).

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

#### *Foreign Exchange Risk*

The Company operates on an international basis and is subject to foreign exchange risk exposures arising from transactions denominated in a foreign currency. 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 amounts are not significant to the Company's consolidated financial results. On an ongoing basis, management monitors changes in foreign currency exchange rates as well as considering 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, 2008. The analysis is based on financial and monetary 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, 2008**

(in thousands of dollars)	Self-sustaining Operations \$	Other Operations \$	Total \$
Cash and cash equivalents	993	2,401	3,394
Accounts receivable	10,991	504	11,495
Accounts payable and accrued liabilities	(5,775)	(692)	(6,467)
Accrued pension liability	(289)	—	(289)
Deferred revenue	(1,138)	—	(1,138)
<b>Net balance sheet exposure</b>	<b>4,782</b>	<b>2,213</b>	<b>6,995</b>

#### **Operating exposure for the six months ended June 30, 2008**

(in thousands of dollars)	\$
Sales	36,227
Operating expenses	31,855
<b>Net operating exposure</b>	<b>4,372</b>

The weighted average US to Canadian dollar translation rate was 1.0085 for the six month period ended June 30, 2008. The translation rate as at June 30, 2008 was 1.0111.

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

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

#### For the six months ended June 30, 2008

(in thousands of dollars)	\$
Net balance sheet exposure of other operations	83
Net operating exposure of other operations	162
<b>Decrease in net income</b>	<b>245</b>

Other comprehensive income would have decreased \$177,000 due to the net balance sheet exposure of self-sustaining operations.

A decrease or weakening of five percent in the Canadian dollar would have had an equal but opposite impact on net 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 equivalents, 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. In the three and six months ended June 30, 2008 and 2007 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 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.

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

The Company's maximum exposure to credit risk for trade accounts receivable is the carrying value of \$19,502,000 as at June 30, 2008 (December 31, 2007 - \$16,595,000). On a geographic basis as at June 30, 2008, approximately 41% (December 31, 2007 - 60%) of the balance of trade accounts receivable was due from Canadian and non-US customers and 59% (December 31, 2007 - 40%) was due from US customers.

Payment terms are generally net 30 days. As at June 30, 2008, the percentages of past due trade accounts receivable were as follows: 25% past due 1 to 30 days (December 31, 2007 - 25%), 8% past due 31 to 60 days (December 31, 2007 - 8%), 4% past due 61 to 90 days (December 31, 2007 - 1%) and 2% past due greater than 90 days (December 31, 2007 - 3%). 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, 2008, the Company had recorded an allowance for doubtful accounts of \$157,200 (December 31, 2007 - \$69,100). The allowance is an estimate of the June 30, 2008 trade receivable balances that are considered uncollectible. The allowance increased by \$60,900 for bad debt expense for the three months ended June 30, 2008. Changes to the allowance during the six months ended June 30, 2008 consisted of bad debt expense of \$113,100 offset by payments of \$25,000.

#### *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 Amount \$	Remainder of 2008 \$	2009 \$	Thereafter \$
Bank indebtedness	6,734	6,734	—	—
Accounts payable and accrued liabilities	12,925	12,005	920	—
Long term debt	7,460	980	6,480	—
Total	27,119	19,719	7,400	—

## ZCL Composites Inc.

### Notes to the Interim Consolidated Financial Statements

For the three and six months ended June 30, 2008

(Unaudited)

#### 13. 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 is required to maintain \$50 million of shareholders' equity to meet its external capital requirement. 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 9% as at June 30, 2008 to be low. Adjusted capital employed is defined by the Company as long term debt plus total shareholders' equity plus accumulated other comprehensive loss.

#### 14. 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	
	2008	2007	2008	2007
	\$	\$	\$	\$
Canada and Foreign	12,382	10,969	22,718	20,015
United States	20,632	17,563	34,093	23,462
	33,014	28,532	56,811	43,477

(in thousands of dollars)	Total assets		Property, plant and equipment and goodwill	
	June 30, 2008	December 31, 2007	June 30, 2008	December 31, 2007
As at	\$	\$	\$	\$
Canada and Foreign	41,060	39,804	18,605	17,408
United States	62,797	54,564	31,452	30,668
	103,857	94,368	50,057	48,076

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.

## **ZCL Composites Inc.**

### **Notes to the Interim Consolidated Financial Statements**

For the three and six months ended June 30, 2008

(Unaudited)

#### **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, 2008 and June 30, 2007, no single customer exceeded 10% of total revenue.

#### **15. Subsequent event**

The Company exercised an option to purchase land and building for \$650,000 on a property lease signed in 2003. The purchase is expected to be finalized during quarter three of 2008.

#### **16. Comparative Figures**

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