ZCL Composites Inc.

Management's Discussion and Analysis
For the three months and six months ended June 30, 2008

ZCL Composites Inc.

Management's Discussion and Analysis

For the three months and six months ended June 30, 2008

August 8, 2008

INTRODUCTION

The following Management's Discussion and Analysis ("MD&A") of ZCL Composites Inc. ("ZCL" or the "Company") should be read in conjunction with the Company's unaudited consolidated financial statements and related notes for the three and six months ended June 30, 2008 and the MD&A and audited consolidated financial statements and related notes for the year ended December 31, 2007, which are available on SEDAR at www.sedar.com. The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All figures presented in this MD&A are in Canadian dollars unless otherwise specified.

The Company's primary business is liquid containment storage systems, including fibreglass underground and aboveground storage tanks, aboveground tanks made of steel, a fibreglass tank lining system and related products and accessories. The Company's other operating activities are currently not significant to the overall operations and therefore are not disclosed separately. Separate disclosure is provided in this MD&A for Canadian and US revenue, with the distinction based on the primary location of the customers for the Company's various operations. Revenue from jurisdictions outside of Canada and the US is not significant and is included with Canadian revenue.

Advisory Regarding Forward-Looking Statements

This document contains forward-looking statements under the heading "Outlook" and elsewhere concerning future events or the Company's future performance, including the Company's projected operating results for 2008 and beyond, revenue and EBITDA targets, business opportunities in the petroleum, water/wastewater and other markets, anticipated capital expenditure trends and activity in the petroleum and other industries and markets served by the Company. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. Actual events or results may differ materially from those reflected in the Company's forward-looking statements due to a number of known and unknown risks, uncertainties and other factors affecting the Company's business and the industries the Company serves generally. These factors include, but are not limited to, fluctuations in the level of petroleum industry capital expenditures, drilling activity and oil and natural gas prices, and other factors that affect demand for the Company's products and services, industry competition, the need to effectively integrate acquired businesses, uncertainties as to the Company's ability to implement its business strategy effectively in Canada and the United States, political and economic conditions, the Company's ability to attract and retain key personnel, and other risks and uncertainties described under the heading "Risk Factors" in the Company's Annual Information Form for the year ended December 31, 2007, and elsewhere in other documents filed with Canadian provincial securities authorities. These documents are available to the public at www.sedar.com.

The Company believes that the expectations reflected in these forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this report should not be unduly relied upon. These statements speak only as of the date of this report. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by the Company or on the Company's behalf, whether as a result of new information, future events, or otherwise, except as may be required under applicable securities laws. The forward-looking statements contained in this document are expressly qualified by this cautionary statement.

Non-GAAP Measures

The Company uses both GAAP and non-GAAP measures to make strategic decisions and set targets and believes that these non-GAAP measures provide useful supplemental information to investors. EBITDA, gross profit, gross margin, cash from operations, and working capital are measures used by the Company that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures used by other companies. Included later in this MD&A are tables calculating or reconciling these non-GAAP measures.

Gross profit is defined as revenue less manufacturing and selling costs. Gross margin is revenue less manufacturing and selling costs divided by revenue and expressed as a percentage. Manufacturing and selling costs include direct materials and labour, variable and fixed manufacturing overhead, and marketing and selling expenses, and exclude amortization, general and administration, and financing expenses.

EBITDA is defined as income from continuing operations before interest, income taxes and amortization on property, plant and equipment, deferred development costs and intangible assets, gains or losses on foreign exchange and gains or losses on sale of property, plant and equipment. Investors are cautioned that EBITDA should not be construed as an alternative to net income as determined in accordance with GAAP.

Cash from operations is defined as cash flows from operating activities before changes in non-cash working capital.

Working capital is defined as current assets less current liabilities.

BUSINESS PROFILE

ZCL is one of North America's leaders in the design, manufacture, and supply of fibreglass liquid storage and handling systems to the petroleum industry. The Company also provides fibreglass tanks to the chemical and pulp and paper industries, steel tanks for custom applications and is developing a growing presence in the water and wastewater industry. The Company has significant operations in Canada with manufacturing facilities located in Alberta, Quebec and Nova Scotia. A wholly owned subsidiary in the Netherlands manufactures Parabeam®, a patented three-dimensional glass fibre material that is a key input into the ZCL double wall tank and tank lining system.

On February 22, 2007, the Company expanded into the US with the acquisition of Xerxes Corporation ("Xerxes"). This acquisition provides ZCL with a strong presence in the US to complement its leading position in Canada. Xerxes also operates in the design, manufacture and marketing of fibreglass reinforced plastic structural products for the petroleum, chemical, water and wastewater industries and has four manufacturing facilities located in California, Texas, Maryland and Iowa. The purchase price for Xerxes 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 ZCL.

DIVIDENDS

On March 18, 2008, the Company's Board of Directors declared a cash dividend of $0.12 per common share for shareholders of record on April 3, 2008, which was paid on April 17, 2008. This dividend represents a 20% increase over the annual dividend declared a year ago.

OVERALL FINANCIAL PERFORMANCE

Second Quarter 2008 Highlights

- Record revenue, net income and diluted earnings per share
- Revenue of $33.0 million, up 16% from $28.5 million in the second quarter last year
- Net income of $3.2 million, up 51% from $2.1 million in the second quarter last year
- Diluted earnings per share of $0.12, up 50% from $0.08 in the second quarter last year
- Backlog of $28.6 million, up 32% from March 31, 2008 and up 37% from June 30, 2007

First Half 2008 Highlights

- Revenue of $56.8 million, up 31% from $43.5 million last year
- Net income of $4.6 million, more than double $2.2 million last year
- Diluted earnings per share of $0.17, up 89% from $0.09 last year

The record second quarter revenue, net income and diluted earnings per share reflect increased tank sales to downstream petroleum customers in both Canada and the United States ("US") as well as increased product sales for tank lining installations primarily in Florida. The growth in the Canadian downstream petroleum sales resulted from increased activity and orders from some of the Company's key customers, while management believes the US growth reflects the capture of increased market share due to higher steel prices and a reduction in the warranty provided by the Steel Tank Institute. The improved results for the first half of 2008 reflect the factors noted above for the quarter and a full six months of the Xerxes operations in 2008 compared to just over four months in 2007.

As at June 30, 2008, the Company had working capital of $20.5 million, total assets of $103.9 million and long term debt of $7.5 million including the current portion.

OUTLOOK

Highlights

- Revenue growth target for 2008 remains unchanged at more than 20%
- EBITDA target for 2008 remains unchanged at 16% of revenue

The Company's revenue and EBITDA targets remain unchanged from the targets originally disclosed in March 2008. The 2008 revenue target is for growth of more than 20% compared to 2007 and the target for EBITDA is to achieve a margin of 16% of revenue compared to 13.9% in the prior year. The Company also has a long-term objective for revenue growth of 15% to 20% per annum and a medium-range objective to improve EBITDA to 20% of revenue.

The 16% revenue growth in the second quarter was below the annual target primarily due to the US to Canadian dollar conversion rate decreasing to approximately 1.01 in the second quarter of 2008, compared to 1.10 in the same quarter last year. A significant portion of the Company's revenue is denominated in US dollars. After eliminating the impact of the change in the conversion rate, total revenue for the second quarter would have been up approximately 22% (see the "Foreign Exchange" analysis in the "Revenue" section below for additional information). The 2008 revenue growth target assumes an average US to Canadian dollar conversion rate of 1.00 in 2008, which was relatively consistent with the experience through the first half of this year and the second half of 2007. For the first half of 2008, the Company's revenue growth of 31% exceeded the annual target due to the timing of the Xerxes acquisition on February 22, 2007

EBITDA represented 17.0% of revenue in the second quarter, a significant improvement relative to 13.9% in the same quarter last year. For the first half of 2008, EBITDA represented 14.7% of revenue, up from 11.8% for the six months ended June 30, 2007. Traditionally, the Company's margins generally improve in the second half of the year due to higher revenue levels.

A key factor impacting the Company's outlook for 2008 is a strong increase in the sales order backlog. As of June 30, 2008, the backlog was $28.6 million, up 32% from $21.7 million at March 31, 2008 and 37% from $21.0 million at June 30, 2007. For comparability purposes, the US dollar denominated portion of the backlog for all three periods were translated into Canadian dollars at the June 30, 2008 closing rate of 1.01. A significant portion of the backlog growth resulted from a 41% increase in sales orders received by the Company's Xerxes operations in the first half of 2008, relative to the same six month period in 2007. This sales order growth reflects increased orders for both downstream petroleum tanks and water and wastewater tanks. The backlog increase also reflects a new three year contract executed in the second quarter for the installation of ZCL's lining system in Hong Kong.

Other factors impacting management's outlook for the remainder of 2008 and beyond include:

- Higher steel prices and the decision by the Steel Tank Institute ("STI") to reduce the warranty on new STI licensed tanks to 10 years from 30 years effective January 1, 2008. ZCL's warranty for fibreglass tanks remains intact at 30 years. Management believes these factors are reflected in the backlog and US revenue growth.
- Continued strong growth opportunities in the water and wastewater market. Currently, the Company has a very small share of this substantial market and over the past few years, strong water and wastewater sales growth has been generated. Through the first half of 2008, water and wastewater revenue was relatively consistent with the prior year, however the orders received and related backlog have shown strong growth. To further capitalize on this opportunity, sales resources continue to be expanded and dedicated to this market in both Canada and the US.
- Regulations adopted by the state of Florida that require all existing single wall underground petroleum storage tanks to be upgraded or replaced with a secondary containment system by the end of 2009. In an article that appeared in the Tampa Tribune earlier this year, it was indicated that "about 40% or 3,200 of the state's gas stations have not yet complied". This leaves upwards of 10,000 plus tanks that need to be upgraded, replaced or shutdown by the end of 2009. A significant increase in short-term demand could result, given that annual demand for the entire US market is typically 12,000 to 15,000 tanks. Through the first half of 2008, the Company has experienced higher product sales for the purpose of lining tanks primarily in Florida; however tank sales in Florida have remained relatively consistent compared with the same period a year earlier. Based on information gathered from state authorities, management believes that the Company is not losing market share as the total number of new tanks installed in Florida, by ZCL and others, has decreased slightly in the first half of 2008 compared with the same period in 2007.

- Continued strong support for ZCL's petroleum storage solutions as evidenced by the two year contract extension executed with Ultramar Ltd. in the second quarter and other contract extensions announced earlier this year. The ZCL team takes significant pride in contracts such as these as they are an expression of confidence in the Company's ability to consistently supply high quality products and a value added approach to customer service. The Company intends to continue to grow its presence in the petroleum market by further capitalizing on the strength of its product solutions and approach to customer service.
- Increases in the price of natural gas in 2008, while not having an impact to date, may result in increased Canadian upstream activity in future periods if prices remain strong over the longer term.
- Opportunities for ZCL's technology in the coal-burning power plant industry due to the regulatory push towards reducing sulphur dioxide emissions. The Company has received expressions of interest for its corrosion resistant fibreglass technology and management believes ZCL's technology is an ideal and cost effective solution for use in scrubbers and chimney stacks that remove sulphur dioxide from flue gas emissions.
- Advances in the use of biofuels may create a need for additional tanks. Biofuels also create a more corrosive environment which management believes favour corrosion resistant fibreglass tanks such as ZCL's. Biofuels increase the presence of tank water bottoms, creating ideal conditions for the growth of naturally occurring, yet very corrosive microorganisms. This phenomenon is known as "Microbial Induced Corrosion" or "MIC".
- Continued support in Asia for the Company's tank lining system. As noted above, a new three year contract was executed in the second quarter of 2008 for the installation of the lining system in Hong Kong. The Company also believes there is potential for additional installations in South East Asia.

In addition to the growth prospects, the Company continues to focus on additional integration opportunities. Further product enhancements and efficiencies are expected through the implementation of Canadian and US operational and manufacturing best practices.

SELECTED FINANCIAL INFORMATION

	Three months ended June 30			Six months ended June 30		
(in thousands of dollars, except per share amounts)	2008 $	2007 $	Change %	2008 $	2007 $	Change %
Operating Results						
Revenue						
Canadian	12,382	10,969	13%	22,718	20,015	14%
US	20,632	17,563	17%	34,093	23,462	45%
Total	33,014	28,532	16%	56,811	43,477	31%
Gross profit (*note 1*)	7,849	5,719	37%	12,408	8,104	53%
% of revenue	*23.8%*	*20.0%*		*21.8%*	*18.6%*	
General and administration	2,246	1,765	27%	4,041	2,987	35%
Amortization	919	926	-1%	1,736	1,678	3%
Financing expense	215	223	-4%	348	568	-39%
Income tax provision	1,267	679	87%	1,728	668	159%
Net income	3,202	2,126	51%	4,555	2,203	107%
EBITDA (*note 1*)	5,603	3,954	42%	8,367	5,117	64%
% of revenue	*17.0%*	*13.9%*		*14.7%*	*11.8%*	
Earnings per share						
Basic	0.12	0.08	50%	0.17	0.09	89%
Diluted	0.12	0.08	50%	0.17	0.09	89%
Cash Flow						
Cash from operations (*note 1*)	4,201	2,769		6,353	3,551	
Changes in non-cash working capital	(2,671)	1,670		(6,188)	(3,682)	
Issue of common shares	-	117		-	37,813	
Net advance of bank indebtedness	2,619	2,265		6,584	5,963	
Net advance (repayment) of long term debt	(500)	(500)		(1,500)	9,500	
Purchase of property, plant and equipment	(577)	(801)		(1,705)	(1,464)	
Business acquisitions	-	-		-	(52,648)	

As at (in thousands of dollars)	June 30 2008	December 31 2007
Financial Position		
Working capital (*note 1*)	20,546	20,642
Total assets	103,857	94,368
Long term debt	7,460	8,938

Note 1 : Gross profit, EBITDA, cash from operations and working capital are non-GAAP measures and are defined earlier under "Non-GAAP Measures".

RESULTS OF OPERATIONS

Revenue

Revenue for the second quarter of 2008 was a record $33.0 million, up $4.5 million or 16% from $28.5 million for the corresponding quarter of 2007. The increase reflects strong growth in tank sales to downstream petroleum customers in both Canada and the US as well as increased product sales for tank lining installations primarily in Florida. The Company generates significant revenue denominated in US dollars, and as a result, the second quarter revenue increase was impacted by the weighted average US to Canadian dollar conversion rate decreasing to approximately 1.01 in the second quarter of 2008, compared to approximately 1.10 in the same quarter a year earlier. Excluding the impact of this change in conversion rate, total consolidated revenue for the second quarter would have been up by approximately 22% over the prior period. (See the "Foreign Exchange" analysis below for additional information).

For the first half of 2008, revenue totalled $56.8 million, an increase of $13.3 million or 31% compared to $43.5 million for the six months ended June 30, 2007. The increase reflects the factors noted above for the quarter and a full six months of the Xerxes operations in the first half of 2008 compared to just over four months in 2007. The first half revenue growth was also impacted by a lower US to Canadian dollar conversion rate. Excluding the impact of this change in conversion rate, total consolidated revenue for the first half of 2008 would have been up by approximately 38%.

Canadian revenue for the second quarter of 2008 totalled $12.4 million, up 13% from $11.0 million in the same quarter last year. For the first half of 2008, Canadian revenue totalled $22.7 million, up 14% compared to $20.0 million for the six months ended June 30, 2007. The increases reflect higher fibreglass tank sales to upstream, downstream and industrial customers.

US revenue for the second quarter of 2008 totalled $20.6 million, up 17% from $17.6 million in the second quarter last year. The increase was due to strong growth in tank sales to downstream petroleum customers and increased product sales for tank lining installations primarily in Florida. Management believes that the growth in downstream petroleum sales reflects the capture of increased market share in the US due to higher steel prices and the reduction in the warranty on tanks licensed by the Steel Tank Institute to 10 years from 30 years effective January 1, 2008. The US revenue increase for the second quarter was also impacted by the lower US to Canadian dollar conversion rate discussed below. Excluding the impact of the change in conversion rate, US revenue for the second quarter of 2008 would have been up approximately 28%.

For the first half of 2008, US revenue totalled $34.1 million, up 45% compared to $23.5 million for the six months ended June 30, 2007. The increase reflects the factors noted above for the quarter and a full six months of the Xerxes operations in the first half of 2008 compared to just over four months in 2007. Excluding the impact of the lower US to Canadian dollar conversion rate, US revenue for the first half of 2008 would have been up approximately 61%.

Foreign Exchange

The Company generates significant revenue denominated in US dollars and is therefore subject to fluctuations in the US to Canadian dollar conversion rate. For the second quarter of 2008, the weighted average conversion rate was 1.01; significantly lower than 1.10 for the second quarter of 2007. Similarly, for the first half of 2008, the weighted average conversion rate of 1.01 was significantly lower than 1.12 in the first half of 2007. If the exchange rate for the second quarter of 2008 would have been in effect a year earlier, the US revenue noted above for the second quarter of 2007 would have been approximately $1.4 million lower (2007 First Half – $2.3 million lower). For additional information on the impact of changes in the US to Canadian dollar exchange rate see note 12 of the Company's June 30, 2008 unaudited interim consolidated financial statements.

Gross Profit and Margin

Gross profit for the second quarter of 2008 was $7.8 million, up 37% from $5.7 million in the same quarter last year. For the first half of 2008, gross profit totalled $12.4 million, an increase of 53% compared to $8.1 million a year earlier. These increases primarily reflect the factors impacting revenue noted above.

Gross margin for the second quarter of 2008 was 23.8% of revenue compared with 20.0% of revenue for the corresponding quarter in 2007. For the first half of 2008, gross margin was 21.8% of revenue compared with 18.6% a year earlier. The improved second quarter and first half margins were due in large part to increased revenue and the fixed manufacturing and selling costs therefore being absorbed over a higher revenue base.

The improved margins also reflect a lower than usual margin in 2007 on the sale of finished goods acquired in conjunction with the acquisition of Xerxes. Upon acquisition, the Xerxes finished goods inventory was recorded at the estimated selling price less the costs to sell the inventory. This resulted in an increase in the carrying value of $1.1 million which was charged to manufacturing costs as the inventory was sold. During the second quarter of 2007, approximately $700,000 (2007 First Half - $800,000) of the increase in carrying value was charged to manufacturing costs. Without this inventory adjustment, gross margin for the second quarter of 2007 would have been 22.4% of revenue (2007 First Half – 20.5%).

General and Administration, Amortization and Financing Expense

General and administration ("G&A") expenses for the second quarter were $2.2 million, up 27% from $1.8 million in the same quarter last year reflecting increased infrastructure support costs and higher public company related costs. For the first half of 2008, G&A expenses were $4.0 million, an increase of 35% compared to $3.0 million for the six months ended June 30, 2007. The first half increase reflects the factors noted above for the quarter and a full six months of the Xerxes operations in 2008 compared to just over four months in 2007. Included in G&A expenses for the first half of 2007 were approximately $300,000 of costs resulting from the acquisition of Xerxes.

Amortization for the second quarter of 2008 was $919,000, consistent with $926,000 in the same quarter last year. For the first half of 2008, amortization expense of $1.7 million was also consistent with a year earlier.

Financing expense for the second quarter of 2008 was $215,000, consistent with $223,000 in the same quarter last year. The most significant component of financing expense is generally interest on the long term debt used to acquire Xerxes. For the first half of 2008, financing expense decreased to $348,000 from $568,000 for the six months ended June 30, 2007. The expense for the first half of 2007 included just over four months of interest expense relating to the acquisition and a foreign exchange loss of approximately $300,000 on US forward contracts closed during the first quarter of 2007. These contracts were purchased to mitigate the currency risk associated with the Xerxes acquisition. No forward exchange contracts were entered into during the first half of 2008 or over the remainder of 2007.

Income taxes

Income tax expense represented 28.4% of pre-tax income for the second quarter of 2008, compared with 24.2% of pre-tax income in the corresponding quarter of 2007. For the first half of 2008, income tax expense represented 27.5% of pre-tax income compared with 23.3% of pre-tax income in the first half of 2007. The Company estimates that its income tax expense for 2008 will be between 26% and 28% of pre-tax income.

Net Income and Earnings per Share

Net income for the second quarter was a record $3.2 million, up 51% from $2.1 million in the same quarter last year due to the higher Canadian and US revenue. Basic and diluted earnings per share were $0.12 for the second quarter of 2008, an increase of 50% compared with $0.08 for the same quarter of 2007.

For the first half of 2008, net income was $4.6 million, more than double $2.2 million for the six months ended June 30, 2007. Basic and diluted earnings per share were $0.17 for the first half of 2008, an increase of 89% compared to $0.09 for the same period last year.

Other Comprehensive Income (Loss)

The Company had other comprehensive loss ("OCL") of $700,000 for the second quarter ended June 30, 2008. The loss reflects the increase in the value of the US dollar relative to the Canadian dollar and the translation of the Xerxes/US operations into Canadian dollars. The operations are classified as self-sustaining foreign operations for accounting purposes where assets and liabilities are translated at the exchange rate in effect at the balance sheet date in accordance with GAAP. The second quarter loss reflected the US to Canadian dollar conversion rate decreasing to approximately 1.01 at June 30, 2008 from 1.02 at March 31, 2008.

For the first half of 2008 the Company had other comprehensive income of $1.2 million reflecting the US to Canadian dollar translation rate increasing to 1.01 at June 30, 2008 from 0.98 at December 31, 2007. The total other comprehensive loss of $7.5 million at June 30, 2008 reflects the US dollar conversion rate decreasing to the rate of approximately 1.01 at June 30, 2008 from 1.17 at the date of acquisition of Xerxes on February 22, 2007.

SUMMARY OF QUARTERLY RESULTS

For the three months ended	**2008**		**2007**				**2006**	
(in thousands of dollars,	**Jun 30**	**Mar 31**	**Dec 31**	**Sep 30**	**Jun 30**	**Mar 31**	**Dec 31**	**Sep 30**
except per share amounts)	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Revenue	33,014	23,797	30,013	31,293	28,532	14,945	14,873	13,974
Net income	3,202	1,353	2,766	2,546	2,126	77	1,488	1,611
Basic earnings per share	0.12	0.05	0.10	0.10	0.08	-	0.07	0.08
Diluted earnings per share	0.12	0.05	0.10	0.10	0.08	-	0.07	0.07

The above table of selected information for the eight most recent quarters should be read in conjunction with the applicable interim unaudited and annual audited consolidated financial statements and accompanying notes.

The Company's financial results have historically been affected by seasonality with the lowest levels of activity occurring in the first and second quarters of the year. The second quarter results of 2008 were the highest of the eight quarters shown above due to the factors impacting revenue noted above. The revenue and earnings for the eight quarters shown above were also impacted by the acquisition of Xerxes on February 22, 2007. The Xerxes operations approximately doubled the Company's revenue and operations. With this addition, the Company's exposure to fluctuations in the US to Canadian dollar exchange rate has increased, which can have a positive or negative impact on the Company's revenue and earnings. For additional information on the impact of changes in the US to Canadian dollar exchange rate see note 12 of the Company's June 30, 2008 unaudited interim consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

As at June 30, 2008, the Company had positive working capital (current assets less current liabilities) of $20.5 million, an improvement relative to $17.8 million at March 31, 2008 and comparable to $20.6 million at December 31, 2007. The consistency with December 31, 2007 reflects positive cash flow from operations being offset by a dividend of $3.2 million, payments of $1.5 million on long term debt and capital asset additions of $1.7 million.

Current assets as at June 30, 2008 increased by $8.4 million relative to December 31, 2007, while current liabilities increased by $8.5 million. Current assets increased in part due to higher receivable and inventory levels. Current liabilities increased due to a $6.6 million increase in the utilization of the Company's operating line and higher accounts payable of $2.0 million due to increased activity in the quarter. As at June 30, 2008, the Company had cash and cash equivalents of $2.4 million, compared to $2.0 million at year end. The Company also has a revolving operating credit facility, provided by a chartered bank, available to a maximum of $15.25 million subject to meeting prescribed margin requirements. The Company was in compliance with all required bank covenants. Management believes that internally generated cash flows, along with the available revolving operating credit facility, will be sufficient to cover the Company's normal operating and capital expenditures in 2008.

During the second quarter of 2008, the Company generated cash flow from operating activities of $4.2 million, before changes in non-cash working capital, compared to $2.8 million in the corresponding quarter of 2007. The increase of $1.4 million from the second quarter of 2007 was primarily due to higher net income achieved during the second quarter of 2008. The Company repaid $0.5 million of long term debt during the second quarter of 2008. The Company also borrowed $2.6 million against its operating line during the second quarter of 2008, which is consistent with the seasonal fluctuations in the Company's business and the $2.3 million drawn during the corresponding quarter of 2007. Capital expenditures of $0.6 million during the second quarter of 2008 were comparable with $0.8 million in the corresponding period in 2007.

In the first half of 2008, the Company generated cash flow from operating activities of $6.4 million, before changes in non-cash working capital, up 79% from $3.6 million in the corresponding period of 2007. The increase of $2.8 million from the same period last year was primarily due to higher net income achieved during 2008. The Company repaid $1.5 million of long term debt during 2008, including $500,000 that was due December 31, 2007 but not withdrawn by the bank until the beginning of 2008. The Company also borrowed $6.6 million against its operating line during 2008, which is consistent with the seasonal fluctuations in the Company's business and the $6.0 million drawn during the corresponding period of 2007. Dividends of $3.2 million were paid in 2008, compared to $2.6 million paid in 2007. Capital expenditures of $1.7 million during 2008 were relatively consistent with $1.5 million for the corresponding period in 2007.

In the first quarter of 2007, the Company acquired Xerxes for $46.3 million. This acquisition was funded from the net proceeds of a "bought deal" private placement and commercial debt financing. The private placement resulted in total gross proceeds of $40.0 million ($37.4 million in net cash proceeds after deducting expenses of the offering of $2.6 million). The balance of the purchase price was funded from a two year term loan from a commercial bank which provided financing of $20.0 million with a minimum repayment requirement of $2.0 million per year. Ten million dollars of the financing was repaid in the first quarter of 2007. The Company also borrowed against its operating line of credit to repay Xerxes' indebtedness of $6.3 million.

Subsequent to June 30, 2008, 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 the third quarter of 2008.

Contractual Obligations

The Company's commitments for operating leases have not changed significantly from amounts disclosed in the December 31, 2007 annual consolidated financial statements.

TRANSACTIONS WITH RELATED PARTIES

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.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

Financial Instruments – Disclosure and Presentation

Effective January 1, 2008, the Company prospectively adopted the Canadian Institute of Chartered Accountants ("CICA") 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 required to enable users to evaluate the nature and extent of risks arising from the Company's financial instruments. The Company has provided the additional required disclosures in its interim consolidated financial statements for the three and six months ended June 30, 2008.

Capital Disclosures

Effective January 1, 2008, the Company prospectively adopted CICA 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. The Company has provided the additional required disclosures in its interim consolidated financial statements for the three and six months ended June 30, 2008.

Inventories

Effective January 1, 2008, the Company retrospectively adopted CICA 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 new section did not have a material impact on the Company's consolidated financial position or results of operations and the additional required disclosures have been provided in the Company's interim consolidated financial statements for the three and six months ended June 30, 2008.

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". 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 convergence plan and assessing the impact of the ultimate adoption of IFRS.

CONTROLS AND PROCEDURES

Management has evaluated whether there were changes in the Company's internal controls over financial reporting during the most recent interim period ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. No material changes were identified.

OUTSTANDING SHARE DATA

As at August 8, 2008, there were 26,450,529 common shares and 250,668 share options outstanding. Of the options outstanding, 178,334 are currently exercisable into common shares.

RECONCILIATION TABLES

The following tables show the calculation or reconciliation of non-GAAP measures used in this MD&A from GAAP measures or amounts reflected in the Company's interim unaudited consolidated financial statements (see "Non-GAAP Measures").

The following table presents the calculation of gross profit and gross margin.

	Three months ended June 30			Six months ended June 30		
(in thousands of dollars)	2008 $	2007 $	Change %	2008 $	2007 $	Change %
Revenue	33,014	28,532	16%	56,811	43,477	31%
Manufacturing and selling costs	25,165	22,813	10%	44,403	35,373	26%
Gross profit	7,849	5,719	37%	12,408	8,104	53%
Gross margin (*Gross profit as a % of revenue*)	*23.8%*	*20.0%*		*21.8%*	*18.6%*	

The following table reconciles net income in accordance with GAAP to EBITDA.

	Three months ended June 30			Six months ended June 30		
(in thousands of dollars)	2008 $	2007 $	Change %	2008 $	2007 $	Change %
Net income	3,202	2,126	51%	4,555	2,203	107%
Amortization expense	919	926	-1%	1,736	1,678	3%
Financing expense	215	223	-4%	348	568	-39%
Income tax expense	1,267	679	87%	1,728	668	159%
EBITDA	5,603	3,954	42%	8,367	5,117	64%
% of revenue	*17.0%*	*13.9%*		*14.7%*	*11.8%*	

The following table presents the calculation of cash from operations.

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
(in thousands of dollars)	$	$	$	$
Net income	3,202	2,126	4,555	2,203
Add items not affecting cash:				
Amortization expense	919	926	1,736	1,678
Future tax expense (recovery)	59	(337)	20	(439)
Stock-based compensation expense	21	54	42	109
Cash from operations	4,201	2,769	6,353	3,551

The following table presents the calculation of working capital.

	As at		
	June 30 2008	December 31 2007	Change
(in thousands of dollars)	$	$	$
Current assets	44,301	35,923	8,378
Current liabilities	23,755	15,281	8,474
Working capital	20,546	20,642	(96)