

Management's Discussion and Analysis

For the second quarter ended June 30, 2007



August 2, 2007

The following Management's Discussion and Analysis ("MD&A") of ZCL Composites Inc. (the "Company") of the results of operations and cash flows for the period ended June 30, 2007, and of the financial position as at June 30, 2007, should be read in conjunction with the Company's unaudited consolidated financial statements and related notes for the period ended June 30, 2007, the MD&A and audited consolidated financial statements and related notes for the nine month fiscal period ended December 31, 2006, available on SEDAR at www.sedar.com, as well as the Message to Shareholders included in this Second Quarter Report. 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.

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 2007 and beyond, and anticipated capital expenditure trends and activity in the petroleum and other industries 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" and elsewhere in the Company's Annual Information Form for the nine month fiscal period ended December 31, 2006, under the heading "Risks and Uncertainties" and elsewhere in the Company's MD&A for the nine month fiscal period ended December 31, 2006 and 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.

The Company adopted certain new accounting policies beginning January 1, 2007 as required by GAAP. Furthermore, with a significant business acquisition completed during the first quarter, certain existing accounting policies were updated to address circumstances resulting from or created by the acquisition. A summary of the newly adopted accounting policies in the period is included herein.

OUR BUSINESS

The Company is one of North America's leaders in the design, manufacturing, and supply of cost-effective fiberglass tank systems to the petroleum industry. Prior to February 22, 2007 the Company's business was conducted primarily in Canada. Effective February 22, 2007, the Company expanded into the U.S. by purchasing 100% of the shares of XAHC, Inc. ("XAHC"), the sole shareholder of Xerxes Corporation ("Xerxes"). Xerxes, now a division of the Company, is involved in the design, manufacture and marketing of fiberglass reinforced plastic structural products for the petroleum, chemical, water and wastewater industries operating from five principal locations in Minnesota, California, Texas, Maryland and Iowa.

The final purchase price for XAHC was \$46.3 million, including fees for professional services employed to assist with and complete the acquisition. The acquisition was funded from the net proceeds received from the Company's recent "bought deal" private placement offering with the balance funded with commercial debt financing.

Prior to the closing of the Xerxes acquisition, the Company had closed a "bought deal" private placement offering of subscription receipts with a syndicate of underwriters whereby the underwriters purchased as principals 4,000,000 subscription receipts at a price of \$10.00 per subscription receipt for total gross proceeds of \$40.0 million (\$37.4 million in net cash proceeds after deducting expenses of the offering of \$2.6 million). Each holder of subscription receipts automatically acquired one common share of the Company in exchange for every one subscription receipt held, without the payment of any additional consideration, upon the closing of the Xerxes acquisition on February 22, 2007.

The balance of the purchase consideration plus additional closing costs was funded from a two year term loan from a commercial bank which provided financing of up to \$20 million (final settlement of \$10 million) with a minimum repayment requirement of \$2.0 million per year.

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's Canadian operations have been affected by seasonality and experienced its lowest levels of activity in the first half of the calendar year, corresponding to the seasonality of the delivery of product to the upstream market and installation of product in the downstream market. Newly acquired operations in the United States are similarly impacted by the seasonality of installations in the northern United States.

OVERVIEW

For the purposes of this MD&A, references to "Canadian operations" shall mean all of ZCL's operations and subsidiaries, including its foreign subsidiary located in the Netherlands, without giving effect to the Xerxes acquisition referred to above. References to "Xerxes" and "U.S. operations" shall mean operations acquired pursuant to the Xerxes acquisition; and, references to "ZCL" and the "Company" shall mean the consolidated operations of ZCL and Xerxes.

The inclusion of revenue from the Company's new U.S. operations had a significant positive impact on the consolidated financial results and more than offset weaker Canadian revenue in the second quarter and first half of 2007, compared with a year earlier.

The weaker upstream revenue in Canada is consistent with the overall decline in the petroleum industry which is a result of the decreased natural gas drilling. In the downstream market, the reduction in sales is a reflection of the very strong first half experienced in 2006. In the current period many of the same customers have delayed some of the orders for later in the year.

The Company's newly acquired U.S. operations experienced modest revenue growth in the second quarter and first half from a year earlier in its most important market sector, the U.S. petroleum industry. Revenue growth was significantly stronger from a year earlier for the second largest market, water and wastewater storage. The U.S. growth trends from a year earlier are noted for analytical purposes but are not relevant to the Company's financial statements because the Company did not own the U.S. operations in 2006.

During the second quarter of 2007 the Company continued work on the integration of its new U.S. operations with its existing Canadian operations. Over the longer term, the Company expects to achieve certain synergies in a number of areas, including material costs, freight, insurance and certain manufacturing processes. During the first half of 2007, the Company benefited from synergies related to the combination of its Canadian and U.S. purchases of resin, the most important raw material in the production of fibreglass. With increased volume, combined with the rising value of the Canadian dollar against the U.S. dollar, the Company was able to defer certain price increases for the resin it purchases.

Also, during the second quarter of 2007, Chevron Hong Kong Limited (Caltex) expanded by two additional sites the previously disclosed contract to install our LIFELINER System™ at Chevron locations in Hong Kong. This brings the total number of sites under contract to eight. Work on all eight sites is scheduled for completion by the end of 2007. The opportunity still exists for multiple locations within South China and Thailand where Chevron (Caltex) has similar operations. We have entered into negotiations with a number of customers in North America for the installation of the LIFELINER System™.

Subsequent to the end of the second quarter of 2007 the Company announced a seven-year supply agreement under which the tank service company, Tank Tech Inc. ("Tank Tech") of Blodgett, Missouri, will sell and install ZCL's PHOENIX System® tank liner product across the U.S. The new agreement replaces a Florida-only, five year agreement between ZCL and Tank Tech announced in 2006. Under the new agreement ZCL and its affiliates retain the right to market and sell the PHOENIX System® directly to U.S. customers. Tank Tech has non-exclusive marketing rights and has exclusive installation rights for the PHOENIX System® in the U.S.

OUTLOOK

The outlook for the Company continues to be the same as outlined in the 2006 annual report. In addition to those comments, the following information relates to the remainder of 2007 and the longer term outlook.

The Company's consolidated order backlog as of June 30, 2007 was \$21.4 million. This represents a strong start to the third quarter and compares with a backlog of \$22.9 million as of March 31, 2007 and \$13.8 million as of June 30, 2006.

ZCL currently anticipates revenue for the full year 2007 in the range of \$105 million to \$115 million, compared with \$55.1 million a year earlier, with the increase being primarily attributable to the Xerxes acquisition. ZCL expects EBITDA in the range of \$16 million to \$18 million compared with \$9.6 million in 2006. The 2007 outlook is based on a number of assumptions, including the expectation that second half 2007 performance will be stronger than first half 2007 performance.

EBITDA is not a recognized measure under GAAP, does not have a standardized meaning prescribed by

GAAP and may not be comparable to similar measures used by other companies. EBITDA is defined as income from continuing operations before interest, income taxes and amortization on property, plant and equipment, deferred costs and intangible assets, gains or losses on foreign exchange and gains or losses on sale of property, plant and equipment. 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. Investors are cautioned that EBITDA should not be construed as an alternative to net income as determined in accordance with GAAP. The table included under the heading "EBITDA" below in this MD&A reconciles net income from continuing operations to EBITDA.

For the Company to achieve its expected revenue and EBITDA growth for the year, it will need to increase its revenue base in the second half of 2007 compared with the first half. Factors which are expected to help the Company achieve this improved performance include, but are not limited to, the following:

- The Company's second half 2007 results will include six months of U.S. operations, while the first half of 2007 included less than five months of U.S. operations, due to the acquisition of Xerxes on February 22, 2007.
- Because of seasonal factors, our operations have traditionally achieved at least 53% to 55% of annual revenue in the second half of the year. We expect this trend to continue in 2007.
- As of June 30, 2007, the Company deferred revenue recognition on tanks and accessories valued at approximately \$2.2 million that it had not shipped. The product, for Canadian customers, has been manufactured, invoiced, and in some cases paid for. Revenue recognition is expected in the second half of 2007 when shipment or signing of storage contracts occurs. Any shipment delays were at the request of customers for various reasons, including their need to defer tank installations due to labour shortages in Alberta.
- We are anticipating several large Canadian orders in the fourth quarter, as well as certain orders involving new uses of our tanks, and a U.S. order in the fourth quarter of 2007 that was postponed from the first half of the year.
- EBITDA for the first half of 2007 included approximately \$1.3 million of expenses that are not expected to recur in the second half of 2007. These expenses included a foreign exchange loss of \$0.3 million, professional fees of \$0.2 million and charges to manufacturing costs of \$0.8 million relating to inventory acquired in the Xerxes acquisition.

Although the Company has experienced upward price pressure on raw materials in the first half of 2007, this has been partly deferred by increased buying power and partly offset by the strengthening of the Canadian dollar. In the second half of 2007, the Company also expects to be able to pass along raw material price increases by raising prices of finished products. As a result, the Company expects to maintain its gross margins in the second half of 2007 at approximately the same levels as the first half of 2007.

Over the past three years, resin prices have not increased as significantly as prices for steel, the primary raw material in steel tanks that compete against the U.S. fibreglass tanks. As a result of these relatively higher steel price increases, a once-significant price advantage for steel tanks has diminished to negligible levels compared with the price of fibreglass tanks.

In the second half of 2007, and over the longer term, ZCL's fibreglass tank business may benefit from a decision taken in the second quarter of 2007 by the Steel Tank Institute, a trade group representing the majority of North America's steel tank manufacturers. The Institute, which provides its members with insurance for warranties on steel tanks for petroleum underground storage, announced that warranties on such steel tanks will be reduced to ten years from 30 years effective January 1, 2008.

Also in the second half of 2007, and over the longer term, ZCL expects that its fibreglass tank business may

benefit from the penetration of ethanol as an auto fuel in North America. Ethanol is increasingly being blended with gasoline at a rate of up to 10% ethanol and 90% gasoline, which can be used by any gasoline-powered vehicle. In some regions of North America, a blend of 85% ethanol and 15% gasoline, known as E85, is making market inroads for vehicles specially equipped to operate on this fuel. Ethanol creates water at the bottom of fuel storage tanks. Microorganisms in the ethanol feed on the water and create an acid which is very corrosive to steel. This problem does not affect fiberglass tanks.

In addition, ZCL expects that its fiberglass tank business may benefit from long-term growth in the Canadian oil sands sector and from long-term growth in North American demand for water and wastewater storage. Fiberglass tanks are becoming increasingly competitive against storage systems made from concrete for water and wastewater.

Internationally, there is a very large and growing need for upgrading both underground and aboveground liquid storage, driven by environmental legislation and industry standards requiring secondary containment for storage of hazardous liquids. We believe there is a large, long-term global market for an alternative to tank replacement when upgrading existing single wall tanks to secondary containment standards, as evidenced by the contract obtained from Chevron Hong Kong Limited (Caltex) and the new agreement signed with Tank Tech in the U.S. subsequent to the end of the second quarter in 2007.

SEGMENTED OPERATIONS

Operating segments are defined as components of the Company for which separate financial information is available and 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.

If an operating segment represents more than 10% of the overall sales, assets or income before administrative costs, amortization, financing charges and income taxes, it must be shown as a separate segment. In prior disclosures, the Home Heating Oil Tank segment incurred losses that exceeded 10% of the overall income of the Company; therefore, this segment was a reportable segment and was disclosed separately. This segment no longer exceeds 10% of sales, assets or net income before administrative costs, amortization, financing charges and income taxes. The Company does not expect this segment to exceed any of these thresholds in the future. Therefore, this operating segment is no longer disclosed separately. Since substantially all of the Company's operations (including Xerxes) are represented by the one reportable operating segment, i.e. the Liquid Containment Storage Systems segment, the Company has discontinued the reporting of separate segmented information.

On a geographic basis, the Company in 2007 began disclosing U.S. revenue separately following the Xerxes acquisition. The Company continues to report two other geographic areas, being Canada and Foreign countries (defined as countries other than Canada and the U.S.).

OVERALL PERFORMANCE

| | Three months ended | | Six months ended | |
|--|--------------------|-----------|------------------|------------------|
| | Jun 30/07 | Jun 30/06 | Jun 30/07 | Jun 30/06 |
| Financial Summary <i>(in thousands of dollars, except per share amounts)</i> | \$ | \$ | \$ | \$ |
| Operating Results | | | | |
| Canadian revenue (Note 1) | 10,969 | 12,552 | 20,015 | 26,213 |
| U.S. revenue | 17,563 | -- | 23,462 | -- |
| Revenue | 28,532 | 12,552 | 43,477 | 26,213 |
| EBITDA (Note 2) | 3,954 | 1,760 | 5,117 | 4,129 |
| Net income from continuing operations | 2,126 | 957 | 2,203 | 2,252 |
| Net income from discontinued operations | -- | -- | -- | 319 |
| Net income | 2,126 | 957 | 2,203 | 2,571 |
| Basic earnings per share: | | | | |
| Continuing operations | \$0.08 | \$0.05 | \$0.09 | \$0.11 |
| Discontinued operations | -- | -- | -- | <u>0.01</u> |
| Total | \$0.08 | \$0.05 | \$0.09 | \$0.12 |
| Diluted earnings per share: | | | | |
| Continuing operations | \$0.08 | \$0.04 | \$0.09 | \$0.11 |
| Discontinued operations | -- | -- | -- | <u>0.01</u> |
| Total | \$0.08 | \$0.04 | \$0.09 | \$0.12 |
| Cash Flow | | | | |
| Cash from operations (Note 3) | 2,769 | 1,365 | 3,551 | 3,375 |
| Issue of common shares | 117 | 767 | 37,813 | 2,741 |
| Dividends paid | 2,600 | -- | 2,600 | -- |
| Additions to property, plant and equipment | 801 | 387 | 1,464 | 522 |
| Acquisitions | -- | -- | 52,648 | -- |
| | | | As at | |
| Financial Position | | | Jun 30/07 | Dec 31/06 |
| Working capital (Note 4) | -- | -- | 20,277 | 18,442 |
| Total assets | -- | -- | 100,273 | 41,415 |

Note 1: Includes revenue from the Company's foreign subsidiary Parabeam Industries BV (Netherlands).

Note 2: EBITDA is defined as income from continuing operations before interest, income taxes and amortization on property, plant and equipment, deferred costs and intangible assets, gains or losses on foreign exchange and gains or losses on sale of property, plant and equipment.

Note 3: Cash from operations is defined as cash flows from operating activities before changes in working capital.

Note 4: Working capital is defined as current assets less current liabilities. Working capital is not a recognized measure under GAAP and may not be comparable to similar measures used by other companies. Investors are cautioned that working capital should not be construed as an alternative to cash flows from operating activities, as determined in accordance with GAAP.

EBITDA (see Note 2, page 6)

EBITDA is not a recognized measure under GAAP and does not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures used by other companies. The Company uses both GAAP and non-GAAP measures to make strategic decisions and set targets and believes that this non-GAAP measure provides useful supplemental information to investors. Investors are cautioned that EBITDA should not be construed as an alternative to net income as determined in accordance with GAAP. The following table reconciles net income from continuing operations to EBITDA.

| | Three months ended | | Six months ended | |
|---|--------------------|-----------|------------------|-----------|
| | Jun 30/07 | Jun 30/06 | Jun 30/07 | Jun 30/06 |
| Reconciliation of net income to EBITDA (in thousands of dollars) | \$ | \$ | \$ | \$ |
| Net income from continuing operations | 2,126 | 957 | 2,203 | 2,252 |
| Financing expense (income) | 223 | (8) | 568 | 39 |
| Income taxes | 679 | 429 | 668 | 1,070 |
| Amortization | 926 | 382 | 1,678 | 768 |
| EBITDA | 3,954 | 1,760 | 5,117 | 4,129 |

RESULTS OF OPERATIONS

Three and Six Months Ended June 30, 2007 Compared to the Three and Six Months Ended June 30, 2006

Revenue

Revenue for the second quarter of 2007 was \$28.5 million, up 127.3% from \$12.6 million in the corresponding quarter of 2006. For the first half of 2007, revenue was \$43.5 million, up 65.9% from \$26.2 million in the first half of 2006.

The U.S. operations added \$17.6 million to total revenue in the second quarter of 2007 (\$23.5 million in the first half of 2007). There was no year-earlier U.S. revenue as the acquisition of Xerxes was not completed until February 22, 2007.

Revenue from Canadian operations for the second quarter of 2007 was \$11.0 million, down 12.6% from \$12.6 million a year earlier. In the first half of 2007, revenue from Canadian operations was \$20.0 million, down 23.6% from \$26.2 million a year earlier).

Continuing the trend established in the first quarter of 2007, many of ZCL's Canadian customers delayed making purchases in the upstream and downstream markets for a variety of reasons including the decrease in natural gas drilling, the scarcity of human resources throughout the industry and the escalating costs in the oilfield services industry.

The Canadian oilfield services industry has continued to experience slower activity levels than the same period last year in the upstream market. According to the Canadian Association of Oil Drilling Contractors (CAODC) rig utilization for the second quarter was 17% as compared to 43% for the same quarter last year. Further, the number of gas well licenses issued during the second quarter of 2007 was 2,238, down 47% from the 4,255 issued during the same quarter last year.

The U.S. marketplace is not experiencing a slowdown. A March, 2007 article prepared by the Petroleum Equipment Institute (PEI), summarized that business should be "comfortable" in 2007, as a result of such activity as the Florida mandatory tank upgrade program, the growing pressure to supply ethanol and biodiesel additives and the California state-required vapour recovery upgrade program

Gross Profit

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. Gross profit and gross margin are not recognized measures under GAAP and do not have standardized meanings prescribed by GAAP and may not be comparable to similar measures used by other companies. 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.

For the second quarter of 2007, gross profit was \$5.7 million, up 126.3% from \$2.5 million a year earlier. Gross margin was 20.0% of revenue in the second quarter of 2007, compared with 20.1% of revenue in the corresponding quarter of 2006.

The gain in gross profit is largely the result of the addition of the U.S. operations for the second quarter and first half of 2007. Gross margin for the first half of 2007 was lower due to the inclusion of costs related to the acquisition of Xerxes. Accounting for the purchase of a business requires finished goods inventory acquired to be recorded at selling price less costs to sell the inventory. This resulted in an increase of \$1.1 million to the carrying value of inventory that is being charged to manufacturing costs as the inventory is sold. During the second quarter, \$0.7 million of this increase to the carrying value of inventory was charged to manufacturing costs (first half of 2007 - \$0.8 million). Without this inventory adjustment, gross margin would have been 22.3% of revenue, an increase of 2.2 percentage points over the corresponding quarter of 2006. The unadjusted gross margin gain was the result of a combination of higher sales volumes, product mix and price increases introduced in February on the U.S. products.

For the first half of 2007, gross profit was \$8.1 million, up 46.2% from \$5.5 million in the corresponding period a year earlier. Gross margin was 18.6% of revenue in the first half of 2007, compared with 21.1% of revenue in the corresponding period a year earlier. Without the inventory adjustment, gross margin in the first half of 2007 would have been 20.5%.

Amortization

Amortization for the second quarter of 2007 was \$0.9 million, up 142.4% from \$0.4 million in the corresponding quarter of 2006. For the first half of 2007, amortization was \$1.7 million, up 118.5% from \$0.8 million in the first half of 2006. For both periods, the overall level of amortization increased partially due to higher capital spending activity in Canada, but primarily as a result of the acquisition of Xerxes.

General and administration

General and administration expenses were \$1.8 million for the second quarter, up 130.1% from \$0.8 million for the corresponding quarter of 2006. For the first half of 2007, general and administrative expenses were \$3.0 million, up 111.2% from \$1.4 million in the first half of 2006. For both periods, expenses increased primarily as a result of the inclusion of Xerxes. The first half total for 2007 also reflects professional fees

relating to the acquisition itself (\$0.2 million) and professional fees incurred for governance compliance and income tax matters (\$0.1 million).

Financing expense (income)

Financing expense for the second quarter of 2007 was \$0.2 million compared with negligible financing income for the corresponding period of 2006. For the first half of 2007, financing expense was \$0.6 million compared with negligible financing expense for the first half of 2006. The most significant component of financing expense for the second quarter of 2007 was interest on the long-term debt used to acquire Xerxes. For the first half of 2007, the Company had a foreign exchange loss of \$0.3 million on U.S. forward contracts closed during the first quarter. These contracts were purchased to mitigate the currency risk associated with the Xerxes acquisition. During the first quarter all forward contracts were closed out. No forward contracts were entered into during the second quarter and there were no forward contracts outstanding as at June 30, 2007.

Income taxes

Income tax expense was \$0.7 million in the second quarter of 2007, up 58.3% from \$0.4 million in the second quarter of 2006. Income tax expense represented 24.2% of pre-tax income in the second quarter of 2007, compared with 31.0% of pre-tax income in the second quarter of 2006.

In the first half of 2007, income tax expense was \$0.7 million, down 37.6% from \$1.1 million in the corresponding quarter of 2006. Income tax expense represented 23.3% of pre-tax income in the first half of 2007, compared with 32.2% of pre-tax income in the first half of 2006.

The Canadian statutory tax rate of approximately 32% and the statutory U.S. tax rate of approximately 40% generated a weighted average tax rate of approximately 36.7% for the quarter and 39% for the year to date. The tax structure implemented with the Xerxes acquisition created a tax savings for the quarter of \$335,000 or 12% and \$477,000 or 16.6% for the year to date.

Net income from continuing and discontinued operations and earnings per share

Net income for the second quarter of 2007 was \$2.1 million, up 122.2% from \$1.0 million for the corresponding quarter of 2006, and is primarily a result of the Xerxes acquisition. Net income per share (basic) was \$0.08 for the second quarter of 2007, up 60% from \$0.05 in the corresponding quarter of 2006. Net income per share (diluted) was \$0.08 for the second quarter of 2006, up 100% from \$0.04 in the corresponding quarter of 2006.

For the first half of 2007, net income from continuing operations was \$2.2 million, down 2.2% from \$2.3 million in the first half of 2006, primarily due to the results of the Xerxes acquisition largely offsetting weaker Canadian results compared to the first half of 2006. After including net income from discontinued operations net income in the first half of 2006 totalled \$2.6 million. There was no income from discontinued operations in the first half of 2007. The net income from discontinued operations of \$0.3 million for the first half of 2006 related to the reversal of estimated disposal costs of certain discontinued operations.

Net income per share (basic) from continuing operations was \$0.09 for the first half of 2007, down 18.2% from \$0.11 for the first half of 2006. After including discontinued operations, net income per share (basic) in the first half of 2006 was \$0.12.

Net income per share (diluted) from continuing operations was \$0.09 for the first half of 2007, down 18.2% from \$0.11 in the first half of 2006. After including discontinued operations, net income per share (diluted) in the first half of 2006 was \$0.12.

For the first half of 2007, the after tax impact of the incremental non cash adjustment for acquired inventory is \$0.8 million. Without this additional charge, the basic and fully diluted earnings per share would have been \$0.11.

SUMMARY OF QUARTERLY RESULTS

The following 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.

| Quarterly Unaudited Results <i>(in thousands of dollars, except per share amounts)</i> | Jun 30/07 \$ | Mar 31/07 \$ | Dec 31/06 \$ | Sep 30/06 \$ |
|--|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| Revenue | 28,532 | 14,945 | 14,873 | 13,974 |
| Net income from continuing operations | 2,126 | 77 | 1,488 | 1,611 |
| Basic earnings per share | \$0.08 | \$0.00 | \$0.07 | \$0.08 |
| Diluted earnings per share | \$0.08 | \$0.00 | \$0.07 | \$0.07 |
| Net income from discontinued operations | - | - | - | - |
| | | | | |
| | Jun 30/06 \$ | Mar 31/06 \$ | Dec 31/05 \$ | Sep 30/05 \$ |
| Revenue | 12,552 | 13,661 | 13,044 | 11,173 |
| Net income from continuing operations | 957 | 1,295 | 1,065 | 820 |
| Basic earnings per share | \$0.05 | \$0.07 | \$0.06 | \$0.05 |
| Diluted earnings per share | \$0.04 | \$0.06 | \$0.05 | \$0.04 |
| Net income from discontinued operations | - | 319 | - | - |

The Company has historically been affected by seasonality and experiences its lowest levels of activity in the first two quarters of the fiscal year. The U.S. operations acquired on February 22, 2007 are similarly impacted by the seasonality of installations in the northern United States.

LIQUIDITY AND CAPITAL RESOURCES

Working capital (current assets less current liabilities) at June 30, 2007 was \$20.3 million compared with \$18.4 million at December 31, 2006. Current assets increased by \$14.4 million while current liabilities increased by \$12.6 million. These changes largely reflect the additional assets and liabilities from the Xerxes acquisition, the \$2.6 million dividend paid April 4, 2007 and \$2.0 million representing the current portion of long term debt.

Future financing requirements for Xerxes will be funded through the consolidated financing arrangements of the Company. The Company does not currently expect Xerxes' future working capital needs to require any increase in the Company's consolidated financing arrangements.

Cash Flows

| | Three months ended | |
|---|---------------------------|-----------------|
| Summary of Cash Flows (in thousands of dollars) | Jun 30/07 \$ | Jun 30/06 \$ |
| Operating activities | 4,439 | 2,148 |
| Financing activities | (718) | 653 |
| Investing activities | (801) | (387) |
| Foreign exchange loss on cash held in foreign currency | (223) | -- |
| Increase in cash | 2,697 | 2,414 |
| Cash, beginning of the period | 1,227 | -- |
| Cash, end of the period | 3,924 | 2,414 |

| | Six months ended | |
|---|-------------------------|-----------------|
| Summary of Cash Flows (in thousands of dollars) | Jun 30/07 \$ | Jun 30/06 \$ |
| Operating activities | (131) | 2,972 |
| Financing activities | 50,676 | (36) |
| Investing activities | (54,186) | (522) |
| Foreign exchange loss on cash held in foreign currency | (237) | -- |
| Increase (decrease) in cash | (3,878) | 2,414 |
| Cash, beginning of the period | 7,802 | -- |
| Cash, end of the period | 3,924 | 2,414 |

Cash generated from operating activities before changes in working capital for the quarter ended June 30, 2007 was \$2.8 million (\$3.6 million in the first half of 2007) compared with \$1.4 million for the same quarter last year (\$3.4 million in the first half of 2006). The increase of \$1.4 million was primarily due to higher net income earned during this quarter due to the acquisition of Xerxes. The slight increase of \$0.2 million year to date is primarily due to Xerxes results replacing the decreased results of the Canadian operations in the first half of 2007 compared with the corresponding period in 2006.

Cash used in financing activities for the quarter ended June 30, 2007 was \$0.7 million as a result of dividends paid of \$2.6 million and a long term debt payment of \$0.5 million offset by an increase in bank indebtedness of \$2.3 million and proceeds on stock options and warrants of \$0.1 million. In the first half of 2007, cash generated from financing activities was \$50.7 million as a result of the equity financing of \$37.4 million undertaken in connection with the acquisition of Xerxes, \$0.4 million raised on the exercise of stock options and warrants, \$10 million of net debt financing raised to fund the acquisition of Xerxes less a long term debt payment of \$0.5 million, and a \$6.0 million increase in bank indebtedness, less dividends paid of \$2.6 million. The Company has total operating lines of credit of up to \$15.25 million, provided by a chartered bank, available to it subject to meeting contractually prescribed margin requirements. As at June 30, 2007, the Company had \$9.3 million available on the operating lines of credit and was in compliance with all required bank covenants.

The acquisition of Xerxes and the related costs associated with the purchase amounted to \$46.3 million. Including the Xerxes bank indebtedness repaid on the date of acquisition, the total cash used for the acquisition amounted to \$52.6 million. Property, plant and equipment additions in this quarter were \$0.8 million (\$1.5 million in the first half of 2007) compared with \$0.4 million for the same quarter last year (\$0.5 million in the first half of 2006). These additions related largely to the purchase of equipment to increase production capacity and efficiency.

Contractual Obligations

The Company's contractual obligations remain as described in Note 8 to the audited December 31, 2006 consolidated financial statements, except as noted below. To establish the captive insurance company, Radigan Insurance Company, the Company has supplied a U.S. \$500,000 Letter of Credit in favor of the Commissioner of Insurance for the State of Montana. As at June 30, 2007, Xerxes' minimum lease commitments under all non-cancelable operating leases for production facilities, office space and equipment were \$9,100,000.

The Company has committed to the purchase of certain land and assets totalling \$3.0 million to be concluded during the third quarter of 2007.

TRANSACTIONS WITH RELATED PARTIES

Trucking services of \$127,000 (2006 - \$133,000) for the three month period and \$166,000 (2006-\$261,000) for the six month period ended June 30, 2007, included in manufacturing and selling costs in the consolidated statements of income, were provided by a corporation controlled by a director of the Company. Accounts payable and accrued liabilities at June 30, 2007 included \$42,000 (December 31, 2006 - \$26,000) owing to the corporation. Normal commercial rates were paid for these services. There are no ongoing contractual or other commitments resulting from these transactions.

CRITICAL ACCOUNTING ESTIMATES

With the acquisition of Xerxes, certain estimates were required in determining the fair values of the acquired assets and liabilities and the remaining useful lives of definite life intangible assets. Management used an external valuator to assist in developing the key assumptions and resulting fair value estimates. The fair value of acquired assets and liabilities was finalized during the second quarter. The most significant adjustment related to an increase in the carrying value of inventory acquired with a corresponding reduction to goodwill.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

Financial instruments, equity and comprehensive income

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants (CICA) Section 3855, Financial Instruments – Recognition and Measurement; Section 3861, Financial Instruments – Disclosure and Presentation; Section 3865, Hedges; Section 1530, Comprehensive Income; and Section 3251, Equity, prospectively without restatement of prior periods.

Section 1530 provides guidance on the reporting and presentation of comprehensive income. Comprehensive income is the change in equity of an enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Other comprehensive income comprises revenues, expenses, gains and losses that are recognized in comprehensive income, but are excluded from net income calculated in accordance with GAAP. Subsequent to the adoption of this new standard, the Company recorded unrealized losses on the translation of self-sustaining foreign operations acquired during the quarter of \$4.6 million (\$5.2 million in the first half of 2007) in other comprehensive income.

Under Section 3855, financial assets and liabilities are classified as either held for trading, available-for-sale, loans and receivables, investments held to maturity, and other financial liabilities. Financial assets classified as held for trading and available-for-sale are measured on the balance sheet at fair value. Subsequent change in the fair value of held for trading financial assets is recognized into net income immediately. Changes in the fair value of financial assets available-for-sale are recorded in comprehensive income until the investment is derecognized or impaired at which time amounts would be recorded to net income. Loans and receivables, investments held to maturity and other financial liabilities are measured on the balance sheet at amortized cost. All derivative instruments of the Company, including those embedded in other financial instruments, are recorded at fair value and classified as held for trading.

On adopting Section 3855 and 3861, the Company classified its financial assets and liabilities of cash, accounts receivable, other assets, and accounts payable and accrued liabilities as held for trading financial instruments. During the quarter, the Company also designated bank indebtedness as financial liabilities held for trading and long term debt as other financial liabilities. The Company has not recorded any financial instruments as available-for-sale, loans or receivables, or held to maturity investments during the quarter.

Prior to the adoption of the new standards, derivatives embedded in other financial instruments were not accounted for separately from the host instrument. On adopting the new standards, the Company performed a review of all of its contracts to identify any embedded derivatives. Embedded derivatives were identified in certain of the Company's insurance contracts which are recorded in other assets and categorized as held for trading.

Section 3865 replaces and expands prior guidance on hedging relationships by prescribing when and how hedge accounting may be applied. Application of hedge accounting is optional. The Company has not entered into any hedge arrangements during the second quarter. During the first quarter, the Company entered into foreign currency forward contracts, the price of which was denominated in U.S. dollars. These derivative contracts, not accounted for as hedges, are marked to market, and any changes in the market value are recorded in income or expense when the changes occur. As of June 30, 2007, there were no outstanding contracts as they were all closed out within the first quarter.

Section 3251 requires separate presentation of changes in equity for the period from net income, other comprehensive income, retained earnings, contributed surplus, share capital and reserves and separate presentation of the components of equity, including retained earnings, accumulated other comprehensive income, contributed surplus, share capital and reserves. The adoption of the new standard did not have a material impact on the presentation of equity of the Company.

Accounting changes

Effective January 1, 2007, the Company adopted CICA Section 1506, Accounting Changes. The new standard allows for voluntary changes in an accounting policy only when the changes result in the financial statements providing reliable and more relevant information, requires a change in accounting policy to be applied retroactively unless impracticable, requires prior period errors to be corrected retrospectively and calls for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. It includes the disclosure, on an interim and annual basis, of a description and the impact on the Company's financial results of any new primary source of GAAP that has been issued but is not yet effective. The adoption of the new standard did not have an impact on the Company's financial position or on the results of its operations.

Recent Accounting Pronouncements

In October 2006, the CICA issued Section 1535, Capital Disclosures. The new standard requires disclosure of qualitative and quantitative information that enables users of financial statements to evaluate the Company's objectives, policies and processes for managing capital. These recommendations are effective for the Company's interim and annual reporting periods beginning January 1, 2008. This new standard is not expected to have a material effect on the Company's consolidated financial position or on its results of operations.

The CICA also issued Section 3862, Financial Instruments – Disclosure and 3863, Financial Instruments – Presentation in October 2006. These Sections will effectively replace existing Section 3861, Financial Instruments – Disclosure and Presentation effective for the Company's interim and annual reporting periods beginning January 1, 2008. Section 3862 requires disclosures by class of financial instruments that enable users to evaluate the significance of financial instruments for the Company's financing position and performance. Disclosures are also required of qualitative and quantitative information that enables users of financial statements to evaluate the nature and extent of the Company's exposure to the risks arising from financial instruments, specifically credit risks, liquidity risks and market risks. Quantitative disclosures must also include a sensitivity analysis for each type of market risk the Company is exposed to and how net income and other comprehensive income would be affected. The Company does not expect the new standard will have a material impact on its consolidated financial position or on its results of operations. Section 3863 carries forward the presentation requirements of 3861 already adopted by the Company. As a result, the Company does not expect the new standard will have a material impact on its consolidated financial position or on its results of operations.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of the Company have designed the Company's disclosure controls and procedures ("DCP") or caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company, including its consolidated subsidiaries, is made known to them by others within the Company.

Internal Control over Financial Reporting

The CEO and the CFO have designed the Company's internal control over financial reporting ("ICFR") or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Acquisition of Xerxes

In respect of the acquired Xerxes operations, the Company's evaluation of the design of its DCP and ICFR included a review of Xerxes' records and accounts as at the date of acquisition by an outside firm of chartered accountants, discussion of Xerxes' results with senior management of Xerxes and obtaining letters of representation from key Xerxes personnel attesting that all material information relating to Xerxes was made known to the Company.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's ICFR within the second quarter of 2007 that have materially affected, or are reasonably likely to materially affect, the Company's ICFR.

OTHER

Outstanding Share Data

As at August 2, 2007, there were 26,112,379 common shares, 276,668 share options ("Options") and 273,150 warrants ("Warrants") outstanding. All of the Warrants and all but 66,667 of the Options are currently exercisable into common shares.