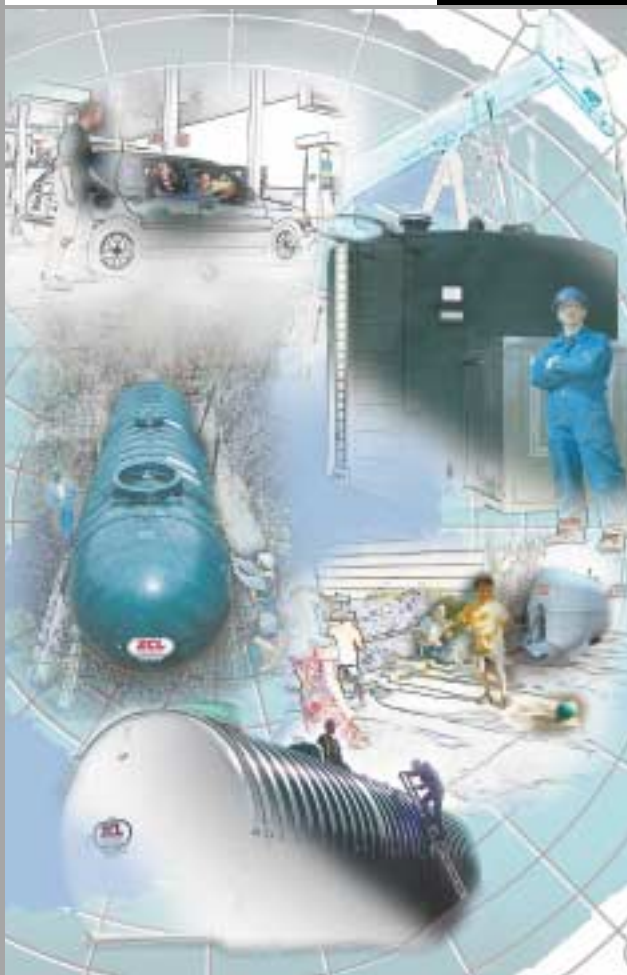


ZCL COMPOSITES INC.
FIRST QUARTER REPORT

2005



Setting a Higher Standard

Message to Shareholders

While the outlook for the downstream and upstream sectors of the petroleum industry, as well as other traditional markets, remains strong for this fiscal year, activity in the first quarter started slow after a record fourth quarter last year. Activity and our order backlog picked up during the quarter, and the second quarter is off to a strong start.

Revenue in the first quarter decreased by 14.9% to \$6.3 million, from a record first quarter last year of \$7.4 million. As a result, net income for the quarter decreased to \$72,000 from \$236,000 in 2003, and basic and diluted earnings per share decreased to \$0.00 from \$0.01 in the first quarter last year.

Meeting and servicing the needs of our customers is the cornerstone of our success. During the quarter, we announced two major customer contracts and the receipt of a prestigious vendor excellence award. Contracts and recognition such as these are an expression of confidence in ZCL, and our commitment and ability to consistently supply the high quality products and services that our customers value.

We have targeted the aboveground storage tank (AGST) and tank lining markets for growth. The business assets of Durex Steel & Alloy Industries Ltd. were acquired in the quarter and the steel tank production has been integrated into our overall liquid storage operations. We can now offer a full line of products to our existing alliance customers as well as to new customers. This acquisition also allows us to access the retail AGST market which has eluded us until now. Other products introduced in recent years – home heating oil tanks, Protector® and Pinnacle™ oilfield tanks, filament wound pressure vessels, as well as custom storage and lining systems – continue to gain market acceptance and further add to revenue.

The development of our tank lining technologies is on schedule and we expect field trials will commence in the latter part of this fiscal year. Tank lining is a very large and lucrative international market and, at this time, there are no competitive alternative products in the marketplace. Customers are the same, and the type and level of service is the same as for our other products. The lining products

adapt proven technology from our double wall tank manufacturing processes and leverage our core competencies.

During the quarter, we were very pleased to announce the payment of our first annual dividend of \$0.06 per common share. This is only a small reward for your trust and patience. In establishing this annual dividend, your Board of Directors carefully considered our results, cash flow and financial position, and the anticipated cash required to continue our strategic growth plan. The long-term contract renewals provide a strong foundation and reflect our ability to maintain innovation and performance. The dividend will be reviewed annually, based on our year-end results.

I am also very pleased to see the improvement in our share price. This increase reflects our performance over the past few quarters. Continued improvement will come from sustained strong financial results, together with an enhanced investor communication program.

We have targeted annual growth in revenue of 15% to 20%, along with a corresponding increase in income. We surpassed this goal last year. Notwithstanding the slow start in the first quarter, we are off to a good start in the second quarter and I am confident that we can reach this target again this year. With the support of our dedicated customers, employees, and shareholders, we will continue to deliver quality products to our customers and create value for our shareholders.



Venence G. Côté
President and Chief Executive Officer

August 4, 2004

Management's Discussion and Analysis

August 4, 2004

The following discussion and analysis of the results of operations and cash flows for the three months ended June 30, 2004, and the financial position as at June 30, 2004, should be read in conjunction with the Company's unaudited consolidated financial statements and related notes for the quarter ended June 30, 2004, the Management's Discussion and Analysis and audited consolidated financial statements and related notes for the year ended March 31, 2004, as well as the Message to Shareholders included in this First Quarter Report.

This discussion includes forward-looking statements that are based on current expectations and are subject to risks and uncertainties. Many internal and external factors may cause actual results to differ materially, including, but not limited to, those outlined in Risks and Uncertainties in the Management's Discussion and Analysis for the year ended March 31, 2004. The Company disclaims any intention or obligation to update or revise any such forward-looking statements, whether as a result of new information, future events, or otherwise.

OVERALL PERFORMANCE

The Company used the same accounting policies and methods for the quarter ended June 30, 2004 as used in the audited annual consolidated financial statements for the year ended March 31, 2004. The consolidated statements of income and retained earnings (deficit) and cash flows for interim periods are not necessarily indicative of results on an annual basis due to seasonal and short-term variations. The Company operates in one reportable segment, which is the manufacture and distribution of liquid storage systems including fiberglass underground and aboveground storage tanks and related products and accessories. Historically, the first and fourth quarters have the lowest levels of activity, corresponding to the seasonality of the installation of underground liquid storage systems in Canada.

Revenue in the first quarter decreased by 14.9% to \$6.3 million, from \$7.4 million last year. Net income for the quarter decreased to \$72,000, from \$236,000 in 2003. Basic and diluted earnings per share decreased to \$0.00, from \$0.01 in the first quarter last year.

While the outlook for the downstream and upstream sectors of the petroleum industry, as well as other traditional markets, remains strong for this fiscal year, activity in the first quarter this year started slow after a record fourth quarter last year. However, activity and the order backlog picked up during the quarter, and the second quarter is off to a strong start. Based on orders and deliveries scheduled for the second quarter, inventories have been increased.

The decrease in net income and earnings per share in the first quarter as compared to last year was due to the lower revenue. Cash flows from operating activities decreased by \$1.1 million, to \$528,000 of cash used in operating activities, from \$545,000 of cash flows from operating activities. This decrease was a result of the reduced level of operations, the build-up of inventories, and the timing of cash receipts and payments, in the first quarter this year. The Company completed the purchase of the business assets of Durex Steel & Alloy Industries Ltd. during the quarter for cash of \$1.2 million, including related acquisition costs.

During the quarter, the first annual dividend of \$0.06 per common share was declared by the Company. Dividends payable of \$1,051,000 were included in current liabilities at June 30, 2004 and subsequently paid on August 4, 2004.

The effect of dilutive share options and warrants in the first quarter was 233,675 (2003 – nil). During the quarter, the first performance threshold with respect to the warrants, of \$1.90 per common share, was reached and one-third of the warrants vested. In 2003, stock options were not included in the calculation of diluted shares as their exercise prices exceeded the average market share price for the quarter, and the warrants were not included as the market share price was below the performance thresholds.

The focus continues to be on the development and marketing of the tank lining technologies, as well as other new products. The Company is working with customers and suppliers to develop new lining materials and processes in order to deliver a product with superior quality and performance, along with inherently safe

installation techniques. Field testing is scheduled to commence in the latter part of this fiscal year. During the first quarter, product development costs of \$135,000 (2003 – nil) were deferred.

RESULTS OF OPERATIONS

Three Months Ended June 30, 2004 Compared to the Three Months Ended June 30, 2003

Revenue

Revenue in the first quarter decreased by 14.9% to \$6.3 million, from \$7.4 million last year. The decrease was due to a lower level of activity in the downstream and upstream sectors of the petroleum industry in the first two months of the quarter. Activity picked up in the latter part of the quarter, and the second quarter is off to a good start. The steel tank manufacturing business, acquired from Durex Steel & Alloy Industries Ltd. during the quarter, has been integrated into the overall liquid storage operations and will further contribute to revenue this year. Products introduced in recent years – domestic heating oil tanks, Protektor® and Pinnacle™ oilfield tanks, filament wound pressure vessels, as well as custom storage and lining systems – continue to gain market acceptance and add to revenue.

Revenue less manufacturing and selling costs

Revenue less manufacturing and selling costs decreased to \$1.0 million (16.4% of revenue) from \$1.4 million (19.4% of revenue) in the first quarter last year. This decrease is due to the lower revenue. Overall manufacturing margins have been maintained at similar levels as last year, with production improvements and cost reductions offsetting the impact of increased raw material input costs.

Amortization

Amortization decreased to \$468,000 for the quarter from \$504,000 last year. The overall level of amortization has decreased, and will further decrease by the end of fiscal 2005, as certain of the deferred costs and intangible assets relating to past acquisitions and start-up operations are fully amortized.

Additional lining development costs were deferred during the quarter, and will continue in fiscal 2005. These additional costs are not anticipated to exceed \$500,000

and will be amortized upon the commercial production of the lining products.

General and administration

General and administration expenses of \$429,000 for the first quarter were approximately the same as last year. These costs have generally been maintained at the same level as last year, but will increase as the Company grows and processes are put in place relating to the requirements of current corporate governance developments.

Financing charges

Financing charges for the quarter were \$3,000, down from \$114,000 last year. The decrease is due to the repayment of long-term bank debt and write-off of related deferred finance costs in the third quarter last year. Foreign exchange gains or losses, included in financing charges, were not significant.

Income taxes

The Company's effective tax rate was 47.4% in first quarter, as compared to 38.9% last year. The Company's statutory income tax rate is approximately the same as last year; the increase in the effective rate was due to non-deductible expenses that are not significant but had a relatively large effect because of the low level of pre-tax income in the first quarter this year.

LIQUIDITY AND CAPITAL RESOURCES

Working capital (current assets less current liabilities) decreased to \$8.3 million at June 30, 2004 from \$10.1 million at March 31, 2004, as current assets decreased by \$572,000 and current liabilities increased by \$1.3 million. At June 30, 2004, accounts receivable decreased by \$732,000 from March 31, 2004 to \$5.6 million, inventories increased by \$2.0 million to \$7.5 million, accounts payable and accrued liabilities increased by \$99,000 to \$4.6 million, and dividends payable were \$1.1 million. The decrease in accounts receivable reflects the reduced revenue in the first quarter. No one customer generally makes up more than 10% of revenue, but at a particular point in time, depending on the timing of sales, there may be higher proportionate exposure in accounts receivable. At June 30, 2004, the largest customer accounted for approximately 8% (March 31, 2004 – two

customers, 26%) of accounts receivable. Inventories have been increased during the first quarter to meet the higher level of activity in the second quarter.

As a result of the use of cash of \$2.0 million during the first quarter, cash decreased from \$1.9 million at March 31, 2004 to bank indebtedness of \$115,000 at June 30, 2004. Cash of \$528,000 was used in operating activities during the first quarter this year, compared to cash flows from operating activities of \$545,000 last year. This decrease was a result of the reduced level of operations, the build-up of inventories, and the timing of cash receipts and payments. There were no financing activities during the first quarter this year, as all long-term debt was repaid in the third quarter last year. In the first quarter this year, the Company completed the purchase of the business assets of Durex Steel & Alloy Industries Ltd. for cash of \$1.2 million, including related acquisition costs. Development costs of \$135,000 (2003 – nil), related to the development of lining materials and processes, were deferred in the first quarter this year.

TRANSACTIONS WITH RELATED PARTIES

The related party transactions are described in note 7 to the unaudited consolidated financial statements for the period ended June 30, 2004. There are no ongoing contractual or other commitments resulting from these transactions.

OUTLOOK

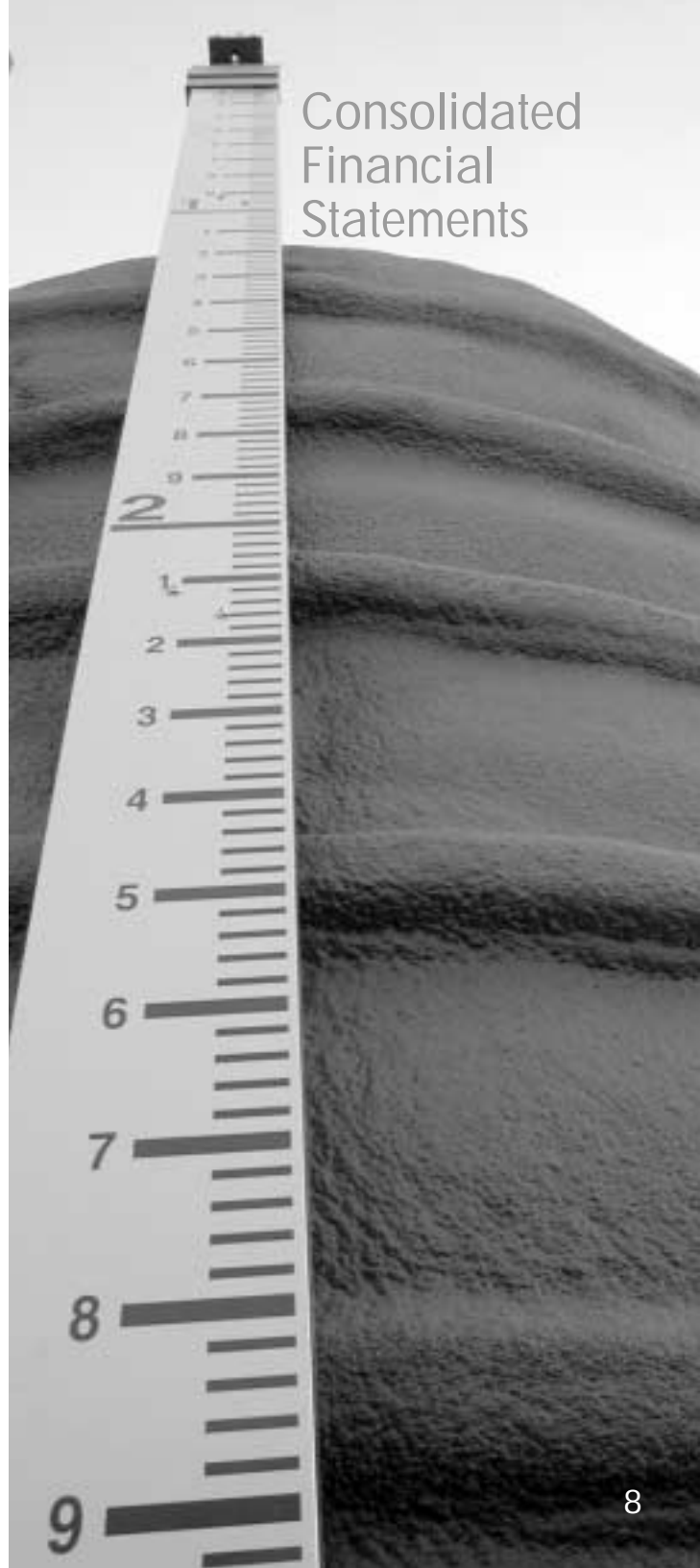
The Company's outlook remains as described in the Management's Discussion and Analysis included in the March 31, 2004 Annual Report.

OTHER

Outstanding Share Data

As at August 4, 2004, there were 17,511,320 common shares, 1,405,000 share options and 3,684,211 warrants outstanding.

Consolidated Financial Statements



Consolidated Balance Sheets

(Unaudited)

(in thousands of dollars)	June 30 2004 \$	March 31 2004 \$
Assets		
Current		
Cash	—	1,880
Accounts receivable	5,631	6,363
Inventories	7,541	5,556
Prepaid expenses	303	188
Future tax assets	639	699
	14,114	14,686
Property, plant and equipment	8,563	7,814
Deferred costs (note 3)	680	717
Intangible assets	1,416	1,324
Goodwill	1,991	1,926
	26,764	26,467
Liabilities and Shareholders' Equity		
Current		
Bank indebtedness	115	—
Accounts payable and accrued liabilities	4,624	4,525
Dividends payable (note 4)	1,051	—
Income taxes payable	33	35
Future tax liabilities	27	27
	5,850	4,587
Government grants	158	160
Future tax liabilities	838	838
	6,846	5,585
Shareholders' equity		
Share capital	18,853	18,853
Contributed surplus (note 5)	92	77
Retained earnings	973	1,952
	19,918	20,882
	26,764	26,467

See accompanying notes

Consolidated Statements of Income and Retained Earnings (Deficit)

(Unaudited)

Three months ended June 30	2004	2003
(in thousands of dollars, except per share amounts)	\$	\$
Revenue	6,308	7,409
Manufacturing and selling costs	5,271	5,970
	1,037	1,439
Amortization (note 3)	468	504
General and administration	429	435
Financing charges	3	114
Income before income taxes	137	386
Income taxes		
Current	5	5
Future	60	145
	65	150
Net income for the period	72	236
Retained earnings (deficit), beginning of the period	1,952	(9,043)
Dividends (note 4)	(1,051)	—
Retained earnings (deficit), end of the period	973	(8,807)
Basic and diluted earnings per share (note 6)	\$0.00	\$0.01

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

Three months ended June 30 (in thousands of dollars)	2004 \$	2003 \$
Cash Flows from Operating Activities		
Cash receipts from customers	6,993	7,774
Cash paid to suppliers and employees	(7,511)	(7,195)
Interest paid	(3)	(27)
Income taxes paid	(7)	(7)
	(528)	545
Cash Flows from Financing Activities		
Repayment of long-term debt	—	(179)
	—	(179)
Cash Flows from Investing Activities		
Business acquisition (note 2)	(1,193)	—
Purchase of property, plant and equipment	(139)	(142)
Deferred development costs (note 3)	(135)	—
	(1,467)	(142)
Increase (decrease) in cash	(1,995)	224
Cash, beginning of the period	1,880	1,333
Cash (bank indebtedness), end of the period	(115)	1,557

See accompanying notes

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2004 and 2003

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 on a basis consistent with those used in the preparation of the most recent annual consolidated financial statements. 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 March 31, 2004. In management's opinion, the interim consolidated financial statements include all adjustments necessary to present fairly such interim financial information.

The consolidated statements of income and retained earnings (deficit) and cash flows for interim periods are not necessarily indicative of results on an annual basis due to seasonal and short-term variations. Historically, the first and fourth quarters of the Company's fiscal year have the lowest levels of activity, corresponding to the seasonality of the installation of underground liquid storage systems in Canada.

2. Business Acquisition

In May 2004, the Company acquired the business assets of Durex Steel & Alloy Industries Ltd. ("Durex") located in Edmonton, Alberta. Durex manufactures steel aboveground storage tanks.

The acquisition was accounted for using the purchase method and the consolidated financial statements include the results of operations from May 7, 2004. Cash consideration for the purchase was \$1,193,000, including acquisition costs. The fair value of assets acquired was as follows:

(in thousands of dollars)	\$
Inventories	128
Property, plant and equipment	800
Non-contractual customer relationships	50
Product certification and safety marks	150
Goodwill	65
Total assets acquired	1,193

Amortization of non-contractual customer relationships is computed using the straight-line method over three years. Product certification and safety marks are indefinite life assets and are not subject to amortization. Of the amount of goodwill, 75% will be deductible for income tax purposes.

3. Deferred Development Costs and Amortization

The unamortized balance of deferred development costs at June 30, 2004 was \$680,000 (March 31, 2004 – \$717,000) which includes \$135,000 (2003 – nil) of development costs incurred during the period. These costs incurred relate to development projects in process at June 30, 2004 and were not amortized during the period. The total amount of research and development charged to expense for the period is not separately identifiable, as such costs are only tracked for development projects that are deferred.

Amortization expense consists of amortization of the following:

Three months ended June 30 (in thousands of dollars)	2004 \$	2003 \$
Property, plant and equipment	190	188
Deferred development costs	172	177
Deferred startup costs	—	35
Intangible assets	108	106
Government grants	(2)	(2)
	468	504

4. Dividends

On June 17, 2004, an annual dividend of \$0.06 per common share, for a total of \$1,051,000, was declared for all shareholders of record on July 14, 2004 and was paid on August 4, 2004.

5. Stock-Based Compensation

The Black-Scholes model, used by the Company to calculate the values of options and warrants, as well as other currently accepted option valuation models, were developed to estimate the fair value of freely-tradeable, fully-transferable options and warrants without vesting restrictions. Such options and warrants differ significantly from the share options and warrants granted by the Company. These models require subjective assumptions, including future share price volatility and expected time until exercise, which affect the calculated values. Accordingly, management believes that these models do not necessarily provide a reliable single measure of the fair values of the share options and warrants granted by the Company.

Share options and warrants granted on or after April 1, 2003

The Company uses the fair value method of accounting for all share options and warrants granted to employees on or after April 1, 2003. During the period, the Company granted 260,000 share options (2003 – nil), all of which were granted with exercise prices at the market share price on the grant date, and transferred to employees 230,000 warrants (2003 – nil), all of which were transferred with exercise prices below the market share price on the transfer date. During the period, \$11,000 (2003 – nil) was recorded as contributed surplus and an expense in manufacturing and selling costs in the statement of income.

The following estimated fair values of these share options and warrants were determined, at the date of the grants, using the Black-Scholes option pricing model with the following weighted-average assumptions:

	Share Options		Warrants	
	Granted at Market	Granted in Excess of Market	Granted in Excess of Market	Granted Below Market
Weighted-average fair value	\$0.65	\$0.29	\$0.18	\$0.74
Risk-free interest rate (%)	3.77	3.89	4.37	3.77
Expected hold period to exercise (years)	4.0	4.0	4.5	3.3
Volatility in the price of the Company's shares (%)	55.5	60.8	60.5	51.4
Dividend yield (%)	0.00	0.00	0.00	0.00

In addition, in accordance with the fair value method of accounting for stock-based compensation for non-employees, during the period, \$4,000 (2003 – nil) was recorded as contributed surplus and a general and administration expense in the statement of income.

Share options and warrants granted in 2003

The fair value of share options and warrants granted in fiscal 2003, all of which were granted with exercise prices in excess of the market share price on the grant date, were determined, at the date of grants, using the Black-Scholes option pricing model. The following table provides the required pro-forma measures of net income and earnings per share had compensation expense been recognized based on the fair value, as at the date of the grant, of the options and warrants granted to employees in 2003, in accordance with the fair value method of accounting for stock-based compensation:

Three months ended June 30 (in thousands of dollars, except earnings per share)	2004 \$	2003 \$
Net income for the period	72	236
Compensation expense	54	56
Pro-forma net income for the period	18	180
Earnings per share:		
Reported basic and diluted earnings per share	0.00	0.01
Compensation expense per share	0.00	0.00
Pro-forma basic and diluted earnings per share	0.00	0.01

5. Stock-Based Compensation - continued

The following estimated fair values of these options and warrants were determined using the following weighted-average assumptions:

	Share Options	Warrants
Weighted-average fair value	\$0.37	\$0.38
Risk-free interest rate (%)	4.0	4.0
Expected hold period to exercise (years)	4.0	5.0
Volatility in the price of the Company's shares (%)	61.6	56.2
Dividend yield (%)	0.00	0.00

6. Earnings Per Share

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

Three months ended June 30	2004	2003
Weighted-average shares for basic earnings per share	17,511,320	17,716,920
Weighted-average shares for diluted earnings per share	17,744,995	17,716,920
Common shares outstanding, end of the period	17,511,320	17,716,920

7. Related Party Transactions

During the period, trucking services of \$81,000 (2003 – \$72,000) were provided by a corporation controlled by a director of the Company. Accounts payable and accrued liabilities at June 30, 2004 included \$35,000 (March 31, 2004 – \$6,000) owing to the corporation. Normal commercial rates were paid for these services.

8. Derivative Financial Instruments

At June 30, 2004, the Company had entered into foreign currency collar arrangements not accounted for as hedges. These arrangements provided for the purchase of euros, up to a total Canadian dollar equivalent of \$860,000 (March 31, 2004 – \$1.5 million), at rates of \$1.566 or \$1.6175 per euro. The fair values of these arrangements, estimated

using market rates at June 30, 2004, are nil (March 31, 2004 – nil). During the period, net realized and unrealized losses of less than \$1,000 (2003 – nil) relating to derivative financial instruments were recorded in financing charges.

9. Comparative Figures

The comparative unaudited consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the current period's consolidated financial statements. In the current period, freight amounts billed to customers are recorded as revenue, rather than netted against freight costs which are recorded as part of manufacturing and selling costs. Accordingly, freight billed to customers of \$252,000 (2003 – \$198,000) was included in revenue.

Corporate Information

Board of Directors

James S. Edwards, Chairman of the Board

Venence G. Côté, Director, President and CEO

Fred J. Dymont, Director

Roderick W. Graham, Director

Simon Sochatsky, Director

Transfer Agent & Registrar

Olympia Trust Company

Calgary, Alberta

Auditors

Ernst & Young LLP

Edmonton, Alberta

General Counsel

Parlee McLaws LLP

Edmonton, Alberta

Stock Listing and Share Symbol

Toronto Stock Exchange: ZCL



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