

Environment **Focus** Innovation

ZCL Composites Inc
First Quarter Report 2006



ZCL
COMPOSITES INC.

Message to Shareholders

We are pleased to report record revenue for the first quarter – an increase of 31.4% to \$8.3 million from \$6.3 million last year. Net income for the quarter increased to \$244,000 from \$72,000 last year. Basic and diluted earnings per share for the first quarter were \$0.01 as compared to \$0.00 last year.

The increase in revenue was primarily due to the acquisition of Triple M Fiberglass Mfg. Ltd. ("Triple M") in April 2005, along with the steel tank manufacturing business purchased in May 2004. Triple M is a manufacturer of fiberglass aboveground and underground tanks, vessels, pipe and other custom environmental products. These specialized products and Triple M's unique manufacturing expertise further enhance our product line and open new markets for us.

The continued strong level of activity in the downstream and upstream sectors of the petroleum industry, as well as our other traditional markets, also contributed to the increased revenue. The outlook for these market sectors remains very positive for this fiscal year.

After signing or renewing long-term supply agreements with several major customers last year, we announced two more during this quarter. These customers have confirmed their confidence in our products and truly are the foundation of our success.

We continue to focus on the marketing of home heating oil tanks and the final testing and marketing of our tank lining technologies. We commenced marketing and selling home heating oil tanks in the New England states late last year, after the approval of these tanks for the USA market by Underwriters' Laboratories ("UL"). Heating or furnace oil is used for heating in about 8 million households in North America, largely Eastern Canada and North-Eastern USA, and our objective is to significantly grow our market share over the next five years.

Our tank lining program is proceeding as planned and final field testing is scheduled to be completed in the first half of this fiscal year. The announced publication by Underwriters' Laboratories of Canada ("ULC") of ORD C58.4, which establishes the technical requirements for tank lining in Canada, is a key milestone in the introduction of our system to the North American marketplace. With the anticipated listing by ULC and UL, we expect that tank lining will add to our revenue in the latter part of this year. We will systematically introduce tank lining to the marketplace and the program will be ramped up as we gain field experience and train qualified applicators in all aspects of this new system.

During the quarter, we were also very pleased to announce our second annual dividend of \$0.08 per common share. This dividend is an increase of \$0.02 or 33% over last year's dividend. In setting this dividend, your Board of Directors carefully considered our strong results, cash flow and financial position, and the anticipated cash required to continue our strategic growth plan. The dividend will be reviewed annually, based on our year-end results.

We remain committed to our strategy of profitable growth and our target of annual revenue growth of 15% to 20% coupled with a corresponding increase in income. We have achieved this goal in the first quarter, and with the strong start to our second quarter, we are confident that we can meet this target for this fiscal year. With the ongoing support of our dedicated customers, employees and shareholders, we will continue to deliver quality products and build value for our shareholders.

A handwritten signature in black ink, appearing to read "Venence G. Côté". The signature is fluid and cursive, with the first name being the most prominent.

Venence G. Côté
President and Chief Executive Officer

August 4, 2005

Management's Discussion and Analysis

August 4, 2005

The following discussion and analysis of the results of operations and cash flows for the period ended June 30, 2005, and the financial position as at June 30, 2005, should be read in conjunction with the Company's unaudited consolidated financial statements and related notes for the period ended June 30, 2005, the Management's Discussion and Analysis and audited consolidated financial statements and related notes for the year ended March 31, 2005, 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, 2005. 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 period ended June 30, 2005 as used in the audited annual consolidated financial statements for the year ended March 31, 2005. The consolidated statements of income and retained earnings 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 lower levels of activity, corresponding to the seasonality of the installation of underground liquid storage systems in Canada.

Revenue increased by 31.4% to a record first quarter \$8.3 million from \$6.3 million last year. Net income for the quarter increased to \$244,000 from \$72,000 in 2004. Basic and diluted earnings per share were \$0.01, as compared to \$0.00 for the quarter last year.

The increase in revenue was primarily due to the acquisition of Triple M Fiberglass Mfg. Ltd. ("Triple M") in April 2005, along with the steel tank manufacturing business purchased from

Durex Steel & Alloy Industries Ltd. ("Durex") in May 2004. In addition, the continued strong level of activity in the downstream and upstream sectors of the petroleum industry, as well as other market sectors, contributed to the increased revenue. The outlook for these market sectors remains very positive for this fiscal year. As was the case last year, after a slow start due to cool and wet weather, activity and the order backlog picked up during the quarter. The second quarter is also off to a strong start. Inventories have been maintained at higher levels to meet orders and deliveries.

The increase in net income in the first quarter was largely due to the higher revenue and positive contribution from the acquisition of Triple M. Overall margins have been maintained at similar levels as last year. In addition, amortization decreased in the first quarter this year as certain deferred costs were fully amortized in the third quarter of last year. Financing charges were higher in the quarter this year due to increased utilization of the bank operating lines of credit and foreign exchange losses.

Cash flows from operating activities during the first quarter this year were \$437,000, after payment of income taxes of \$1.2 million, compared to \$528,000 of cash used in operating activities last year. This increase was largely due to the timing of sales and collection of accounts receivable, the higher level of operations and the acquisition of Triple M. The second annual dividend of \$0.08 (2004 – \$0.06) per common share was declared in the first quarter this year and dividends of \$1.4 million (2004 - \$1.1 million) were paid in the second quarter. The shares of Triple M were acquired for cash of \$2.6 million, including bank indebtedness assumed, in the first quarter this year, and the business assets of Durex were purchased for cash of \$1.2 million in the first quarter last year.

The effect of dilutive share options and warrants on the weighted-average shares outstanding was 2,259,443 (2004 – 233,675) shares for the quarter. Two-thirds of the outstanding warrants vested last year. In the first quarter this year, the remaining warrants were not included in the calculation of diluted shares as the market price was below the performance threshold. Last year, certain share options and warrants were not included in the calculation of diluted shares as the market price was below the exercise prices or the performance vesting thresholds.

Management's Discussion and Analysis continued

In December 2004, a portion of the Company's manufacturing plant in Waverley, Nova Scotia was destroyed in an electrical fire. This facility is used largely to produce home heating oil tank products. All damaged property, equipment and inventories have been repaired or replaced. It is anticipated that insurance proceeds from the Company's insurers (subject to a \$25,000 deductible under the insurance policy) will cover all damages. Accounts receivable at June 30, 2005 included \$459,000 (March 31, 2005 - \$590,000) related to the insurance claim, of which \$175,000 has been collected subsequent to the end of the quarter. Manufacturing has resumed and the plant has been fully restored.

The Company continues to focus on the marketing of home heating oil tanks and the final testing and marketing of its tank lining technologies. Marketing and sales of home heating oil tanks commenced in the New England states in the latter part of last fiscal year, following the Underwriters' Laboratories ("UL") approval of these tanks for the USA market. Heating or furnace oil is used for heating in about 8 million households in North America, largely Eastern Canada and North-Eastern USA.

Tank lining development costs of \$178,000 (2004 - \$135,000) were deferred during the quarter. While the level of development costs has exceeded the initial estimated amount, the development program is proceeding as planned and final field testing of the lining product is scheduled to be completed in the first half of fiscal 2006. With the announced publication by Underwriters' Laboratories of Canada ("ULC") of ORD C58.4 (Other Recognized Document) and the anticipated listing by ULC and UL, this new product is expected to add to revenue in the latter part of fiscal 2006. Tank lining will be systematically introduced to the marketplace and the lining program will be ramped up as field experience is gained and qualified applicators are trained in all aspects of this new system.

RESULTS OF OPERATIONS

Three Months Ended June 30, 2005 Compared to the Three Months Ended June 30, 2004

Revenue

Revenue in the first quarter increased by 31.4% to \$8.3 million from \$6.3 million last year. The increase in revenue was primarily due to the acquisitions of Triple M and Durex. In addition, the continued strong level of activity in the downstream and upstream sectors of the petroleum industry, as well as other market sectors, contributed to the increased revenue. Activity picked up in the latter part of the first quarter last year, and continued through last fiscal year and into this year. Products introduced in recent years – home 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 increased to \$1.3 million (15.8% of revenue) from \$1.0 million (16.4% of revenue) in the first quarter last year. 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 charges.

The increase in revenue less manufacturing and selling costs in the quarter was due to the increased revenue. Overall margins have been maintained at similar levels as last year. While manufacturing overhead and marketing and selling expenses have also generally been maintained at similar levels as last year, certain higher expenses were incurred to support the increased operations and increased marketing and sales activities related to home heating oil and tank lining products.

Amortization

Amortization decreased by \$105,000, to \$363,000 for the first quarter from \$468,000 last year. The overall level of amortization has decreased due to the deferred costs related to the acquisition of the assets of ZCL-USA, Inc. being fully amortized last year, partially offset by the increase in amortization with the acquisitions of Triple M and Durex.

Additional lining development costs were deferred during the first quarter. These development costs will be amortized upon the commencement of commercial production of the lining products.

General and administration

General and administration expenses were \$462,000 or 5.6% of revenue for the first quarter as compared to \$429,000 or 6.8% of revenue last year. These costs have generally been maintained at the same level as last year, but are increasing 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 first quarter were \$69,000, up from \$3,000 last year. The increase is the result of the higher utilization of the operating lines of credit (bank indebtedness), as well as foreign exchange losses related to the translation of transactions denominated in foreign currencies and the accounts of Parabeam Industries B.V.

Income taxes

The Company's overall effective tax rate was 41.1% in the first quarter as compared to 47.4% last year. The Company's statutory income tax rate is approximately the same as last year; the decrease in the effective rate was due to non-deductible expenses that are not significant but had a larger effect last year because of the lower level of pre-tax income.

The Company was in a taxable position in the latter part of last year and in the first quarter this year. The majority of tax losses of prior years have been utilized, and current future tax assets largely represent the remaining tax losses that are available and anticipated to be utilized this year. Future tax liabilities largely represent the carrying value of assets in excess of their tax bases.

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

(in thousands of dollars, except per share amounts)

	Jun 30/05	Mar 31/05	Dec 31/04	Sep 30/04
Revenue	8,287	10,372	11,056	11,020
Net income	244	1,151	1,028	1,229
Basic earnings per share	\$0.01	\$0.07	\$0.06	\$0.07
Diluted earnings per share	\$0.01	\$0.06	\$0.05	\$0.07
	Jun 30/04	Mar 31/04	Dec 31/03	Sep 30/03
Revenue	6,308	7,901	10,726	7,896
Net income	72	485	1,134	97
Basic earnings per share	\$0.00	\$0.03	\$0.06	\$0.01
Diluted earnings per share	\$0.00	\$0.03	\$0.06	\$0.01

Historically, the first and fourth fiscal quarters generally have the lower levels of activity, corresponding to the seasonality of the installation of underground liquid storage systems in Canada. This seasonality is expected to continue, but may diminish as the Company expands its product lines into new markets that have different seasonality or that are less influenced by the effect of weather in the timing of installation.

LIQUIDITY AND CAPITAL RESOURCES

Working capital (current assets less current liabilities) at June 30, 2005 was \$10.4 million, as compared to \$12.9 million at March 31, 2005. Current assets decreased by \$2.2 million and current liabilities increased by \$288,000. These changes largely reflect the cash acquisition of Triple M and the declaration of dividends (dividends payable at June 30, 2005) during the quarter.

Management's Discussion and Analysis continued

At June 30, 2005, accounts receivable decreased by \$3.5 million from March 31, 2005 to \$7.8 million, inventories increased by \$3.0 million to \$10.2 million, accounts payable and accrued liabilities decreased by \$1.3 million to \$5.1 million, dividends payable increased to \$1.4 million, and income taxes payable decreased by \$1.1 million to \$271,000. These changes reflect the elevated level of operations, acquisition of Triple M, declaration of dividends, and payment of income taxes during the quarter. Inventories have been maintained at higher levels to meet the continued robust activity anticipated in the second quarter of this fiscal year.

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, 2005, the three largest customers accounted for approximately 24% (March 31, 2005 – two customers, 22%) of accounts receivable.

Cash Flows

Cash flows from operating activities during the first quarter this year were \$437,000, after payment of income taxes of \$1.2 million, compared to \$528,000 of cash used in operating activities for the quarter last year. This increase was largely due to the timing of sales and collection of accounts receivable, the increased level of operations and the acquisition of Triple M.

As a result of the decrease in cash during the period, net advances on the revolving operating lines of credit (bank indebtedness) were \$1.2 million (2004 – \$115,000) during the first quarter. The Company has operating lines of credit of \$10.3 million provided by a chartered bank.

Summary of Cash Flows

Three months ended June 30

(in thousands of dollars)

	2005	2004
	\$	\$
Operating activities	437	(528)
Financing activities	1,244	115
Investing activities	(3,064)	(1,467)
Decrease in cash	(1,383)	(1,880)
Cash, beginning of the period	1,383	1,880
Cash, end of the period	-	-

The shares of Triple M were acquired for cash of \$2.6 million, including bank indebtedness assumed, in the first quarter this year, and the business assets of Durex were purchased for cash of \$1.2 million in the first quarter last year. Product development costs, related to lining materials and processes, of \$178,000 (2004 – \$135,000) were deferred in the quarter. Property, plant and equipment additions in the first quarter were \$289,000 (2004 – \$139,000); these additions related largely to the purchase of equipment for tank lining and to increase production capacity and efficiency, and the upgrade of computer and other office equipment.

In August 2004, the Toronto Stock Exchange (“TSX”) accepted notice of a normal course issuer bid (“NCIB”) filed by the Company. For the twelve-month period from August 19, 2004 and ending August 18, 2005, the Company may purchase on the TSX up to a maximum of 875,566 common shares, being approximately 5% of the issued and outstanding common shares. No shares have been purchased pursuant to this NCIB.

Contractual Obligations

In addition to the operating leases disclosed in the audited annual consolidated financial statements for the year ended March 31, 2005, the minimum rental under the terms of the operating lease for the premises of Triple M is \$182,000 per year for a period of five years to March 31, 2010.

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, 2005. 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, 2005 Annual Report.

OTHER

Outstanding Share Data

As at August 4, 2005, there were 17,980,885 common shares, 1,135,401 share options and 3,434,245 warrants outstanding.

Consolidated Balance Sheets

(unaudited)

(in thousands of dollars)

Assets

Current

Cash
Accounts receivable
Inventories
Prepaid expenses
Future tax assets

Property, plant and equipment
Deferred costs *[note 3]*
Intangible assets
Goodwill

Liabilities and Shareholders' Equity

Current

Bank indebtedness *[note 4]*
Accounts payable and accrued liabilities
Dividends payable *[note 5b]*
Income taxes payable
Future tax liabilities

Government grants
Future tax liabilities

Shareholders' equity

Share capital *[note 5a]*
Contributed surplus *[note 5a]*
Retained earnings

See accompanying notes

	June 30 2005 \$	March 31 2005 \$
	-	1,383
	7,751	11,294
	10,151	7,120
	315	548
	140	250
	18,357	20,595
	10,023	8,246
	880	707
	1,072	1,085
	1,991	1,991
	32,323	32,624
	1,200	-
	5,052	6,337
	1,438	-
	271	1,336
	24	24
	7,985	7,697
	149	151
	1,475	947
	9,609	8,795
	19,321	19,277
	206	171
	3,187	4,381
	22,714	23,829
	32,323	32,624

Consolidated Statements of Income and Retained Earnings

(unaudited)

Three months ended June 30

(in thousands of dollars, except per share amounts)

Revenue

Manufacturing and selling costs *[note 6a and 7]*

Amortization *[note 3]*

General and administration *[note 6a]*

Financing charges *[note 8]*

Income before income taxes

Income taxes

Current

Future

Net income for the period

Retained earnings, beginning of the period

Dividends *[note 5b]*

Retained earnings, end of the period

Basic and diluted earnings per share *[note 9]*

See accompanying notes

	2005 \$	2004 \$
	8,287	6,308
	6,979	5,271
	1,308	1,037
	363	468
	462	429
	69	3
	414	137
	100	5
	70	60
	170	65
	244	72
	4,381	1,952
	(1,438)	(1,051)
	3,187	973
	\$0.01	\$0.00

Consolidated Statements of Cash Flows

(unaudited)

Three months ended June 30

(in thousands of dollars)

Cash Flows from Operating Activities

Cash receipts from customers

Cash paid to suppliers and employees

Interest paid

Income taxes paid

Cash Flows from Financing Activities

Net advances on bank indebtedness *[note 4]*

Issue of common shares *[note 5a]*

Cash Flows from Investing Activities

Business acquisition, including bank indebtedness assumed *[note 2]*

Purchase of property, plant and equipment

Deferred development costs *[note 3]*

Decrease in cash

Cash, beginning of the period

Cash, end of the period

See accompanying notes

	2005	2004
	\$	\$
	13,060	6,993
	(11,390)	(7,511)
	(68)	(3)
	(1,165)	(7)
	437	(528)
	1,200	115
	44	-
	1,244	115
	(2,597)	(1,193)
	(289)	(139)
	(178)	(135)
	(3,064)	(1,467)
	(1,383)	(1,880)
	1,383	1,880
	-	-

Notes to Consolidated Financial Statements

June 30, 2005 and 2004 (unaudited)

1. Financial Statement Presentation and Significant Accounting Policies

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles 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, 2005. 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 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 lower levels of activity, corresponding to the seasonality of the installation of underground liquid storage systems in Canada.

2. Business Acquisitions

a) Fiscal 2006

Effective April 1, 2005, the Company acquired 100% of the shares of Triple M Fiberglass Mfg. Ltd. ("Triple M") located in Edmonton Alberta. Triple M manufactures fiberglass underground and aboveground tanks, vessels, pipe and other custom environmental products.

The acquisition was accounted for using the purchase method and the consolidated financial statements include the results of operations from April 1, 2005. Cash consideration for the purchase was \$2,000,000, including acquisition costs. The fair value of the net assets acquired and liabilities assumed was as follows:

(in thousands of dollars)	\$
Bank indebtedness assumed	(597)
Non-cash working capital	1,330
Property, plant and equipment	1,720
Non-contractual customer relationships	75
Customer order backlog	20
Product certification and safety marks	20
Future tax liabilities	(568)
Net assets acquired	2,000

Amortization of non-contractual customer relationships is computed using the straight-line method over three years. Amortization of customer order backlog is computed using the straight-line method over six months. Product certification and safety marks are indefinite life assets and are not subject to amortization.

The minimum rental under the terms of the operating lease for the premises of Triple M is \$182,000 per year for a period of five years to March 31, 2010.

b) Fiscal 2005

Effective May 7, 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% is deductible for income tax purposes.

Notes to Consolidated Financial Statements continued

3. Deferred Costs and Amortization

The unamortized balance of deferred costs at June 30, 2005 and March 31, 2005 is comprised of deferred development costs and includes \$178,000 (2004 - \$135,000) of development costs incurred during the three month period. These costs related to a development project in process at June 30, 2005 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)	2005 \$	2004 \$
Property, Plant and equipment	232	190
Deferred development costs	5	172
Intangible assets	128	108
Government grants	(2)	(2)
	363	468

4. Bank Indebtedness

The Company has operating lines of credit of \$10,250,000 provided by a chartered bank. These lines of credit are payable on demand and bear interest at prime rate plus 0.25% (4.50%; March 31, 2005 – 4.50%). The operating lines of credit contain certain restrictive covenants including the maintenance of certain financial ratios and limitations on capital expenditures and additional debt. The Company has pledged as collateral a general security agreement, guarantees of subsidiaries, and a pledge of inventory under section 427 of the Bank Act.

5. Share Capital and Contributed Surplus

a) Share capital and contributed surplus

Issued and outstanding

(in thousands of dollars, except shares)	Share Capital				Contributed Surplus	
	2005		2004		2005	2004
	Shares #	\$	Shares #	\$	\$	\$
Balance, beginning of the period	17,943,919	19,277	17,511,320	18,853	171	77
Share options exercised for cash	25,333	33	–	–	–	–
Warrants exercised for cash	11,633	11	–	–	–	–
Stock-based compensation	–	–	–	–	35	15
Balance, end of the period	17,980,885	19,321	17,511,320	18,853	206	92

At the Annual General and Special Meeting of Shareholders on August 18, 2003, the shareholders approved the reduction of the stated capital of the Company. Accordingly, in fiscal 2004, contributed surplus was reduced by \$745,000, share capital by \$8,298,000, and accumulated deficit by \$9,043,000.

b) Dividends

On June 15, 2005, an annual dividend of \$0.08 (2004 - \$0.06) per common share was declared for all shareholders of record on July 14, 2005. The dividends of \$1,438,000 (2004 - \$1,051,000) are to be paid on August 4, 2005.

c) Share options and warrants

	2005		2004	
	Share options #	Warrants #	Share options #	Warrants #
	Balance, beginning of the period	1,160,734	3,445,878	1,145,000
Granted	–	–	260,000	–
Exercised	(25,333)	(11,633)	–	–
Balance, end of the period	1,135,401	3,434,245	1,405,000	3,684,211

6. 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 granted and warrants transferred 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 granted and warrants transferred by the Company.

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

The Company uses the fair value method of accounting for all share options granted and warrants transferred to employees on or after April 1, 2003. During the first quarter this year, no share options were granted (2004 – granted 260,000 options with exercise prices at the market share price on the grant date), and 137,106 (2004 – 230,000) warrants were transferred to employees with exercise prices below the market share price on the transfer date. Stock-based compensation expense of \$35,000 (2004 - \$11,000) was recorded in the first quarter in manufacturing and selling costs and general and administration in the consolidated statements of income.

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

	Share Options		Warrants	
	Granted in Excess of Market	Granted at Market	Transferred in Excess of Market	Transferred Below Market
Weighted-average fair value	\$0.29	\$0.65	\$0.18	\$1.02
Risk-free interest rate (%)	3.89	3.77	4.37	3.45
Expected hold period to exercise (years)	4.0	4.0	4.5	3.0
Volatility in the price of the Company's shares (%)	60.8	55.5	60.5	53.1
Dividend yield (%)	0.00	0.00	0.00	0.92

In accordance with the fair value method of accounting for stock-based compensation for non-employees, nil (2004 - \$4,000) was recorded in the first quarter as general and administration expense in the consolidated statements of income.

b) Share options granted and warrants transferred in fiscal 2003

The fair value of share options granted and warrants transferred in fiscal 2003, all of which were granted or transferred with exercise prices in excess of the market share price on the grant or transfer date, were determined, at the date of grants or transfers, 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 or transfer, of the options granted and warrants transferred to employees in fiscal 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)	2005 \$	2004 \$
Net income for the period	244	72
Stock-based compensation expense	53	54
Pro-forma net income for the period	191	18
Earnings per share:		
Reported basic and diluted earnings per share	0.01	0.00
Compensation expense per share	0.00	0.00
Pro-forma basic and diluted earnings per share	0.01	0.00

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 (%)	0.0	0.0

7. Related Party Transactions

During the three month period, trucking services of \$86,000 (2004 - \$81,000), 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, 2005 included \$7,000 (March 31, 2005 - \$6,000) owing to the corporation. Normal commercial rates were paid for these services.

Notes to Consolidated Financial Statements continued

8. Financing Charges

Three months ended June 30 (in thousands of dollars)	2005 \$	2004 \$
Interest, short term	31	8
Foreign exchange losses (gains)	38	(5)
	69	3

9. 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 (in thousands of dollars, except number of shares)	2005 \$	2004 \$
Numerator:		
Net income available to common shareholders	244	72
Denominator:		
Weighted-average shares outstanding - basic	17,949,606	17,511,320
Effect of dilutive securities		
Share options	710,626	115,278
Warrants	1,548,817	118,397
Weighted-average shares outstanding - diluted	20,209,049	17,744,995

In 2005, certain of the warrants were not included in the calculation of diluted shares as the market price was below the performance vesting threshold. In 2004, certain share options were not included in the calculation of diluted shares as their exercise prices, plus the amount of compensation cost attributed to future service and not yet recognized, exceeded the average market share price, and certain of the warrants were not included as the market price was below the performance vesting thresholds.

10. Derivative Financial Instruments

At June 30, 2004, the Company had entered into foreign currency collar arrangements not accounted for as hedges (June 30, 2005 – nil). These arrangements provided for the purchase of euros, up to a total Canadian dollar equivalent of \$860,000, at rates of \$1.566 or \$1.6175 per euro. The fair values of these arrangements, estimated using market rates at June 30, 2004, were nil. During the period in 2004, net realized and unrealized losses of less than \$1,000 related to derivative financial instruments were recorded in financing charges.

Corporate Information

Board of Directors

James S. Edwards, Chairman of the Board
Venence G. Côté, Director, President and CEO
Fred J. Dymont, Director
Nancy L. Smith, Director
Simon Sochatsky, Director

Annual General Meeting

1:00 pm on Monday, August 15, 2005
at The Westin Edmonton
10135 - 100 Street, Edmonton, Alberta

Corporate Office

6907 - 36 Street
Edmonton, Alberta
Canada T6B 2Z6

Common Shares Outstanding

as of August 4, 2005
Total Outstanding: 17,980,885

Investor Relations

Copies of this Quarterly Report
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or email tony.barlott@zcl.com

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General Counsel

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Stock Listing and Share Symbol
Toronto Stock Exchange: **ZCL**



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