

Making A Difference

ZCL Composites Inc.
Second Quarter Report Ended September 30, 2006
Fiscal Period Ending December 31, 2006



ZCL
COMPOSITES INC.

Message To Shareholders

Once again, I am very pleased to announce another strong quarterly performance. Revenue for the second quarter increased by 25.1% to a record \$14.0 million from \$11.2 million for the same quarter last year, and increased 36.3% to \$26.5 million for the six-month period from \$19.5 million for the six-month period last year. With the continued strength of our order backlog and the strong start to the third quarter, we remain confident that we can achieve our target of annual revenue growth of 15% to 20% coupled with a corresponding increase in income.

Net income for the second quarter increased 96.5% to \$1.6 million from \$820,000 last year, and increased 141.4% to \$2.6 million for the six-month period from \$1.1 million last year. Basic earnings per share for the second quarter were \$0.08 as compared to \$0.05 last year, and \$0.12 for the six-month period as compared to \$0.06 last year. Diluted earnings per share for the second quarter were \$0.07 as compared to \$0.04 last year, and \$0.12 for the six-month period as compared to \$0.05 last year.

Selling prices were adjusted during the first two quarters this year to offset the higher raw material costs incurred last year. Higher revenues coupled with improved margins resulted in the significantly higher net income. The outlook for all market sectors remains very positive for this fiscal period as the backlog at the end of the second quarter remains strong. The third quarter is also off to a very good start. Inventories have been maintained at higher levels to meet orders and deliveries.

On August 25, 2006, the Company was notified of the formal listing by Underwriters Laboratories in the United States ("UL") of the Phoenix *Lining System* and Underwriters Laboratories of Canada ("ULC") of the LIFELINER *System*™ in accordance with recognized industry standards. These listings pave the way to market additional UL / ULC listed products that will begin to add to our revenues before year end as originally communicated and represents another milestone in the continued growth of ZCL.

These unique internal fibreglass systems allow "in-situ" upgrades of a single wall tank to a secondary contained lining system using a patented three dimensional glass fabric combined with a proprietary state-of-the-art curing system. 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. There are significant opportunities to establish ZCL's tank lining technologies as the preferred method of upgrading single wall tanks to a secondary contained tank.

On October 20, 2006, the Company was awarded a contract by Chevron Hong Kong Limited (Caltex) to install the LIFELINER *System*™ for a number of single wall tanks at two locations representing test sites. Upon the successful completion of these sites, the opportunity exists for multiple locations within Hong Kong and throughout Southeast Asia where Chevron (Caltex) has similar operations.

The Company also received an order from Shell Canada to upgrade a number of sites in Ontario. Further opportunities exist in North America and Southeast Asia for the corrosion free storage of new fuels including the new ethanol blended fuels and other blends now being legislated in certain parts of Canada and the USA.

With the significant demand placed on the Company's Edmonton fibreglass tank manufacturing facility, the Company is planning to expand its current complex. It is anticipated that a larger manufacturing facility will not only alleviate the growing level of backlog for product, but will also improve the manufacturing throughput by as much as 50%.

During the quarter, the Company was pleased to pay its third annual dividend of \$0.10 per common share that was declared in the first quarter. This dividend, which was an increase of \$0.02 per share or 25% over last year's dividend, was set by your Board of Directors with consideration of our strong results, cash flow and financial position, and the anticipated cash required to continue our strategic growth plan.

We are very encouraged by the significant growth of our operations during the first two quarters of this year. The Company is looking forward to continued growth not only in our traditional markets but also with new products and markets, particularly with the lining program that offers such a win-win situation for both our customers and our shareholders. Our sales and backlog remain strong, and the balance sheet and cash flows are very healthy. We are in an exceptional position to take advantage of new market opportunities through organic growth and acquisitions that build value for our shareholders.



Venence G. Côté
President and Chief Executive Officer

October 31, 2006

Management's Discussion and Analysis

October 31, 2006

The following discussion and analysis of the results of operations and cash flows for the period ended September 30, 2006, and the financial position as at September 30, 2006, should be read in conjunction with the Company's unaudited consolidated financial statements and related notes for the period ended September 30, 2006, the Management's Discussion and Analysis and audited consolidated financial statements and related notes for the year ended March 31, 2006, as well as the Message to Shareholders included in this Second 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, 2006. 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 September 30, 2006 as it used in the audited annual consolidated financial statements for the year ended March 31, 2006. 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.

Revenue for the second quarter increased by 25.1% to a record \$14.0 million from \$11.2 million for the quarter last year, and increased by 36.3% to \$26.5 million for the six-month period from \$19.5 million for the six-month period last year. Net income for the second quarter increased to \$1.6 million from \$820,000 for the quarter last year, and increased to \$2.6 million for the six-month period from \$1.1 million last year. Basic earnings per share for the second quarter were \$0.08 as compared to \$0.05 last year, and \$0.12 for the six-month period as compared to \$0.06 for the same period last year. Diluted earnings per share for the second quarter were \$0.07 as compared to \$0.04 last year, and \$0.12 for the six-month period as compared to \$0.05 for the period last year.

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. Most areas of

operations experienced significant increases in revenue while fixed manufacturing costs remained relatively unchanged from the same quarter last year. The outlook for these market sectors remains very positive for this fiscal year as the backlog at the end of the second quarter is very strong. The third 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 second quarter was largely due to higher revenue and positive contribution from most areas of operation with the exception of the contribution from home heating oil tanks. Overall margins have increased as the price increases introduced during the first and second quarters have taken effect.

Notwithstanding the higher revenue during the period, the increase in net income in the second quarter and six-month period this year was largely due to higher overall margins: -- a result of increased selling prices introduced during the first and second quarters this year in response to the increase in raw material prices late last year. Amortization increased this year with the introduction of patent amortization which commenced during the third quarter last year and the commencement during the current quarter of the amortization of the deferred costs. Financing charges were lower this year because of decreased utilization of the bank operating lines of credit and foreign exchange gains compared to foreign exchange losses in the prior year.

Cash flows from operating activities were \$880,000 during the second quarter (\$3,028,000 for the six-month period) this year, compared to \$356,000 of cash from operating activities during the quarter (\$793,000 for the six-month period) last year. This increase was largely due to the timing of sales and collection of accounts receivable partially offset with the increasing level of inventory with the higher level of operations. Cash flows from the financing activities included the third annual dividend of \$0.10 (2005 – \$0.08) per common share. Dividends of \$2.1 million (2005 - \$1.4 million) were paid in the current quarter.

The effect of dilutive share options and warrants on the weighted-average shares outstanding was 1,331,843 shares (2005 – 2,263,809) for the second quarter and 1,360,397 (2005 – 2,261,625) for the six-month period. The final third of the outstanding warrants vested during the first quarter as a result of the final performance threshold being met. In the first quarter last year, the remaining unvested warrants were not included in the calculation of diluted shares as the market price was below the performance threshold.

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 produces primarily home heating oil tank products. Manufacturing resumed in the fourth quarter of last year and the plant has been fully restored. As anticipated, insurance proceeds from the Company's insurers (subject to a \$25,000 deductible under the insurance policy) covered virtually all damages. Accounts receivable at September 30, 2006 was \$21,000 (March 31, 2006 - \$305,000) related to the insurance claim.

The Company continues to focus on the marketing of home heating oil tanks. Sales and profitability levels for home heating oil tanks continue to be weaker than anticipated in a particularly soft market. The lack of legislation with a definite tank replacement timeline has led end users to postpone their tank replacement. Inventories have levelled off and production of smaller accessories has been re-allocated from other manufacturing plants to the Waverley plant.

The Company changed its year end from March 31 to December 31 to coincide with companies involved in the oil and gas industry. This fiscal period end will therefore be for the nine months ending December 31, 2006. Appropriate comparisons and reconciliations will be provided in order to easily evaluate our financial performance during the upcoming transition period.

On August 25, 2006, the Company was notified of the formal listing by Underwriters Laboratories in the United States ("UL") of the Phoenix *Lining System* and Underwriters Laboratories of Canada ("ULC") of the LIFELINER *System*™ in accordance with recognized industry standards. These listings pave the way to market additional UL / ULC listed products that will begin to add to our revenues before year end as originally communicated and represents another milestone in the continued growth of ZCL.

These unique internal fibreglass systems allow "in-situ" upgrades of a single wall tank to a secondary contained lining system using a patented three dimensional glass fabric combined with a proprietary state-of-the-art curing system. 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. There are significant opportunities to establish ZCL's tank lining technologies as the preferred method of upgrading single wall tanks.

As the tank lining program is fully developed, no additional development costs were deferred in the second quarter. Total development costs deferred, related to tank lining, are \$1.1 million. The Company commenced amortization in the second quarter following notification of the formal UL/ULC listing. Lining programs have commenced in Ontario and have been approved in Hong Kong. The lining program will be ramped up as field experience is gained and qualified applicators are trained in all aspects of this new system.

On August 9, 2006, at the Company's Annual General Meeting, the shareholders approved the Stock Option Plan (2006), replacing the existing Stock Option Plan (1996). The primary difference in the two plans is that the 2006 plan allows the number of shares reserved for issuance to increase automatically to equal 10% of the total number of shares issued and outstanding. Any options and stock option agreements issued under the 1996 plan are deemed to be issued under the 2006 plan and governed accordingly. No options have yet to be granted under the current plan.

The purpose of the plan is to, among other things, secure for the Company and its shareholders the benefits of incentives inherent in share ownership by the directors, management and employees of the Company.

The Company's Preserver Warranty Program is an enhanced warranty program that has been backed by a third party insurance company which insures our customers up to \$2 million for defective material and workmanship for a period of 10 years. The Company will, effective December 1, 2006, insure this coverage through its own captive insurance company. The insurance carrier has assured the Company that it will continue to cover existing policy holders for the remainder of their respective terms for all policies written up to November 30, 2006.

With the significant demand placed on the Company's Edmonton fibreglass tank manufacturing facility, the Company is planning to expand its current complex. It is anticipated that a larger manufacturing facility will not only alleviate the growing level of backlog for product, but will also improve the manufacturing throughput by as much as 50%.

SEGMENTED ACTIVITY

Operating segments are defined as components of the Company for which separate financial information is available that is evaluated regularly by the chief operating decision maker in allocating resources and assessing performance. The chief operating decision maker of the Company is the Chief Executive Officer.

Management's Discussion and Analysis continued

The Company operates in two reportable segments namely Liquid Containment Storage Systems (including underground and aboveground storage tanks and related products and accessories) and Home Heating Oil Tanks. In addition to the above-noted operating segments, corporate administration and other operating segments reported to the CEO and are included in the All Other reportable segment. Revenue for the All Other reportable segment is primarily from the Company's operations in The Netherlands which manufactures and sells a three-dimensional fabric material. Segmented information is shown on these product lines in Note 12 which highlights Liquid Containment Storage, Home Heating Oil Tanks and All Other segments combined.

For the quarter, sales recorded in the Liquid Containment Storage Systems segment were \$13.2 million (2005 - \$10.2 million) generating income before income taxes of \$3.3 million (2005 - \$1.8 million). For the six month period ended September 30, 2006, sales recorded in the Liquid Containment Storage Systems segment were \$24.9 million (2005 - \$17.6 million) generating income before income taxes of \$5.7 million (2005 - \$3.0 million). Sales are higher this year with increased volume combined with higher prices.

Sales recorded in the Home Heating Oil Segment were \$411,000 (2005 - \$512,000) for the quarter and \$963,000 (2005 - \$846,000) for the six months ended September 30, 2006, generating a loss before income taxes of \$249,000 (2005 - \$175,000) for the quarter and a loss before income taxes of \$521,000 (2005 - \$368,000) for the six months ended September 30, 2006.

RESULTS OF OPERATIONS

Period Ended September 30, 2006 Compared to Period Ended September 30, 2005

Revenue

Revenue for the second quarter increased by 25.1% to a record \$14.0 million from \$11.2 million for the quarter last year, and increased by 36.3% to \$26.5 million for the six-month period from \$19.5 million for the six-month period last year. 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. Most areas of operations experienced significant increases in revenue while fixed manufacturing costs remained relatively unchanged from the same quarter last year. The outlook for these market sectors remains very positive for this fiscal year as the backlog at the end of the second quarter is very strong. The third quarter is also off to a strong start. Inventories have been maintained at higher levels to meet orders and deliveries.

Revenue less manufacturing and selling costs

Revenue less manufacturing and selling costs increased to \$3.5 million (25.3% of revenue) from \$2.2 million (19.9% of revenue) in the second quarter last year, and to \$6.1 million (22.9% of revenue) from \$3.5 million (18.2% of revenue) for the six-month period 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.

Overall margins have increased as a result of the price increases introduced during the first and second quarters of this year. Manufacturing overhead and marketing and selling expenses have increased, however, at a lower rate than the sales increase.

Amortization

Amortization increased by \$43,000 to \$413,000 for the second quarter from \$370,000 last year, and increased by \$62,000 to \$795,000 for the six-month period from \$733,000 last year. The overall level of amortization has increased largely due to the amortization of patents and the deferred development costs of the tank lining program.

General and administration

General and administration expenses were \$675,000 or 4.8% of revenue (2005 - \$490,000 or 4.4% of revenue) for the second quarter, and \$1,442,000 or 5.4% of revenue (2005- \$952,000 or 4.9% of revenue) for the six-month period. These costs have increased from last year as a result of the significant quarter over quarter growth, certain cost increases including larger quarterly accruals for bonuses paid annually, and higher stock based compensation expenses. Resources have been employed to define, improve and document risk analysis and internal controls to comply with Multilateral Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*.

Financing charges

Financing charges for the second quarter were \$11,000 (\$3,000 for the six-month period), down from \$94,000 for the quarter (\$163,000 for the six-month period) last year. The decrease is the result of the lower utilization of the operating lines of credit (bank indebtedness), as well as current year foreign exchange gains compared to foreign exchange losses in the prior year, related to the translation of transactions denominated in foreign currencies and the accounts of Parabeam Industries B.V.

Management's Discussion and Analysis continued

Income taxes

The Company's overall effective tax rate was 34.0% in the second quarter (32.9% for the six-month period), as compared to 35.4% for the quarter (36.8% for the six-month period) last year. The federal and certain provincial governments announced a number of changes to income taxes and rates during the first quarter. As a result of these changes, the Company has a slightly overall effective income tax rate compared to the prior fiscal year.

The higher effective rate last year was also due to non-deductible expenses that were not significant but had a larger effect last year because of the lower level of pre-tax income.

All tax losses of prior years were utilized in the year ended March 31, 2006. 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)

	Sept 30/06	June 30/06	Mar 31/06	Dec 31/05
Revenue	13,974	12,552	13,662	13,044
Net income	1,611	957	1,295	1,065
Basic earnings per share	\$0.08	\$0.05	\$0.07	\$0.06
Diluted earnings per share	\$0.07	\$0.04	\$0.06	\$0.05

	Sept 30/05	June 30/05	Mar 31/05	Dec 31/04
Revenue	11,173	8,287	10,372	11,056
Net income	820	244	1,151	1,028
Basic earnings per share	\$0.05	\$0.01	\$0.07	\$0.06
Diluted earnings per share	\$0.04	\$0.01	\$0.06	\$0.05

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. However, as the Company has expanded 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, the seasonality impact has been diminished.

LIQUIDITY AND CAPITAL RESOURCES

Working capital (current assets less current liabilities) at September 30, 2006 was \$17.6 million, as compared to \$15.9 million at March 31, 2006. Current assets increased by \$2.8 million and current liabilities increased by \$1.2 million. These changes reflect the higher level of operations.

At September 30, 2006, cash increased to \$1.2 million from a bank indebtedness of \$114,000 at March 31, 2006, accounts receivable decreased by \$560,000 from March 31, 2006 to \$12.1 million, inventories increased by \$2.2 million to \$11.6 million, accounts payable and accrued liabilities increased by \$472,000 to \$6.2 million, and income taxes increased by \$802,000 to \$1.2 million from \$447,000 at March 31, 2006. These changes reflect the continued strong level of operations during the period. Inventories have been maintained at higher levels to meet the robust activity anticipated in the third 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 September 30, 2006, one customer accounted for approximately 8% (March 31, 2006 – two customers, 23%) of accounts receivable.

Cash Flows

Cash flows from operating activities were \$880,000 during the second quarter (\$3,028,000 for the six-month period) this year, compared to \$356,000 of cash from operating activities during the quarter (\$793,000 for the six-month period) last year. This increase was largely due to the timing of sales and collection of accounts receivable, and is partially offset by the increasing level of inventory with the higher level of operations.

As a result of the increase in cash provided from operating activities for the period ended

Summary of Cash Flows Six months ended September 30th (in thousands of dollars)	Three months		Six months	
	2006	2005	2006	2005
	\$	\$	\$	\$
Operating activities	880	356	3,028	793
Financing activities	(1,724)	215	(1,071)	1,459
Investing activities	(382)	(571)	(769)	(3,635)
Increase (decrease) in cash	(1,226)	—	1,188	(1,383)
Cash, beginning of the period	2,414	—	—	1,383
Cash, end of the period	1,188	—	1,188	—

Management's Discussion and Analysis continued

September 30, 2006, there were no net advances on the revolving operating lines of credit (bank indebtedness) which was decreased to nil from \$114,000 at March 31, 2006. The Company has operating lines of credit of \$10.25 million provided by a chartered bank.

Property, plant and equipment additions were \$382,000 (2005 – \$177,000) in the second quarter and \$769,000 (2005 – \$466,000) in the six-month period; these additions related largely to the purchase of equipment to increase production capacity and efficiency, and the upgrade of computer and other office equipment.

In August 2005, the Toronto Stock Exchange ("TSX") accepted notice of a normal course issuer bid ("2005 NCIB") filed by the Company. For the twelve-month period from August 25, 2005 to August 24, 2006, the Company could have purchased on the TSX up to a maximum of 899,210 common shares, being approximately 5% of the issued and outstanding common shares. No shares were purchased pursuant to the 2005 NCIB which expired August 24, 2006.

Contractual Obligations

The Company's contractual obligations remains as described in Note 8 to the audited March 31, 2006 consolidated financial statements.

TRANSACTIONS WITH RELATED PARTIES

The related party transactions are described in note 7 to the unaudited consolidated financial statements for the period ended September 30, 2006. 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, 2006 Annual Report.

OTHER

Outstanding Share Data

As at October 31, 2006, there were 21,258,112 common shares, 606,335 share options and 797,750 warrants outstanding.

Consolidated Balance Sheets

(unaudited)

	September 30 2006 \$	March 31 2006 \$
<i>(in thousands of dollars)</i>		
Assets		
Current assets		
Cash	1,188	—
Accounts receivable	12,094	12,654
Inventories	11,609	9,422
Prepaid expenses	328	310
Future tax assets	48	48
	25,267	22,434
Property, plant and equipment	10,157	9,901
Deferred costs <i>[note 3]</i>	1,129	1,165
Intangible assets	815	1,066
Goodwill	1,991	1,991
	39,359	36,557
Liabilities and Shareholders' Equity		
Current liabilities		
Bank indebtedness <i>[note 4]</i>	—	114
Accounts payable and accrued liabilities <i>[note 7]</i>	6,171	5,699
Income taxes payable	1,249	447
Future tax liabilities	256	256
	7,676	6,516
Government grants	138	143
Future tax liabilities	1,310	1,467
	9,124	8,126
Shareholders' equity		
Share capital <i>[note 5a]</i>	22,606	21,397
Contributed surplus <i>[note 5a]</i>	456	348
Retained earnings	7,173	6,686
	30,235	28,431
	39,359	36,557

See accompanying notes

Consolidated Statements of Income and Retained Earnings

(unaudited)

Periods ended September 30	Three months		Six months	
	2006 \$	2005 \$	2006 \$	2005 \$
(in thousands of dollars, except per share amounts)				
Revenue	13,974	11,173	26,526	19,460
Manufacturing and selling costs <i>[notes 6a and 7]</i>	10,433	8,949	20,458	15,928
	3,541	2,224	6,068	3,532
Amortization <i>[note 3]</i>	413	370	795	733
General and administration <i>[note 6a]</i>	675	490	1,442	952
Financing charges <i>[note 8]</i>	11	94	3	163
Income before income taxes	2,442	1,270	3,828	1,684
Income taxes				
Current	877	115	1,417	215
Future	(46)	335	(157)	405
	831	450	1,260	620
Net Income for the period	1,611	820	2,568	1,064
Retained earnings, beginning of the period	5,562	3,187	6,686	4,381
Dividends <i>[note 5b]</i>	-	-	(2,081)	(1,438)
Retained earnings, end of the period	7,173	4,007	7,173	4,007
Basic earnings per share <i>[note 10]</i>	\$0.08	\$0.05	\$0.12	\$0.06
Diluted earnings per share <i>[note 10]</i>	\$0.07	\$0.04	\$0.12	\$0.05

See accompanying notes

Consolidated Statements of Cash Flows

(unaudited)

Periods ended September 30

	Three months		Six months	
	2006	2005	2006	2005
(in thousands of dollars, except per share amounts)	\$	\$	\$	\$
Cash Flows from Operating Activities				
Net income for the period	1,611	820	2,568	1,064
Add (subtract) non-cash items:				
Amortization expense	413	370	795	733
Future tax (recovery) expense	(46)	335	(157)	405
Stock-based compensation expense <i>[note 6a]</i>	56	51	193	86
	2,034	1,576	3,399	2,288
Changes in non-cash working capital:				
Decrease (increase) in accounts receivable	(1,686)	(1,981)	560	2,710
Decrease (increase) in inventories	(647)	476	(2,187)	(1,446)
Decrease (increase) in prepaid expenses	113	64	(18)	305
Increase (decrease) in accounts payable and accrued liabilities	497	466	472	(1,718)
Increase (decrease) in income taxes payable	569	(245)	802	(1,346)
Cash flows from operating activities	880	356	3,028	793
Cash Flows from Financing Activities				
Issue of common shares <i>[note 5a]</i>	357	10	1,124	54
Dividends paid	(2,081)	(1,438)	(2,081)	(1,438)
Net (repayment) advances of bank indebtedness	–	1,643	(114)	2,843
Cash flows from (used in) financing activities	(1,724)	215	(1,071)	1,459
Cash Flows from Investing Activities				
Business acquisition, including bank indebtedness assumed <i>[note 2]</i>	–	–	–	(2,597)
Purchase of property, plant and equipment	(382)	(177)	(769)	(466)
Deferred development costs <i>[note 3]</i>	–	(394)	–	(572)
Cash flows used in investing activities	(382)	(571)	(769)	(3,635)
Increase (decrease) in cash	(1,226)	–	1,188	(1,383)
Cash, beginning of the period	2,414	–	–	1,383
Cash, end of the period	1,188	–	1,188	–

See accompanying notes

Notes to Consolidated Financial Statements

September 30, 2006 and 2005 (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, 2006. 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 slight seasonal and short-term variations. Historically, the first and fourth quarters of the Company's fiscal year generally have the lower levels of activity, corresponding to the seasonality of the installation of underground liquid storage systems in Canada. However, as the Company has expanded 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, the seasonality impact has been diminished.

2. Business Acquisitions

There were no business acquisitions during the current fiscal period.

In April 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 two to three years. Amortization of customer order backlog was computed using the straight-line method over six months. Product certification and safety marks are indefinite life assets and are not subject to amortization.

3. Deferred Costs and Amortization

The unamortized balance of deferred costs at September 30, 2006 and March 31, 2006 was comprised of deferred development costs. There were no development costs incurred during the three month period (2005 - \$394,000) or the six month period ended September 30, 2006 (2005 - \$572,000). Amortization for the costs related to the deferred development project commenced during the quarter (\$26,000). 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:

Periods ended ended September 30	Three months		Six months		
(in thousands of dollars)	\$	2006	\$	2005	\$
Property, plant and equipment	262	238	513	470	470
Deferred development costs	31	4	36	9	9
Intangible assets	123	130	251	258	258
Government grants	(3)	(2)	(5)	(4)	(4)
	413	370	795	733	733

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% (6.25%; March 31, 2006 – 5.75%). 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

	Share Capital				Contributed Surplus	
	2006		2005		2006	2005
	Shares		Shares		Shares	
(in thousands of dollars, except shares)	#	\$	#	\$	\$	\$
Balance, as at March 31	20,118,953	21,397	17,943,919	19,277	348	171
Share options exercised for cash	25,333	29	25,333	33	–	–
Warrants exercised for cash	776,593	738	11,633	11	–	–
Stock-based compensation expense	–	–	–	–	137	35
Reclassification of fair value of stock options and warrants previously expensed	–	29	–	–	(29)	–
Balance, as at June 30	20,920,879	22,193	17,980,885	19,321	456	206
Share options exercised for cash	230,399	256	8,000	7	–	–
Warrants exercised for cash	106,834	101	3,333	3	–	–
Stock-based compensation expense	–	–	–	–	56	51
Reclassification of fair value of stock options and warrants previously expensed	–	56	–	–	(56)	–
Balance, at at September 30	21,258,112	22,606	17,992,218	19,331	456	257

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 2003, 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, 2006, an annual dividend of \$0.10 (2005 - \$0.08) per common share was declared for all shareholders of record on June 26, 2006. The dividends of \$2,081,000 (2005 - \$1,438,000) were paid on August 4, 2006.

c) Share options and warrants

	2006		2005	
	Share options #	Warrants #	Share options #	Warrants #
Balance, as at March 31	812,067	1,681,177	1,160,734	3,445,878
Granted	50,000	–	–	–
Exercised	(25,333)	(776,593)	(25,333)	(11,633)
Balance, as at June 30	836,734	904,584	1,135,401	3,434,245
Exercised	(230,399)	(106,834)	(8,000)	(3,333)
Balance, as at September 30	606,335	797,750	1,127,401	3,430,912

6. Stock-Based Compensation

The Black-Scholes model, used by the Company to calculate the values of options and warrants, as well as certain 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 this fiscal year, 50,000 share options were granted at the market share price in the first quarter (2005 – nil), and no warrants were transferred to employees (2005 – 137,106 warrants were transferred in the first quarter with exercise prices below the market share price on the transfer date). Stock-based compensation expense of \$56,000 (2005 - \$51,000) in the second quarter and \$193,000 (2005 - \$86,000) in the six-month period was recorded in manufacturing and selling costs and general and administration in the consolidated statements of income.

Notes to Consolidated Financial Statements continued

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 at Market	Granted in Excess of Market	Transferred in Excess of Market	Transferred Below Market
Weighted-average fair value	\$0.85	\$0.29	\$0.18	\$1.02
Risk-free interest rate (%)	3.90	3.89	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 (%)	52.8	60.8	60.5	53.1
Dividend yield (%)	0.88	0.00	0.00	0.92

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:

Periods ended September 30	Three months		Six months	
	2006	2005	2006	2005
(in thousands of dollars, except earnings per share)	\$	\$	\$	\$
Net income for the period	1,611	820	2,568	1,064
Stock-based compensation expense	8	51	61	104
Pro-forma net income for the period	1,603	769	2,507	960
Earnings per share:				
Reported basic earnings per share	0.08	0.05	0.12	0.06
Compensation expense per share	0.00	0.01	0.00	0.01
Pro-forma basic earnings per share	0.08	0.04	0.12	0.05
Reported diluted earnings per share	0.08	0.04	0.12	0.05
Compensation expense per share	0.00	0.00	0.00	0.00
Pro-forma diluted earnings per share	0.08	0.04	0.12	0.05

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

Trucking services of \$133,000 (2005 - \$101,000) for the second quarter and \$266,000 (2005 - \$187,000) for the six-month period, 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 September 30, 2006 included \$53,000 (March 31, 2006 - \$16,500) owing to the corporation. Normal commercial rates were paid for these services.

8. Financing Charges

Periods ended September 30	Three months		Six months	
	2006	2005	2006	2005
(in thousands of dollars)	\$	\$	\$	\$
Interest, short term	14	60	25	91
Foreign exchange (gains) losses	(3)	34	(22)	72
	11	94	3	163

9. Income Taxes

During the year, the federal and certain provincial governments announced a number of changes to income taxes and rates. As these changes received royal assent and were therefore substantively enacted during the first quarter, the Company made an adjustment to reduce income tax expense by approximately \$92,600 for that quarter. The resulting future tax liabilities reflect the lower anticipated taxes that will be paid as the temporary income tax differences reverse in future years.

10. 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:

Periods ended September 30	Three months		Six months	
	2006	2005	2006	2005
(in thousands of dollars, except number of shares)	\$	\$	\$	\$
Numerator:				
Net income available to common shareholders	1,611	820	2,568	1,064
Denominator:				
Weighted-average shares outstanding - basic	21,078,499	17,986,552	20,820,453	17,986,180
Effect of dilutive securities				
Share options	524,137	723,313	549,926	716,969
Warrants	807,706	1,540,496	810,471	1,544,656
Weighted-average shares outstanding - diluted	22,410,342	20,250,361	22,180,850	20,229,805

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.

11. Statement of Cash Flows

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

	Three months		Six months	
	2006	2005	2006	2005
	\$	\$	\$	\$
Interest paid	14	81	25	149
Income taxes paid	308	412	615	1,577

12. Segmented Information

Operating segments are defined as components of the Company for which separate financial information is available that is evaluated regularly by the chief operating decision maker in allocating resources and assessing performance. The chief operating decision maker of the Company is the Chief Executive Officer.

The Company operates in two reportable segments namely Liquid Containment Storage Systems, including underground and aboveground storage tanks and related products and accessories, and Home Heating Oil Tanks. In addition to the above noted operating segments, corporate administration and other operating segments reported to the Chief Executive Officer

and are included in the All Other reportable segment. Revenue for All Other is derived from the sale of finished three-dimensional fabric materials from the Company's operations in the Netherlands.

Segmented information is summarized as follows:

For the three months ended	September 30, 2006				
	Liquid Containment Storage	Home Heating Oil Tanks	All Other	Inter-Segment Adjustments	Total
(in thousands of dollars)	\$	\$	\$	\$	\$
Revenue	13,236	411	925	(598)	13,974
Inter-segment revenue	–	–	(598)	598	–
External revenue	13,236	411	327	–	13,974
General and administration expenses	–	–	675	–	675
Interest expense	–	–	14	–	14
Amortization expense	357	27	29	–	413
Income (loss) before income taxes	3,333	(249)	(642)	–	2,442
Acquisition of property plant and equipment	364	–	18	–	382
Goodwill	1,991	–	–	–	1,991
Total Assets	36,449	2,514	706	(310)	39,359

	September 30, 2005				
	Liquid Containment Storage	Home Heating Oil Tanks	All Other	Inter-Segment Adjustments	Total
(in thousands of dollars)	\$	\$	\$	\$	\$
Revenue	10,151	512	867	(357)	11,173
Inter-segment revenue	–	–	(357)	357	–
External revenue	10,151	512	510	–	11,173
General and administration expenses	–	–	490	–	490
Interest expense	–	–	60	–	60
Amortization expense	324	27	19	–	370
Income (loss) before income taxes	1,825	(175)	(380)	–	1,270
Acquisition of property plant and equipment	166	–	11	–	177
Goodwill	1,991	–	–	–	1,991
Total Assets	30,316	2,978	821	(270)	33,845

Notes to Consolidated Financial Statements continued

For the six months ended

	September 30, 2006				
	Liquid Containment Storage	Home Heating Oil Tanks	All Other	Inter-Segment Adjustments	Total
(in thousands of dollars)	\$	\$	\$	\$	\$
Revenue	24,855	963	1,969	(1,261)	26,526
Inter-segment revenue	—	—	(1,261)	1,261	—
External revenue	24,855	963	708	—	26,526
General and administration expenses	—	—	1,442	—	1,442
Interest expense	—	—	25	—	25
Amortization expense	691	55	49	—	795
Income (loss) before income taxes	5,687	(521)	(1,338)	—	3,828
Acquisition of property plant and equipment	751	—	18	—	769
Goodwill	1,991	—	—	—	1,991
Total Assets	36,449	2,514	706	(310)	39,359

	September 30, 2005				
	Liquid Containment Storage	Home Heating Oil Tanks	All Other	Inter-Segment Adjustments	Total
(in thousands of dollars)	\$	\$	\$	\$	\$
Revenue	17,619	846	1,836	(841)	19,460
Inter-segment revenue	—	—	(841)	841	—
External revenue	17,620	846	995	—	19,460
General and administration expenses	—	—	952	—	952
Interest expense	—	—	91	—	91
Amortization expense	639	55	39	—	733
Income (loss) before income taxes	2,988	(368)	(936)	—	1,684
Acquisition of property plant and equipment	455	—	11	—	466
Goodwill	1,991	—	—	—	1,991
Total Assets	30,316	2,978	821	(270)	33,845

Information about geographic areas

Revenue for the periods ending September 30

	Three months		Six months	
	2006	2005	2006	2005
(in thousands of dollars)	\$	\$	\$	\$
Canada	13,647	10,663	25,818	18,465
Foreign countries	327	510	708	995
	13,974	11,173	26,526	19,460

Property, plant, equipment and goodwill for the periods ending September 30

	2006	2005
(in thousands of dollars)	\$	\$
Canada	11,513	11,248
Foreign countries	635	701
	12,148	11,949

Revenue is attributed to the geographic area based on location of the Company's operations. No revenue attributed to any individual foreign country is material. The property, plant and equipment relating to foreign countries are located in The Netherlands.

Corporate Information

Board of Directors

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

Corporate Office

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Common Shares Outstanding
as of October 31, 2006
Total Outstanding: 21,258,112

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