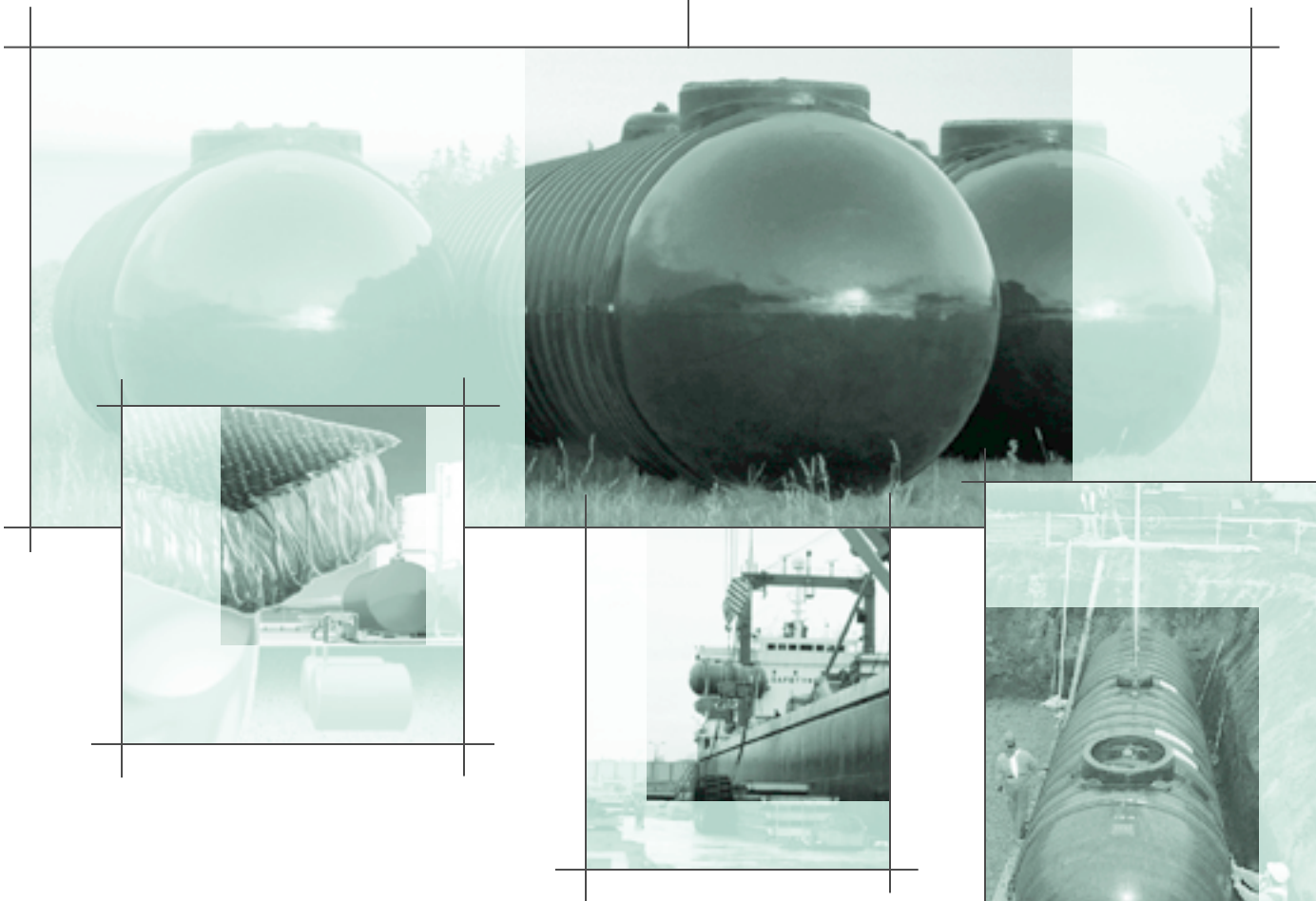


# 2000 THIRD QUARTER R E P O R T



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**ZCL**  
COMPOSITES INC.

*Protecting The Environment*

## Report to Shareholders

The steps we are taking to grow our core business have significantly impacted our current results – these same endeavours will drive our future profitability. We are moving towards a resolution of the litigation with our USA licensor. We are now very close to realizing some payback from the significant costs we have incurred, and the long time it has taken, to introduce our tank lining products. We continue to develop new international markets for our tank manufacturing and lining technology. At the same time, we are working on new products for the domestic marketplace, which will generate further sources of revenue. We have had success in reducing our manufacturing costs, and are working diligently to reduce costs even more.

The trends in the domestic marketplace continue to be very upbeat. Significant liquid storage programs are projected by the industry, as oil and gas prices along with the industry's confidence are maintained at higher levels. While activity in the downstream sector of the Canadian Petroleum industry was down in the third quarter as compared to last year, indications for the fourth quarter and next year are very exciting. Upstream activity continues to increase sharply – due to the warm weather, activity did not increase significantly until late in the third quarter. New products will be introduced into these, and other markets, in the near future.

Revenue was \$5.7 million for the quarter (\$18.9 million for nine months), as compared to \$6.1 million in the third quarter (\$19.6 million for nine months) last year. Domestic sales for the year are up substantially from last year – there were no export sales this year, while sales to the Philippines, prior to the opening of the plant by ZCL Enviro Systems, Inc., were approximately \$2.0 million for the nine month period last year.

The preliminary injunction in the United States, restraining the Company from selling double-wall tanks outside of Canada, is still in place, and the arbitration and litigation process is ongoing. The trial date has been set for late in the fourth quarter. While we continue to make progress, the period in which these matters will be determined is uncertain. Management remains confident that this dispute will be positively resolved. The high cost of this litigation is one of the primary reasons our earnings are down from last year – this is a necessary investment in our future

international growth and profit. Costs relating to this litigation, included in general and administration expenses, were approximately \$1.3 million for the first nine months this year as compared to approximately \$500,000 last year.

USA marketing efforts are aimed at tank lining products. The Florida Department of Environmental Protection, Bureau of Petroleum Storage Systems, has granted approval for the use of the Phoenix System as a method of secondary containment for underground storage tanks in the State of Florida. Approval in the Florida market is a critical step that opens the door to establish the Phoenix System as the preferred method of upgrading single-wall tanks across North America. Significant opportunities exist for the widespread adoption of this lining system by major oil and other companies that require tank upgrades. Marketing of the Devmat 3D Plus System of secondary containment for tank floors in large diameter aboveground tanks is also moving ahead, with the first system sales made during the second quarter. Final approval of this system from the State of Florida was also granted late in the third quarter. This aboveground lining system was authorized by the Fuels Safety Division of the Technical Standards and Safety Authority of the Province of Ontario in October 1999.

The operations of ZCL Enviro Systems, Inc. in the Philippines made a positive contribution during the period. This contribution will escalate in future periods as sales increase and production margins improve. UL approval of the Philippines facility was received during this quarter. The expansion of this plant, to double existing capacity, will be completed in the fourth quarter to meet current demand and anticipated requirements of other customers in the region.

Major oil companies are re-evaluating their global programs relating to standardization of specifications for liquid storage systems, including the upgrade of existing tanks that otherwise may require costly replacement. Our technology, which represents the new generation of environmental protection, is poised to change the industry and meet these global needs.

### Results for the Quarter

Net loss was \$405,000 for the third quarter (net loss of \$17,000 for nine months) as compared to net earnings of \$124,000 for the quarter (net earnings of \$602,000 for nine

months) last year. After adjusting for the costs of the convertible subordinated debenture, basic net loss per share was \$0.06 for the third quarter (\$0.05 for nine months) this year as compared to a loss of \$0.02 for the quarter (\$0.05 for nine months) last year. Fully diluted earnings per share are anti-dilutive and therefore not presented.

Earnings before amortization and other expenses decreased from \$1.4 million in the third quarter (\$4.5 million or 22.9% of revenue for nine months) last year, to \$964,000 this quarter (\$4.3 million or 23.0% of revenue for nine months this year). The decrease for this quarter is attributed to the decline in revenue and a change in the product mix. Overall manufacturing margins have been maintained. Production efficiencies have offset the effect of certain increased costs, as some of our raw materials have gone up due to increased oil prices.

General and administration expenses increased to \$1.1 million in the quarter (\$2.7 million for nine months) from \$761,000 in the third quarter (\$1.8 million for nine months) last year. Professional fees relating to the USA litigation were significantly higher this year. Net interest expense increased slightly from \$149,000 in the third quarter (\$518,000 for nine months) last year to \$168,000 in the quarter (\$569,000 for nine months) this year. A portion of general and administration and interest expenses were allocated to discontinued Distribution operations last year.

As we reported last quarter, the Belleville, Ontario property was sold in November 1999. The net proceeds of the sale were used to pay down long-term debt (\$500,000), and to reduce bank indebtedness. Certain costs were incurred in this quarter to complete the shutdown of this facility. Occupancy and other operating costs relating to this plant have now been eliminated, and tanks for the eastern Canada market will continue to be manufactured at our more efficient facility in Drummondville, Quebec.

Cash flows from operating activities during the nine month period were \$1.3 million this year as compared to cash used for operating activities of \$1.6 million last year. Cash of \$2.7 million was used for discontinued operations last year.

Cash used for financing activities increased to \$3.6 million for the nine month period this year from \$1.5 million last year. As indicated in our Annual Report, the Company repaid \$1.85 million of the convertible subordinated debenture this year, plus the make-whole premium on this amount. Cash flows from investing activities were \$1.9

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Nine months ended December 31	1999	1998
	\$	\$
	(000's)	(000's)

### CASH FLOWS FROM OPERATING ACTIVITIES

Cash receipts from customers	17,898	18,780
Cash paid to suppliers and employees	(15,822)	(17,409)
Interest paid	(506)	(377)
Income taxes recovered (paid)	(17)	115
Cash flows from continuing operations	1,553	1,109
Cash flows from discontinued operations	(208)	(2,660)
	1,345	(1,551)

### CASH FLOWS FROM FINANCING ACTIVITIES

Issue of long-term debt		450
Repayment of long-term debt	(1,031)	(917)
Repayment of convertible subordinated debenture	(1,850)	
Convertible subordinated debenture costs	(696)	(1,057)
	(3,577)	(1,524)

### CASH FLOWS FROM INVESTING ACTIVITIES

Collection of note receivable		2,150
Collection of proceeds receivable	1,813	
Net proceeds on disposal of capital assets	1,148	
Purchase of capital assets	(377)	(677)
Cost of other assets	(700)	(983)
Business acquisition	50	
	1,934	490

<b>Increase in bank indebtedness</b>	(298)	(2,585)
Bank indebtedness, beginning of the period	(1,021)	(7,735)
<b>Bank indebtedness, end of the period</b>	(1,319)	(10,320)

million in the nine months this year, as compared to \$490,000 last year. This year, \$1.8 million was collected from the proceeds receivable from the sale of ZCL Distribution Inc. Last year, \$2.1 million was collected on the note receivable from the sale of the Pultrusion division.

Costs relating to the development and start-up of the USA markets continued to be capitalized in the third quarter. Amortization of start-up costs relating to the Philippines operations commenced in the fourth quarter of last year.

\$1.3 million was drawn on the bank operating line of credit at December 31, 1999, as compared to \$10.3 million at December 31, 1998 and \$1.0 million at March 31, 1999. Long-term debt decreased to \$3.5 million, from \$4.7 million at December 31, 1998 and \$4.6 million at March 31, 1999. After the loss and the costs of the convertible subordinated

## CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

Period ended December 31	Three months		Nine months	
	1999	1998	1999	1998
	\$	\$	\$	\$
	(000's)	(000's)	(000's)	(000's)

<b>Revenue</b>	<b>5,661</b>	6,096	<b>18,860</b>	19,600
<b>Earnings before the following</b>	<b>964</b>	1,447	<b>4,345</b>	4,493
Amortization	(283)	(275)	(872)	(817)
General and administration	(1,121)	(761)	(2,713)	(1,833)
<b>Operating earnings (loss)</b>	<b>(440)</b>	411	<b>760</b>	1,843
Interest	(168)	(149)	(569)	(518)
Gain (loss) on disposal of capital assets	3		(124)	
Share of income from affiliate	23		35	
<b>Earnings (loss) before income taxes</b>	<b>(582)</b>	262	<b>102</b>	1,325
<b>Income taxes</b>				
Current	(18)	(8)	(29)	(22)
Future	195	(125)	(90)	(576)
	177	(133)	(119)	(598)
<b>Net earnings (loss) from continuing operations</b>	<b>(405)</b>	129	<b>(17)</b>	727
<b>Net loss from discontinued operations</b>		(5)		(125)
<b>Net earnings (loss) for the period</b>	<b>(405)</b>	124	<b>(17)</b>	602
<b>Basic net earnings (loss) per share</b>				
From continuing operations	(\$0.06)	\$0.00	(\$0.05)	\$0.02
Net earnings (loss) for the period	(\$0.06)	(\$0.02)	(\$0.05)	(\$0.05)

debenture for the period, total shareholders' equity decreased to \$16.8 million from \$17.0 million at March 31, 1999.

The Company has reviewed all systems, both internal and external, and completed the replacement or upgrade of internal systems that were not Year 2000 compliant. These systems will continue to be monitored and upgraded for any further Year 2000 changes identified and introduced by hardware and software manufacturers. Year 2000 assurances have been received from suppliers of critical materials and services. No Year 2000 problems have been encountered to date, and no significant additional costs are anticipated to be incurred. Although the change in date has occurred, it is not possible to conclude that all aspects of the Year 2000 issue that may affect the Company, including those relating to the efforts of customers, suppliers, and third parties, have been fully resolved.

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

	December 31	March 31
	1999	1999
	\$	\$
	(000's)	(000's)

### ASSETS

<b>Current</b>		
Accounts receivable	5,475	4,631
Proceeds receivable		1,813
Inventories	5,496	6,175
Prepaid expenses	418	175
Future tax asset	35	477
	11,424	13,271
Investment in affiliate	690	655
Capital assets	7,660	9,187
Other assets	5,341	5,028
Future tax asset	2,050	1,421
	27,165	29,562

### LIABILITIES AND SHAREHOLDERS' EQUITY

<b>Current</b>		
Bank indebtedness	1,319	1,021
Accounts payable and accrued liabilities	4,760	4,377
Income taxes payable	57	50
Current portion of long-term debt	719	711
Convertible subordinated debenture – liability portion	200	2,050
	7,055	8,209
Long-term debt	2,814	3,853
Government grants	250	268
	10,119	12,330
Non-controlling interest	203	203
<b>Shareholders' equity</b>		
Capital stock	20,078	20,078
Convertible subordinated debenture – equity portion	6,250	5,938
Contributed surplus	45	45
Deficit	(9,530)	(9,032)
	16,843	17,029
	27,165	29,562



**V. (Ven) Côté**  
President & Chief Executive Officer



**Tony Barlott**  
Vice President Finance & Chief Financial Officer

