

2001 THIRD QUARTER REPORT



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ZCL
COMPOSITES INC.

Report to Shareholders

The strong performance of the Company continued in the third quarter. Our performance reflects the buoyant marketplace driven by high oil and gas prices, coupled with the success in focusing on our core business and improving our manufacturing processes. While historically the second and third quarters have the highest level of activity, these positive results are expected to continue over the next year.

Revenue for the third quarter increased by over 48% to \$8.4 million from \$5.7 million last year, and to \$23.4 million for the nine-month period this year from \$18.9 million last year. This increase reflects the continuing strong markets in both the downstream and upstream sectors of the Canadian petroleum industry, as well as other market sectors using our products.

As part of our core business, we are exploring new markets for our products, and developing new products that utilize our manufacturing technologies and expertise. New products, including our fiberglass Fuel Oil Tank and Septic Tank introduced earlier this year, contributed to our increased revenue and will generate increasing sources of revenue.

At the same time, we have not lost sight of our strategy to be the leading global supplier of liquid storage systems. We are considering tank markets in other countries and exploring alternatives to implement this strategy, but are proceeding with caution.

As previously reported, the USA operations are incurring losses, and we are not satisfied with the progress in developing markets for tank lining products. Our partner, who holds 49% of ZCL-USA, Inc. and manages the business, has commenced legal action against us alleging breach of certain agreements. We are confident these allegations are without merit, and are working toward resolving the dispute and eliminating the losses.

ZCL Enviro Systems, Inc. in the Philippines contributed to our profitable third quarter. Major customers in the region commenced substantial tank procurement programs late in the second quarter, and have indicated these programs will continue in the next year. Coupled with the UL approval and expansion of the plant last year, ZCL Enviro Systems is well positioned to meet the requirements of customers, and take advantage of the increased demand for their products.

We thank all our stakeholders for their continued support and patience. Management is committed to improving the performance of the Company. Our proven technology, our leadership in the industry, and our innovation in meeting the needs of our customers, will drive our success into the new millennium.

Financial Results

Net earnings for the third quarter were \$436,000 (\$1.4 million for nine months), up significantly from a loss of \$405,000 in the quarter (loss of \$17,000 for nine months) last year. After adjusting for the costs of the convertible subordinated debenture, basic net earnings per share was \$0.03 for the third quarter (\$0.09 for nine months), as compared to a loss of \$0.06 for the quarter (loss of \$0.05 for nine months) last year. Fully diluted earnings per share are anti-dilutive and accordingly are not presented.

Operating earnings before amortization, general and administration and other costs increased significantly, to \$2.1 million for the third quarter (25.2% of revenue for the quarter this year, as compared to 19.7% of revenue last year) and \$5.5 million for the nine-month period. The substantial increase of approximately \$1.0 million over the quarter last year is the result of the increased revenue. Losses incurred by ZCL-USA, Inc. are included in operating results this year, while losses of ZCL-USA last year were capitalized as deferred start-up costs.

Overall tank manufacturing margins have been maintained or slightly increased as compared to last year. Increased raw material costs have been offset by continued improvements in our manufacturing processes. Recent higher costs for natural gas and electricity do not have a significant impact on production costs.

Plant shutdown and restructuring costs of \$537,000 in the third quarter consist of management restructuring and termination, and legal and other costs to review the operations and defend the legal action relating to ZCL-USA, Inc. Last year, occupancy and other costs, including losses on disposal, relating to the shutdown of the Belleville plant were \$150,000 in the third quarter (\$461,000 for nine months). The Belleville, Ontario property was sold in the third quarter of last year and no additional costs relating to the shutdown of the plant were incurred this year.

Licence litigation costs of \$75,000 in the third quarter of this year relate to the expired option to purchase Xerxes Corporation's global license business, which was paid as part of the settlement in May 2000. Last year, licence litigation costs (professional fees and other costs relating to the litigation with Xerxes in the USA) of \$664,000 were incurred in the third quarter (\$1.3 million during the nine-month period).

Working capital increased by \$551,000 in the third quarter, and \$1.5 million for the nine-month period. Cash was \$180,000 at December 31, 2000, as compared to bank indebtedness of \$1.3 million at December 31, 1999 and \$3.5 million at March 31, 2000. Accounts payable and accrued liabilities include approximately \$873,000 of deferred revenue at December 31, 2000 (\$Nil at December 31, 1999 and March 31, 2000).

Long-term debt decreased to \$2.8 million, from \$3.5 million at December 31, 1999 and \$3.4 million at March 31, 2000. Total shareholders' equity increased to \$17.0 million, after the earnings and costs of the convertible subordinated debenture for the period.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Nine months ended December 31		
	2000	1999
(in thousands of dollars)	\$	\$

CASH FLOWS FROM OPERATING ACTIVITIES

Cash receipts from customers	24,943	17,948
Cash paid to suppliers and employees	(19,672)	(15,822)
Interest paid	(410)	(506)
Income taxes paid	(3)	(17)
Cash flows from continuing operations	4,858	1,603
Cash flows from discontinued operations	79	(208)
	4,937	1,395

CASH FLOWS FROM FINANCING ACTIVITIES

Repayment of long-term debt	(539)	(1,031)
Repayment of convertible subordinated debenture		(1,850)
Convertible subordinated debenture costs	(422)	(696)
	(961)	(3,577)

CASH FLOWS FROM INVESTING ACTIVITIES

Collection of proceeds receivable	236	1,813
Proceeds on disposal of capital assets		1,148
Purchase of capital assets	(439)	(377)
Cost of other assets	(75)	(700)
	(278)	1,884

Increase (decrease) in cash and cash equivalents	3,698	(298)
Bank indebtedness, beginning of the period	(3,518)	(1,021)
Cash (bank indebtedness), end of the period	180	(1,319)

In the Statement of Cash Flows, cash and cash equivalents consist of cash and bank indebtedness. Operating activities generated cash flows of \$4.9 million for the nine-month period this year, up significantly from \$1.4 million last year.

Cash required for financing activities decreased to \$961,000 for nine months this year, from \$3.6 million last year. Last year, \$1.85 million of the convertible subordinated debenture, plus the make-whole premium on this amount, was repaid from the proceeds of the sale of ZCL Distribution Inc. In addition to scheduled repayments, \$500,000 of long-term debt was repaid in the third quarter last year from the proceeds of the sale of the Belleville property.

CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

Period ended December 31	Three months		Nine months	
	2000	1999	2000	1999
(in thousands of dollars)	\$	\$	\$	\$

Revenue	8,405	5,661	23,437	18,860
Manufacturing and selling costs	6,289	4,547	17,915	14,279
	2,116	1,114	5,522	4,581
Amortization	348	283	1,085	872
General and administration	471	457	1,595	1,408
Plant shutdown and restructuring costs	537	150	537	461
License litigation costs	75	664	75	1,305
Operating earnings (loss)	685	(440)	2,230	535
Interest	160	168	466	569
Gain on disposal of capital assets		(3)		(101)
Share of loss (income) from affiliate	(15)	(23)	40	(35)
Earnings (loss) before income taxes	540	(582)	1,724	102

Income taxes

Current	13	18	26	29
Future	210	(195)	695	90
	223	(177)	721	119

Net earnings (loss) before the following	317	(405)	1,003	(17)
Non-controlling interest	119		374	
Net earnings (loss) for the period	436	(405)	1,377	(17)

Basic net earnings (loss) per share	\$0.03	(\$0.06)	\$0.09	(\$0.05)
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Cash required for investing activities was \$278,000 for nine months this year, as compared to cash flows from investing activities of \$1.9 million last year. Last year, \$1.8 million was collected from the sale of ZCL Distribution Inc., and \$1.1 million was received from the disposal of the Belleville property. Costs relating to the development and start-up of the USA markets were capitalized and included in other assets last year, while losses of ZCL-USA, Inc. are included in operating results this year.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	December 31		March 31
	2000	2000	
(in thousands of dollars)	\$	\$	\$

ASSETS

Current			
Cash	180		
Accounts receivable	6,735		7,416
Proceeds receivable			236
Inventories	3,838		4,716
Prepaid expenses	299		282
Future tax asset	200		363
	11,252		13,013
Investment in affiliate	670		710
Capital assets	7,446		7,512
Other assets	4,650		5,237
Future tax asset	2,589		2,820
	26,607		29,292

LIABILITIES AND SHAREHOLDERS' EQUITY

Current			
Bank indebtedness			3,518
Accounts payable and accrued liabilities	6,332		6,120
Income taxes payable	77		54
Current portion of long-term debt	719		719
Convertible subordinated debenture – liability portion	200		200
	7,328		10,611
Long-term debt	2,095		2,634
Government grants	225		243
	9,648		13,488
Non-controlling interest			101
Shareholders' equity			
Capital stock	20,078		20,078
Convertible subordinated debenture – equity portion	6,796		6,393
Contributed surplus	45		45
Deficit	(9,960)		(10,813)
	16,959		15,703
	26,607		29,292


V. (Ven) Côté
 President & Chief Executive Officer


Tony Barlott
 Vice President Finance
 & Chief Financial Officer

