

Annual Report
2002



ZCL
COMPOSITES INC.



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15
years
1987 - 2002
of excellence

Established in 1987, ZCL has grown to become Canada's leading supplier of fiberglass storage systems to the petroleum industry. An unrelenting drive to manufacture **superior tanks that "simply will not corrode"** has made ZCL the preferred choice in many industrial and retail sectors. The Company developed Canada's first double wall fiberglass fuel storage system and continues to innovate with expanding product lines with many applications. ZCL remains committed to quality products, continually raising the standards for environmentally safe, long lasting tank technology. The vision is to be the leading global provider of liquid storage solutions.

Message to Shareholders



Venence G. Côté
President & Chief Executive Officer

Fellow Shareholders,

Our 2002 year began with record high activity levels in the oil and gas industry, only to see activity in North America decelerate due to lower commodity prices, mergers and acquisitions, and economic uncertainty in the second half of the year. Despite these challenges in the marketplace, ZCL's strategy and focus delivered record financial operating results and a strong balance sheet.

Corporate values, performance, and resilience are put to the test during challenging times. We have demonstrated our ability to overcome the impact of a general slowdown in the economy, as well as the effects of unforeseen events such as those of last September 11th. In the face of a 14% reduction in revenue, from record levels in the previous year, our operating earnings increased by nearly \$1.0 million. Our pre-tax earnings increased by the same amount, and net earnings climbed to \$1.8 million (basic and diluted earnings per share of \$0.11) from \$1.5 million last year (basic and diluted earnings per share of \$0.09).

Corporate values,
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Our successes are the result of a series of steps taken over the past three years. We have implemented production improvement and cost reduction programs, and restructured our operations. Non-core activities were divested, excess capacity eliminated, and our organization restructured. The parameters for future growth were established with the settlement of the litigation with Xerxes Corporation in May 2000, and further confirmed when we took

control of the development and marketing of our tank lining technology with the acquisition of the assets of ZCL-USA, Inc. in June 2001.

The Company answered the demands of the ever changing needs of the industry by introducing new products, such as our large-diameter multi-compartment tanks capable of storing up to 100,000 liters. These tanks offer significant savings to the end-user in terms of lower installation costs, as well as provide versatility in configuration. During the year, we also introduced our new pressure vessel to the upstream sector, a market traditionally exclusive to steel products.

Likewise, the introduction of our domestic heating oil tank to the Eastern Provinces and North Eastern States has been well received, and will serve as a platform for the launching of our future ULC approved aboveground storage tank. This market represents significant growth potential in both Canada and the USA.

Ongoing testing of our tank lining system continues to demonstrate the ability to meet the corrosion protection, secondary containment, and monitoring needs of a very promising multi-billion dollar market in North America. The acquisition of Mocoat Services Inc. in May 2002 adds considerable expertise and strength in this key market and gives us a complementary lining product.

ZCL is committed to providing safe, cost-effective solutions to meet the needs of our customers. We are privileged to have long term contracts and alliances with many of the major oil and gas companies. These alliances demonstrate their confidence in the quality of our products, as well as form the cornerstone of our business. After 15 years and over 25,000 tanks sold, we have an unblemished history of no warranty claims and ZCL tanks have not had a single leak attributed to internal or external corrosion.

The Company made significant progress during the year by focusing on our core business, delivering positive results and significantly strengthening our balance sheet as we move forward. Notwithstanding the economic slowdown and uncertainty in the past year, the North American petroleum industry is recovering and many companies are forecasting major capital expenditures for the coming year. With continued strength in our primary markets, we expect to sustain our earnings in our core business over the next year.

We now look to growth in Canada, in the USA and internationally, utilizing our strong domestic base, customer alliances, manufacturing expertise, technology and innovation. As the leader in the industry, our vision is to be the leading global provider of environmentally-friendly liquid storage solutions.

Our successes are largely attributable to the quality of our people, and to our strong management team. I want to publicly thank every one of them for their contributions to our performance. I wish to also extend my deepest appreciation to our Board of Directors for their hard work and guidance, to our suppliers who are equally committed to value and quality, and to our valued customers and shareholders for their continued confidence and support.



Venence G. Côté
President and Chief Executive Officer

Historical Highlights

ZCL Composites Inc. was incorporated on September 14, **1987**. After raising private equity and financing from Western Diversification, the Company commenced the redesign and development of liquid storage products to meet the needs of the Canadian marketplace which had converted to the metric system.

In February **1988**, the exclusive right to utilize certain technical information for the manufacture and sale of underground tanks in Canada was obtained from Xerxes Corporation. The license agreement expires on December 31, 2008.

With regulatory approval from Underwriters' Laboratories of Canada (ULC) in December 1988, ZCL began production of single wall storage tanks at its new Edmonton, Alberta manufacturing plant. The Company received approval for Canada's first double wall fiberglass underground storage tank in May **1989**. Production commenced in August 1989 at the second manufacturing plant in Drummondville, Quebec.

In the same period, ZCL signed its first national contract with a Canadian major oil company. From **1989 to 1993**, the Company gained market share and earned the support of other major oil companies. Today, ZCL is privileged to have long term alliances with most major and independent oil companies, which clearly demonstrate their confidence in the Company's products and service.

ZCL continued to innovate and lead the Canadian liquid storage industry. In January **1994**, the important strategic acquisition of CAE Fiberglass Ltd., the Company's main competitor, was completed. ZCL's Preserver double wall technology, including the exclusive insurance-backed warranty against pollution, was introduced early in **1995**.

During this time, ZCL also developed fiberglass pultrusion technology for the production of residential and commercial decking and tank related products. The assets of this division were later sold in March 1998.

In September **1995**, the Company raised equity through an Initial Public Offering of its common shares on the Toronto Stock Exchange, and is listed under the symbol ZCL.

In order to create a higher value-added product for customers by presenting tanks as the central piece of a total liquid storage solution, ZCL acquired two petroleum handling equipment distributors in February **1996** and created a national distribution company, ZCL Distribution Inc. This acquisition virtually doubled the annual revenue base.

In March **1998**, the Company acquired LeGay Fiberglass (1993) Limited, a custom fiberglass tank manufacturer based in Nova Scotia. The acquisition added considerable strength in the key Atlantic Canadian market and allowed the Company to supply customers with products ranging from underground storage tanks to aquaculture tanks.



The Company entered the southeast Asian market on the strength of an alliance with a major international oil company. In September 1998, with a local partner, ZCL Enviro Systems, Inc. opened a manufacturing facility in Manila, Philippines. This operation would act as a beachhead for expansion throughout Asia and serve as a model for future global growth.

At approximately the same time, the Company incorporated ZCL-USA, Inc. with an American partner to sell its products in the large USA market. After commencement of litigation with a USA licensor in November 1998, ZCL-USA, Inc. concentrated its development and marketing efforts on the new tank lining system to meet the needs of upgrading single wall tanks across North America.

During this period, ZCL focused on the profitability and growth of its core business and pursued new product development. In February 1999, ZCL Distribution Inc. was sold to free up capital resources. In May 2000, the Company settled the litigation with the USA licensor and established the parameters for future growth. As part of the focus on operational efficiency, ISO 9002 certification of the Drummondville plant was received in November 1999 and the Edmonton plant in May 2000.

The Company's 40% interest in ZCL Enviro Systems, Inc. was sold in January 2001 to its local partner in the Philippines. ZCL Enviro Systems, Inc. continues to pay royalties under a long term licensing agreement, as well as purchase specialized raw materials from ZCL.

The Company continues to innovate in the marketplace. In the summer of 2000, the only fiberglass aboveground domestic heating oil tank surpassed stringent fire tests and was approved by ULC. In the summer of 2001, ZCL produced the first fiberglass pressure vessel for storing corrosive produced water and liquids from flare gas streams.

In June 2001, ZCL took control of the development and marketing of the tank lining technology with the acquisition of the business assets, intellectual property and proprietary know-how of ZCL-USA, Inc. Most recently, ZCL acquired Mocoat Services Inc. of Nisku and Calgary, Alberta in May 2002. This new subsidiary provides corrosion prevention services to many industries across Western Canada, and manufactures a proprietary, patent-pending tank lining or secondary containment system.

The Company now looks to growth in Canada, in the USA and internationally, utilizing the strong domestic base, customer alliances, and manufacturing expertise established since 1987. As the innovator in the industry, the vision is to be the leading global provider of environmentally-friendly liquid storage solutions.



Management's Discussion and Analysis



Tony G. Barlott
Vice President Finance &
Chief Financial Officer

The following discussion and analysis should be read in conjunction with the audited consolidated financial statements of the Company, and the notes relating thereto, as well as the Message to Shareholders and other management discussion included in this Annual Report.

This report 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 Business Environment and Risk below.

Business Overview and Outlook

Core Business and Vision

ZCL Composites Inc. was incorporated in 1987 under the Canada Business Corporations Act. The Company has grown to become Canada's leading supplier of liquid storage systems. An unrelenting drive to provide solutions to meet the needs of customers, and to manufacture superior products that "simply will not corrode", has helped make ZCL the preferred choice in many retail, industrial and consumer sectors. The Company has 90% of the Canadian major and independent oil company market, most of whom have adopted ZCL's technology as their standard for their retail networks.

The Company's core business is the manufacture and distribution of liquid storage systems, including fiberglass underground and aboveground storage tanks and related products and accessories. ZCL markets its tanks under the "Greentank" and "Protektor" trademarks, and combines tanks and related products under the "Prezerver" trademark for complete liquid storage systems carrying a \$2 million insurance-backed warranty against pollution.

ZCL has led the way in fiberglass tank technology, from the ULC listed single wall storage tank in 1988, to the development and introduction of the first double wall tank manufactured in Canada. The Company continues to innovate with expanding product lines that safely store petroleum products, hazardous liquids, sewage and water, as well as liquid storage solutions for many industries. We remain committed to continue to set the standards for economical, environmentally-safe and long-lasting liquid storage technology.

The Company predominantly serves the retail (downstream) and production (upstream) sectors of the Canadian petroleum industry, with combined revenue from these sectors

comprising approximately 85% of total revenue. Industrial and consumer products make up the remaining portion of the Company's revenue, including the aquaculture, fisheries, chemical and other industrial sectors.

Many factors drive the demand for our products. Some of these factors in the petroleum industry include:

- increased environmental legislation, standards and awareness;
- the replacement, or requirement for secondary containment and monitoring, of ageing and leaking tanks;
- demographic changes which result in changes in locations of retail gasoline outlets;
- design modifications and marketing trends that lead to changes in sites, configurations and locations;
- storage requirements for new fuels and additives;
- new entrants to retail and other markets; and
- economic conditions in the industry, including commodity prices and drilling activity.

Other industrial and consumer sectors will have similar factors, in addition to industry specific circumstances and trends.

Management's vision for the Company is to be the leading global provider of environmentally-friendly liquid storage solutions.

Business Strategy and Outlook

To realize our vision we must maintain our position in the Canadian marketplace, and pursue growth opportunities in related products and markets. Domestic and international markets

for the Company's tank manufacturing and lining technologies will continue to be developed by leveraging our customer relationships and innovative industry leadership. Continued success in reducing manufacturing costs and improving production processes will further enhance future profitability.

The Prezerver system and other product innovations, such as the Protektor aboveground tank, were introduced in recent years, and have a high level of industry acceptance. Utilizing similar technology and manufacturing expertise, a number of new products were recently successfully introduced into several market sectors. Additional products are under development, including aboveground products to compete in markets traditionally served only by steel tanks.

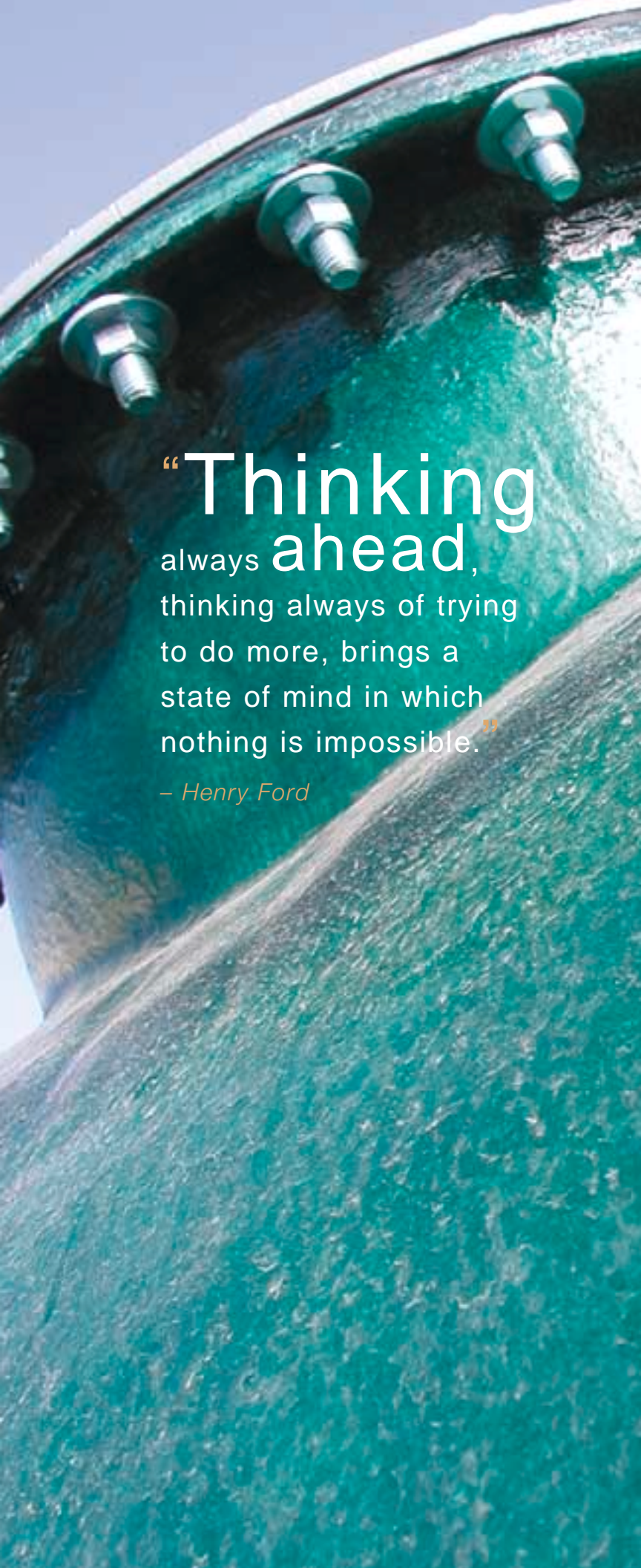
New products, which will generate increasing sources of revenue, include:

- domestic heating oil tanks to meet government regulations, and increased insurance and industry standards and awareness, for the over 1.3 million households in Canada and 6.6 million households in the USA which use heating oil;
- the horizontal Protektor II and vertical Pinnacle tanks for the safe storage of produced water, in response to the trend to aboveground low cost storage, and new industry and government guidelines, in the upstream market;
- filament wound pressure vessels for aboveground, or direct underground burial, storage of corrosive produced water and liquids from flare stacks;
- oil-water separators, to meet increasingly stringent regulations regarding water and waste-water treatment from run-off streams, as well as many other applications for the separation of oil from water;
- water and sewage holding and treatment systems, to meet the environmental needs of growing markets in rural areas, new housing developments, and recreational facilities;
- custom products in many industries, such as aquaculture, marine, agriculture, petrochemical, pulp and paper, to meet a wide variety of long-lasting, safe storage and corrosion prevention applications, and environmental regulations; and
- fiberglass restoration, tank roof systems and coating systems, to meet the corrosion protection needs in various industries.

The parameters for future growth were established with the settlement of the litigation with Xerxes Corporation, a USA licensor, in May 2000: ZCL can sell aboveground tanks and tank lining systems anywhere in the world including the United States, and can sell or license our Prezerver tank technology anywhere in the world where Xerxes does not sell tanks directly or through a licensee. These parameters were further confirmed when the Company took control of the development and marketing of our tank lining technology with the acquisition of the business assets, intellectual property and proprietary know-how of ZCL-USA, Inc. in June 2001.

Significant opportunities exist to establish ZCL's tank lining technologies as the preferred method of upgrading single wall tanks across North America, both underground and aboveground. In conjunction with an alliance of major suppliers, we are developing and testing new lining materials and processes that will provide superior quality and ease of installation. The acquisition of Mocoat Services Inc., in May 2002, provides complementary lining products and adds considerable expertise and strength in the key tank lining market.

International opportunities for our technology and our manufacturing expertise will proliferate. Our global strategy will be implemented cautiously and profitably by developing joint ventures with local partners.



“Thinking
always ahead,
thinking always of trying
to do more, brings a
state of mind in which
nothing is impossible.”

– *Henry Ford*

“ When it comes to the future, there are three kinds of people: those who let it happen, those who make it happen, and those who wonder what happened.”

– Carol Christensen



Underground liquid storage systems, marketed under the Greentank™ and Prezerver™ trademarks, comply with ULC standards and are the most environmentally sound storage systems on the market today.

In the USA marketplace, we are moving forward in a cautious and prudent manner, including not only tank lining but also aboveground tanks such as aquaculture, domestic heating oil and other specialty tanks.

Notwithstanding the economic slowdown and uncertainty in the past year, the North American petroleum industry is recovering. Certain upgrade and new installation programs in both the upstream and downstream sectors of the petroleum industry were deferred during the year because of low commodity prices and merger and acquisition activity. Many companies are forecasting major capital expenditures for the coming year.

With continued strength in our primary markets, we expect to sustain our earnings in our core business over the next year. We now look to growth in Canada, in the USA and internationally, utilizing our strong domestic base and customer alliances, our technology and manufacturing expertise, and our innovation and leadership in the industry. Major oil companies are establishing global programs relating to procurement and standardization of specifications for their liquid storage systems, including the upgrade of existing tanks that otherwise may require costly replacement.

Critical Success Factors and Capability to Deliver Results

We will take advantage of our strengths and past successes to achieve our vision and strategic goals. Our

emphasis on meeting the needs of the marketplace, and the quality of our team energized to meet these challenges, will be critical to our continuing success. At the same time, we must maintain our focus on quality manufacturing processes, cost containment and operating efficiency. Providing solutions for the liquid storage needs of our customers will depend on our ability to continue to develop and introduce new products through innovation and technology.

Steps taken to reinforce and restructure our core business significantly impacted earnings in the past. Production and overhead costs have been reduced, manufacturing margins have been increased, and the Company's financial position has been strengthened. All energy and resources are concentrated on the growth and profitability of the core business in Canada and abroad, including the development and introduction of new products into the marketplace.

Management believes it has sufficient human resources and capital assets, including facilities, and will add to the current base as required to achieve growth. Capital and product development expenditures required to achieve growth are not significant, are commensurate with increased revenue and profit opportunities, and can be financed from working capital. Information and operational systems and processes are in place and will be further enhanced as required to meet the needs of the Company.

Moving forward with a sound capital structure will allow the Company to take advantage of growth opportunities and meet all challenges in the marketplace. The recent acquisition of Mocoat Services Inc. was completed largely through the issue of common shares of the Company. Management is currently addressing the refinancing of the debenture, which is due on November 30, 2002, and other anticipated financing requirements of the Company, through a combination of conventional term debt and equity. While specific arrangements, and the mix of debt and equity, have not been finalized, management is confident that adequate financing can be established.

Consolidated Results

Basis of Presentation

The consolidated financial statements include the results and financial position of ZCL Composites Inc. and its wholly-owned subsidiaries, LeGay Fiberglass (1993) Limited and Five H Sales Ltd.

In June 2001, the Company acquired all the rights, title and interest to the business assets, intellectual property and proprietary know-how of, and redeemed its 51% interest in, ZCL-USA, Inc. The results of operations of ZCL-USA, Inc., including the non-controlling interest which represented the minority shareholder's equity interest, are included to the date of the redemption of its shares.

The Company's 40% interest in ZCL Enviro Systems, Inc. (Philippines) was sold effective January 1, 2001, and was accounted for and reported using the equity method to the date of sale. ZCL Enviro Systems, Inc. continues to pay royalties under a long term licensing agreement, as well as purchase specialized raw materials from the Company.

The Company discontinued its distribution operations during 1999 and sold the principal assets of Five H Sales Ltd. in 2000. Certain amounts relating to these discontinued operations are included in the consolidated statements as described in note 13 to the financial statements.

Subsequent to March 31, 2002, the Company acquired 100% of Mocoat Services Inc. The results of operations of this subsidiary will be included in the consolidated statements from the date of acquisition, May 1, 2002.

“**Profit** in business comes from repeat customers, customers that boast about your project or service, and that bring friends with them.”

– *W. Edwards Deming*



Aboveground tanks and filament wound pressure vessels are produced for the oil and gas industry.

“Thinking is the hardest work there is, which is probably the reason why so few engage in it.”

– Henry Ford



ULC listed aboveground fiberglass double wall domestic heating oil tanks provide safe, non-corrosive containment for home heating fuel oil.

Financial Reporting

In the Consolidated Statements of Earnings, revenue includes total amounts billed to customers for products and related services. Manufacturing and selling costs include direct materials and labour, manufacturing overhead, and marketing and selling expenses, and exclude amortization, general and administration, and other costs.

Effective April 1, 2001, the Company adopted the new recommendations of The Canadian Institute of Chartered Accountants with respect to accounting for goodwill. Under these recommendations, goodwill is not amortized but an impairment loss is recognized when events or circumstances occur that would indicate that the carrying amount of goodwill exceeds its fair value. As recommended, the change has not been applied retroactively.

Prior to the adoption of this change in accounting policy, the Company elected to disclose goodwill charges in the Consolidated Statements of Earnings as a separate line item after the provision for income taxes. Basic and diluted earnings per share are reported before and after goodwill charges.

Results

Quarterly results

Years ended March 31 (in thousands of dollars, except per share amounts)	Q1 Jun 30	Q2 Sep 30	Q3 Dec 31	Q4 Mar 31	Year
2002					
Revenue	6,607	7,857	5,772	4,874	25,110
Net earnings	387	915	459	75	1,836
Basic and diluted earnings per share	\$0.02	\$0.08	\$0.03	(\$0.02)	\$0.11
2001					
Revenue	6,495	8,537	8,405	5,907	29,344
Net earnings	225	716	436	157	1,534
Basic and diluted earnings per share	\$0.00	\$0.06	\$0.03	\$0.00	\$0.09

Results of operations include certain non-recurring costs which are generally infrequent, material and quantifiable. These costs are not considered to be part of the ongoing operations and are not expected to recur in the future. Results are discussed both including and excluding these other costs, which are described in the tables below and in note 10 to the consolidated financial statements.

Operating highlights

Years ended March 31 (in thousands of dollars)	2002	2001	2000	1999	1998
Revenue	25,110	29,344	25,704	24,121	23,872
Revenue less manufacturing and selling costs	6,579	6,706	5,895	5,354	4,747
Percent of revenue	26.2%	22.9%	22.9%	22.2%	19.9%
Earnings from continuing operations before taxes, interest and amortization (EBITDA)					
Before other costs*	4,840	5,197	4,131	3,599	3,234
After other costs	4,742	4,261	549	2,313	3,234
Operating earnings					
Before other costs*	3,504	3,420	2,887	2,636	2,581
After other costs	3,406	2,484	(695)	1,350	2,581

* Other costs are restructuring of \$98,000 (2001 – \$861,000; 2000 – \$637,000; 1999 – \$585,000; 1998 – \$Nil) and license litigation of \$Nil (2001 – \$75,000; 2000 – \$2.945 million; 1999 – \$701,000; 1998 – \$Nil).

Operating earnings

Operating earnings before other costs (restructuring and license litigation) increased to \$3.5 million this year from \$3.4 million in 2001. Operating earnings after other costs increased significantly to \$3.4 million from \$2.5 million in 2001.

The core liquid storage systems business continues to generate strong positive results. Although revenue in 2002 decreased from record levels in 2001, earnings increased over last year. This was largely due to the elimination of losses of ZCL-USA, Inc. in the last three quarters of 2002, continued success in reducing production and overhead costs, and significantly reduced restructuring and license litigation costs in 2002.

Revenue

Revenue in 2002 decreased by 14.4% to \$25.1 million, from \$29.3 million in 2001. In the latter part of 2002, various upgrade and new installation programs in both the upstream and downstream sectors of the petroleum industry were deferred because of economic and political uncertainty, low commodity prices and merger and acquisition activity. Revenue from other new products, such as the domestic heating oil tank, septic tank, and filament wound pressure vessel, although new to their markets and not as significant as the major product lines, continues to grow.

“If everyone is
thinking alike,
then somebody **isn't**
thinking.”

– Gen George S. Patton



Custom underground and aboveground tanks and related products are manufactured for a wide range of industrial and commercial sectors, including fish and lobster holding tanks for the aquaculture and marine industry.

“I can't figure the stock market out. I think it's wacky. I have done well with a **long-term strategy** and will continue being a long-term investor.”

—*Scott McNealy*



CSA approved water and sewage treatment tanks have a number of applications in a variety of industries, including domestic and recreational storage of water, waste water and household sewage.

Revenue less manufacturing and selling costs

Revenue less manufacturing and selling costs decreased slightly to \$6.6 million (26.2% of revenue) from \$6.7 million in 2001 (22.9% of revenue). The decrease is due to lower revenue. Despite lower revenue, the relative increase as a percentage of revenue can be attributed largely to reduced losses of ZCL-USA, Inc. These losses were eliminated in the last three quarters of 2002 with the acquisition of the assets and redemption of the shares of ZCL-USA, Inc. during the first quarter. Overall manufacturing margins have been maintained at similar levels as last year, with ongoing production improvements and cost reductions offsetting the effect of increased input costs.

Amortization

Amortization, excluding goodwill charges, increased slightly to \$1.328 million for the year from \$1.252 million in 2001.

As described in Note 1 to the consolidated financial statements, effective April 1, 2001, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to accounting for goodwill, and as recommended, the change has not been applied retroactively. Goodwill was not amortized this year, and no provision for impairment loss was required. Goodwill charges of \$161,000 last year were recorded as a separate line item after the provision for income taxes.

General and administration

General and administration expenses decreased to \$1.7 million in 2002 from \$2.0 million in 2001, continuing a trend experienced over the past several years (2000 – \$2.0 million; 1999 – \$1.8 million after allocation \$465,000 to discontinued operations; 1998 – \$1.5 million after allocation of \$455,000 to discontinued operations).

Other costs – restructuring and license litigation

Restructuring costs (2002 – \$98,000; 2001 – \$861,000; 2000 – \$637,000; 1999 – \$585,000; 1998 – \$Nil) consisted of legal and other costs to review the operations and resolve a dispute with the non-controlling shareholder of ZCL-USA, Inc., occupancy and other costs related to the shutdown of the Belleville, Ontario plant, and management restructuring and termination.

The restructuring of operations has been completed and no additional costs are anticipated. As part of the ZCL-USA, Inc. acquisition agreement, the claims and legal action commenced by the non-controlling shareholder were fully resolved. The plant shutdown is completed and costs in prior years included a loss on the disposal of the property in 1999. Management restructuring and termination last year included the renegotiation and renewal of the President and CEO's contract and the elimination of a senior management position.

License litigation costs (2002 – \$Nil; 2001 – \$75,000; 2000 – \$2.9 million; 1999 – \$701,000; 1998 – \$Nil) were legal fees and other costs related to the litigation with Xerxes Corporation in the USA. This litigation was fully settled in May 2000 and no further costs have been incurred with respect to this matter. The \$75,000 cost in 2001 related to the expired option to purchase Xerxes' global license business, which was paid as part of the settlement.

Interest

Interest for the year decreased to \$313,000 from \$570,000 in 2001, reflecting lower bank indebtedness and long-term debt levels and reduced interest rates.

Income from affiliate

The Company's 40% interest in ZCL Enviro Systems, Inc. (Philippines) was sold effective January 1, 2001, and was accounted for and reported using the equity method to the date of sale.

Income taxes

Future income taxes relate primarily to the utilization of losses of prior years for income tax purposes, and include \$145,000 (2001 – \$49,000) related to the effect on future tax assets of a reduction in federal and provincial income tax rates.

Current income taxes include capital taxes and withholding taxes incurred on royalties from ZCL Enviro Systems, Inc. (Philippines).

The Company has accumulated losses for tax purposes which may be carried forward to reduce taxable income in future years as described in note 11 to the consolidated financial statements. The potential income tax benefit of these losses has been recognized for accounting purposes.

Non-controlling interest

The results of operations of ZCL-USA, Inc., including the non-controlling interest which represented the minority shareholder's equity interest, are included to the date of the redemption of its shares in June 2001.

Net earnings

The table below outlines the basic and diluted earnings (loss) per share for the years 1998 to 2002. In the calculation of basic and diluted earnings (loss) per share, the net earnings (loss) was adjusted for the costs, net of future income tax benefits, of the convertible subordinated debenture. Stock options and warrants are not included in the calculation of diluted shares as their exercise prices exceeded the average market share price for the years. The convertible subordinated debenture is not included in the calculation of diluted shares as the market share price was below the threshold conversion price of \$3.00.

Net earnings (loss) highlights

Years ended March 31 (in thousands of dollars, except per share amounts)	2002	2001	2000	1999	1998
Net earnings (loss) from continuing operations after goodwill charges					
Before other costs**	1,901	2,128	1,380	1,039	1,070
Per share	\$0.12	\$0.15	\$0.08	\$0.04	\$0.09
After other costs	1,836	1,534	(895)	222	1,070
Per share	\$0.11	\$0.09	(\$0.17)	(\$0.05)	\$0.09
Net earnings (loss) from discontinued operations	—	—	(225)	1635	(5,228)
Net earnings (loss) for the year after goodwill charges	1,836	1,534	(1,120)	1,857	(4,158)
Per share	\$0.11	\$0.09	(\$0.19)	\$0.00	(\$0.49)

** Other costs are the net amounts, after income taxes, of restructuring and license litigation costs.

The after-tax effect of other costs (restructuring and license litigation) was a reduction in basic and diluted net earnings (loss) per share of \$0.01 for 2002, \$0.06 for 2001, \$0.25 for 2000, \$0.09 for 1999 and \$Nil for 1998.

There were no discontinued operations in 2002 and 2001. Discontinued operations in 2000 and 1999 related to the sale of distribution operations, and 1998 related to the disposal of the pultrusion assets.

Financial Condition and Liquidity

Working capital increased by over \$2.5 million during the year to \$7.4 million, as current assets remained constant at \$11.7 million at March 31, 2002, and current liabilities decreased by \$2.5 million to \$4.3 million. This increase is related to the profitable operating results for the year and the redemption of the shares of ZCL-USA, Inc.

Note 2 to the consolidated financial statements describes the agreement receivable of \$1.2 million due from ZCL Enviro Systems, Inc. (Philippines). While it is expected that this receivable will be collected in full, there is credit risk associated with the collection of the amount.

Cash flows from continuing operating activities decreased to \$2.6 million this year from \$5.0 million in 2001. This decrease is due to the timing of cash receipts and payments during the years. Cash of \$113,000 was used for discontinued operations in 2002, and certain further accrued costs will be paid out in the next year.

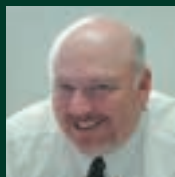
Cash used for financing activities remained constant at \$1.3 million in 2002. Scheduled repayment of long-term debt was \$722,000 (2001 – \$719,000), and convertible subordinated debenture cash costs were \$563,000 (2001 – \$562,000).

Cash used in investing activities increased to \$1.2 million in 2002 from \$142,000 in 2001. In 2002, assets of \$996,000 were acquired from ZCL-USA, Inc. as described in note 15 to the consolidated financial statements. Last year, proceeds were received from the sales of the interest in ZCL Enviro Systems, Inc. (\$245,000) and the assets of Five H Sales Ltd. (\$236,000). Capital assets of \$155,000 (2001 – \$528,000) were purchased, related largely to the acquisition of equipment to manufacture new products and increase production capacity and efficiency, and the upgrade of computer equipment.

Bank operating lines of credit in excess of \$10 million are available, of which no amounts were drawn at March 31, 2002 and 2001. Total long-term debt decreased to \$1.9 million at March 31, 2002, from \$2.6 million in 2001.

Total shareholders' equity increased to \$18.8 million at March 31, 2002 from \$17.1 million in 2001, as a result of the earnings for the year and the net convertible subordinated debenture costs. In accordance with Canadian generally accepted accounting principles relating to financial instruments, \$7.6 million (2001 – \$7.0 million) of the remaining convertible subordinated debenture, including accretion of the additional amount payable at maturity, has been presented as equity. Costs of the debenture, net of future tax benefits, are charged directly to deficit.

*Ron Fink, National Operations Manager.
Joined ZCL in 1989*



*Nelson Reason, Project and
Maintenance Coordinator. Joined
the ZCL team at start-up in 1988*

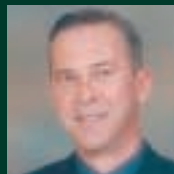


15
years
1987 – 2002
of excellence

*Debbie Saanum,
Payroll Supervisor.
With us since 1988*



*Claude Duval,
National Sales and
Marketing Manager.
Joined ZCL in 1989*



ZCL values the input of all its employees, many of whom are shareholders. Our strength as a corporation lies in the technical savvy of a diverse skill base and the excellent products our people produce. We are grateful for their loyal support and admire their dedication and hard work. Shown here are some of the longer serving members of our team.

*Denis Michaud,
Drummondville Plant
Foreman. Part of the team
since 1988*



*Derek Bolianatz, Lining Systems Manager.
With ZCL since 1988*



*Peter Shackley, Engineering Manager.
Joined ZCL in 1994, and was with
CAE from 1969*



*Phil McGill, Edmonton
Maintenance Manager. Joined
the ZCL team at start-up in 1988*

A close-up, artistic photograph of the Canadian flag, showing the red and white colors and the maple leaf design. The flag is draped and folded, creating soft shadows and highlights. The text is overlaid on the bottom left portion of the image.

Canada's
#1 Selling
Fiberglass Tanks

Business Environment and Risk

In the normal course of business, the Company's operations continue to be influenced by a number of internal and external factors, and exposed to risks and uncertainties, that can affect its business, financial condition and operating results.

The activities of the Company are subject to ongoing operational risks including the performance of key suppliers, product performance, government and other industry regulations, successful integration of new acquisitions, dependence on key personnel, and reliance on information systems, all of which may affect the ability of the Company to meet its obligations. The ongoing ability to meet the needs of the marketplace is dependent on the development and introduction of new products and services. While management believes its innovation and technology make it a leader in the industry, revenue and results may be affected if products are not accepted in the marketplace, are not approved by regulatory authorities, or if products are not brought to market in a timely manner.

ZCL is engaged in competitive markets, subject to global economic and political influences and the financial strength of its customers. The Company is the leading manufacturer of fiberglass underground storage tanks in Canada, and its technology and products (high value-added complete liquid storage systems), operating structure, and professional customer service, differentiate it from its competitors. Although the primary market for ZCL's products continues to be the Canadian petroleum industry, expanding into global markets, and other markets beyond the petroleum industry, will minimize the dependency on any particular industry or economic sector.

The Company manufactures and sells products that have a direct impact on the environment. The Company maintains high quality standards at its production facilities, uses only the most reputable suppliers for raw materials and other products distributed, and has an unblemished history of no liability nor warranty problems. ZCL also maintains insurance coverage for its operations, including general liability insurance. Each Prezerver fuel storage system carries a \$2 million insurance-backed warranty against pollution for a period of ten years. There is no guarantee that insurance will sufficiently cover all potential claims, or that adequate or any insurance can be obtained or maintained. Liability or claims may also arise that cannot be insured or management may choose not to insure due to high premiums or for other reasons.

The Company's operating results are reported in Canadian dollars. A portion of the revenue and expenses are generated or incurred in other currencies, largely United States dollars, Euros and Philippines pesos. The exchange rate risk, on an annual basis, primarily reflects the impact of fluctuating exchange rates on the net difference between revenue and expenses in each of the currencies. Exposures to foreign currency fluctuations are not hedged. Substantially all business activities are currently carried out in Canada, but it is anticipated that this will be a continuing risk in the future as the Company continues to expand into global markets.

Management Report

The Annual Report, including the consolidated financial statements, is the responsibility of the management of the Company. The consolidated financial statements were prepared by management in accordance with accounting principles generally accepted in Canada. When alternative accounting methods exist, management has chosen those it considers most appropriate in the circumstances. The significant accounting policies used are described in note 1 to the consolidated financial statements. The integrity of the information presented in the financial statements, including estimates and judgments relating to matters not concluded by year end, is the responsibility of management. Financial information presented elsewhere in this Annual Report has been prepared by management and is consistent with the information in the consolidated financial statements.

Management is responsible for the establishment and maintenance of systems of internal accounting and administrative controls which are designed to provide reasonable assurance that the financial information is accurate and reliable, and that the Company's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities and for final approval of the annual consolidated financial statements. The Board appoints an Audit Committee comprising three directors, none of whom is an officer or employee of the Company or its subsidiaries. The Audit Committee meets at least four times each year to discharge its responsibilities under a written mandate from the Board of Directors. The Audit Committee meets with management and with the independent auditors to satisfy itself that they are properly discharging their responsibilities, reviews the consolidated financial statements and the Auditors' Report, and examines other auditing and accounting matters.

The consolidated financial statements have been reviewed by the Audit Committee and approved by the Board of Directors of ZCL Composites Inc. The consolidated financial statements have been examined by the shareholders' auditors, Ernst & Young LLP, Chartered Accountants. The Auditors' Report outlines the nature of their examination and their opinion on the consolidated financial statements of the Company. The independent auditors have full and unrestricted access to the Audit Committee, with and without management being present.



Venence G. Côté
President and
Chief Executive Officer



Tony G. Barlott
Vice President Finance
and Chief Financial Officer

Auditors' Report

To the Shareholders of
ZCL Composites Inc.

We have audited the consolidated balance sheets of **ZCL Composites Inc.** as at March 31, 2002 and 2001 and the consolidated statements of deficit, earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Edmonton, Canada
May 23, 2002

Ernst & Young LLP
Chartered Accountants

Consolidated Balance Sheets

As at March 31	2002	2001
(in thousands of dollars)	\$	\$
Assets [notes 6, 7 and 8]		
Current		
Cash	191	193
Accounts receivable [note 2]	5,510	5,501
Proceeds receivable [note 2]		515
Current portion of agreement receivable	1,016	
Inventories [note 3]	4,738	4,861
Prepaid expenses	186	269
Future tax asset	44	350
	11,685	11,689
Agreement receivable [note 2]	230	
Capital assets [note 4]	6,951	7,410
Other assets [note 5]	2,434	2,514
Goodwill	1,926	1,926
Future tax asset	1,263	2,541
	24,489	26,080
Liabilities and Shareholders' Equity		
Current		
Accounts payable and accrued liabilities	3,304	5,863
Income taxes payable	97	76
Current portion of long-term debt	731	723
Convertible subordinated debenture – liability portion [note 7]	200	200
	4,332	6,862
Long-term debt [note 8]	1,181	1,911
Government grants	194	219
	5,707	8,992
Commitments and contingency [note 16]		
Shareholders' equity		
Capital stock [note 9]	20,078	20,078
Convertible subordinated debenture – equity portion [note 7]	7,635	6,962
Contributed surplus	45	45
Deficit	(8,976)	(9,997)
	18,782	17,088
	24,489	26,080

See accompanying notes

On behalf of the Board:



Venence G. Côté
Director



Ian Brown
Director

Consolidated Statements of Deficit

Years ended March 31	2002	2001
(in thousands of dollars)	\$	\$
Deficit, beginning of the year	(9,997)	(10,813)
Net earnings for the year	1,836	1,534
Convertible subordinated debenture costs, net of future tax benefit of \$421,000 (2001 – \$413,000) [note 7]	(815)	(718)
Deficit, end of the year	(8,976)	(9,997)

See accompanying notes

Consolidated Statements of Earnings

Years ended March 31	2002	2001
(in thousands of dollars)	\$	\$
Revenue [note 2]	25,110	29,344
Manufacturing and selling costs [note 14]	18,531	22,638
	6,579	6,706
Amortization	1,328	1,252
General and administration	1,747	2,034
Restructuring costs [note 10]	98	861
License litigation costs [note 10]		75
Operating earnings	3,406	2,484
Interest [note 8]	313	570
Income from affiliate [note 2]		(20)
Earnings before income taxes and other	3,093	1,934
Income taxes [note 11]		
Current	40	39
Future	1,225	705
	1,265	744
Earnings before goodwill charges and non-controlling interest	1,828	1,190
Goodwill charges [note 1]		161
Non-controlling interest	(8)	(505)
Net earnings for the year	1,836	1,534
Basic and diluted earnings per share [note 12]:		
Before goodwill charges	\$0.11	\$0.11
After goodwill charges	\$0.11	\$0.09

See accompanying notes

Consolidated Statements of Cash Flows

Years ended March 31	2002	2001
(in thousands of dollars)	\$	\$
Cash Flows from Operating Activities		
Cash receipts from customers	23,714	31,657
Cash paid to suppliers and employees	(20,877)	(26,087)
Interest paid	(241)	(504)
Income taxes paid	(19)	(18)
Cash flows from continuing operations	2,577	5,048
Cash flows from discontinued operations	(113)	86
	2,464	5,134
Cash Flows from Financing Activities		
Repayment of long-term debt	(722)	(719)
Convertible subordinated debenture costs	(563)	(562)
	(1,285)	(1,281)
Cash Flows from Investing Activities		
Collection of proceeds receivable [note 13]		236
Proceeds from sale of affiliate [note 2]		245
Acquisition of assets [note 15]	(996)	
Purchase of capital assets	(155)	(528)
Cost of other assets	(30)	(95)
	(1,181)	(142)
Increase (decrease) in cash	(2)	3,711
Cash (bank indebtedness), beginning of the year	193	(3,518)
Cash, end of the year	191	193

See accompanying notes

Notes to Consolidated Financial Statements

March 31, 2002 and 2001

1. Significant Accounting Policies

The Company's business is the manufacture and distribution of liquid storage systems including fiberglass underground storage tanks. Substantially all business activities are carried out in Canada.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Because the precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period necessarily involves the use of estimates and approximations which have been made using careful judgment. Actual results could differ from those estimates and approximations. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

Basis of presentation

The consolidated financial statements include the accounts of ZCL Composites Inc. (the "Company") and its subsidiary companies, consisting of LeGay Fiberglass (1993) Limited (100%), Five H Sales Ltd. (100%), and ZCL-USA, Inc. (51% – see note 15). All significant intercompany transactions and balances have been eliminated in the preparation of these consolidated financial statements. Non-controlling interest represented the minority shareholder's equity interest in ZCL-USA, Inc.

Revenue recognition

Revenue is recorded and related costs are transferred to manufacturing and selling costs upon change of ownership. This normally occurs at the time of shipment of the product, however in circumstances where the customer chooses to temporarily store goods on the Company's premises, revenue is recognized upon manufacturing completion.

Income taxes

The Company uses the liability method to account for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Foreign currency translation

Financial statements of foreign subsidiaries included in the consolidated financial statements are translated as follows: monetary items at the rate of exchange in effect at the balance sheet date; non-monetary items at historical exchange rates; and revenue and expense items at the average exchange rate for the year. Any resulting gains or losses are included in income in the period incurred.

Notes to Consolidated Financial Statements continued

March 31, 2002 and 2001

1. Significant Accounting Policies (continued)

Inventories

Raw materials are valued at the lower of cost, determined on an average cost basis, and replacement cost. Work in progress and finished goods are valued at the lower of manufacturing cost and net realizable value on a specific item basis. Manufacturing cost includes the cost of raw material, direct labour costs, and applicable production overheads.

Capital assets

Capital assets are recorded at cost. Amortization is computed using the declining balance method at the following annual rates:

Buildings	4%
Land improvements	10%
Manufacturing equipment	10%
Office equipment	20%

Other assets

Amortization of other assets is computed using the straight-line method over the following periods:

Product and market development costs	5 – 10 years
Licenses	term of licensing agreements
Deferred start-up costs	5 years
Deferred finance charges	term of loan or 5 years

Certain costs relating to the development of new products, markets and facilities are capitalized as product and market development or deferred start-up costs.

Management regularly assesses the carrying value of other assets, based on its projections of operating income and undiscounted cash flows, for any impairment in that carrying value, and recognizes any write-down which is required in the period in which permanent impairment is identified.

Government grants

Government grants relating to capital assets have been recorded as a deferred credit and are being amortized on the same basis as the capital assets.

Financial instruments

The fair value of financial assets and financial liabilities approximates carrying value.

Stock option plan

The Company has a stock option plan, which is more fully described in note 9. No compensation expense is recognized for these plans when stock options are issued. Any consideration paid on the exercise of stock options is credited to share capital. If stock or stock options are repurchased the excess of the consideration paid over the carrying amount of the stock or stock options canceled is charged to retained earnings.

Earnings per share

Basic earnings per share is computed based on the weighted average number of common shares outstanding during the year. Diluted earnings per share is computed using the treasury stock method, which assumes that the cash that would be received on the exercise of options is applied to purchase shares at the average price during the period and that the difference between the shares issued upon exercise of the options and the number of shares obtainable under this computation, on a weighted average basis, is added to the number of shares outstanding. Antidilutive options are not considered in computing diluted earnings per share.

Change in accounting policy – goodwill

Effective April 1, 2001, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to accounting for goodwill. Under these recommendations, goodwill is not amortized but an impairment loss is recognized when events or circumstances occur that would indicate that the carrying amount of goodwill exceeds its fair value. As recommended, the change has not been applied retroactively.

Reconciliations of reported net earnings and earnings per share to amounts adjusted to exclude amortization of goodwill are as follows:

(in thousands of dollars)	2002 \$	2001 \$
Reported net earnings for the year	1,836	1,534
Goodwill charges		161
Adjusted net earnings for the year	1,836	1,695

Basic and diluted earnings per share

Reported net earnings for the year	\$0.11	\$0.09
Goodwill charges		0.02
Adjusted net earnings for the year	\$0.11	\$0.11

2. Agreement Receivable

Effective January 1, 2001, the Company sold its 40% interest in ZCL Enviro Systems, Inc. ("Enviro"), a corporation incorporated under the laws of the Philippines, for \$760,000. The Company has had the following transactions with Enviro since January 1, 2001:

(in thousands of dollars)	January 1, 2001 \$	Revenue \$	Payments received \$	March 31, 2002 \$
Accounts receivable	903	365	(537)	731
Proceeds receivable	760		(245)	515
	1,663	365	(782)	1,246

Notes to Consolidated Financial Statements continued

March 31, 2002 and 2001

2. Agreement Receivable (continued)

The accounts receivable were subject to regular credit terms and the proceeds receivable were originally due by March 2002. Due to political and economic circumstances, Enviro did not make all payments when due and has now agreed to pay the remaining balance, plus interest, in installments by June 30, 2003. Under the terms of the sale agreement, the Company is entitled to the return of its 40% interest in Enviro should payments not be received.

Management is of the opinion that the amounts owing, plus interest, will be collected in full. There is credit risk associated with the collection of these amounts.

The following amounts relate to Enviro:

(in thousands of dollars)	2002 \$	2001 \$
Revenue	200	518
Accounts receivable		904
Proceeds receivable		515
Agreement receivable	1,246	

Income from affiliate is comprised of:

(in thousands of dollars)	2002 \$	2001 \$
Share of loss		(40)
Gain on disposal		60
	—	20

These transactions have been recorded at their exchange amounts.

3. Inventories

(in thousands of dollars)	2002 \$	2001 \$
Raw materials	2,114	2,057
Work in progress	160	234
Finished goods	2,464	2,570
	4,738	4,861

4. Capital Assets

(in thousands of dollars)	2002		2001	
	Cost	Accumulated amortization	Cost	Accumulated amortization
	\$	\$	\$	\$
Land	293		293	
Buildings	2,852	696	2,852	606
Land improvements	154	66	116	57
Manufacturing equipment	8,664	4,561	8,564	4,118
Office equipment	1,040	729	1,030	664
	13,003	6,052	12,855	5,445
Net book value		6,951		7,410

Amortization of \$589,000 (2001 – \$606,000), net of government grant amortization of \$25,000 (2001 – \$24,000), was recorded on the capital assets.

5. Other Assets

(in thousands of dollars)	2002		2001	
	Cost	Accumulated amortization	Cost	Accumulated amortization
	\$	\$	\$	\$
Product and market development costs	2,690	709	514	229
Licenses	682	488	682	435
Deferred start-up costs	707	455	3,340	1,435
Deferred finance charges	40	33	796	719
	4,119	1,685	5,332	2,818
Net book value		2,434		2,514

Amortization of \$808,000 (2001 – \$731,000) was recorded on the other assets.

6. 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 0.50% (4.25%; 2001 – 7.00%). The bank indebtedness contains certain restrictive covenants including the maintenance of certain financial ratios and the limitation of capital expenditures. The Company has pledged as collateral for the bank indebtedness a general security agreement and collateral mortgage totaling \$15,000,000; a first floating charge on inventory and book debts and a second floating charge against all other assets of the Company; second chattel mortgages against capital assets; and a pledge of inventory under section 427 of the Bank Act.

Notes to Consolidated Financial Statements continued

March 31, 2002 and 2001

7. Convertible Subordinated Debenture

During 1998, the Company received \$11,000,000 under a convertible subordinated debenture bearing interest at 9.75%. The debenture, plus an amount accruing daily sufficient to generate to the lender an additional rate of return of 8.25% per annum (the "Additional Amount Payable"), is due on November 30, 2002. A first fixed and floating charge and general security agreement over all assets of the Company, subject to the charges of the operating and term lenders, an assignment of insurance policies, and all intellectual property have been pledged as collateral for the debenture. The debenture agreement contains certain restrictive covenants including the maintenance of certain financial ratios and the limitation of capital expenditures. Warrants to purchase 500,000 common shares of the Company at a price of \$2.45, expiring on November 30, 2002, were issued to the lender in connection with the debenture.

In 1999 and 2000, the Company repaid \$5,500,000 of the debenture. A make-whole premium based on the present value, over the period remaining to maturity of the debenture, of the difference between the debenture interest rate of 9.75% and the lender's reinvestment rate of return, is payable on amounts repaid. Subsequent to the year-end, the Company agreed to make monthly payments of \$100,000 on the debenture commencing in May 2002. No make-whole premium is payable on these monthly repayments.

The debenture, and the Additional Amount Payable, are convertible with 120 days notice to common shares of the Company at the Company's option, at any time after May 1, 2002. Any interest payable under the debenture is convertible with 120 days notice to common shares of the Company at any time at the Company's option. The conversions are at a price per share equal to the twenty-day weighted average trading price of the shares on The Toronto Stock Exchange, providing that this price is greater than \$3.00.

In accordance with Canadian generally accepted accounting principles relating to financial instruments, convertible debt is classified, in its component parts, as a liability or as equity in accordance with the substance of the contractual arrangements.

The component parts have been measured at their respective estimated fair values, and assessed probability of settlement, at the time the debenture was issued. The liability portion of the debenture, in the amount of \$200,000 (2001 – \$200,000), has been calculated as the interest conversion notice period of 120 days. The balance of the debenture plus the accretion of the Additional Amount Payable has been presented as shareholders' equity. This amount will continue to be increased during the period to maturity to reflect further accretion of the Additional Amount Payable.

8. Long-Term Debt

	2002	2001
(in thousands of dollars)	\$	\$
Term loan bearing interest at the rate of the lender's cost of funds plus 2.5%, payable in monthly instalments of \$46,400 plus interest until December 2003; the interest rate applied at March 31, 2002 was 5.112% (2001 – 7.948%)	939	1,495
Property term loan bearing interest at the lender's cost of funds plus 2.75%, payable in monthly instalments ranging from \$5,000 to \$10,000 plus interest until March 2010; the interest rate applied at March 31, 2002 was 5.362% (2001 – 8.198%)	823	899
Bank loan bearing interest at prime rate plus 1.00%, payable in instalments of \$7,500 plus interest until November 2003; the interest rate applied at March 31, 2002 was 4.75% (2001 – 7.50%)	150	240
	1,912	2,634
Less current portion	731	723
	1,181	1,911

The aggregate amount of payments required to meet retirement provisions is as follows:

(in thousands of dollars)	\$
2003	731
2004	530
2005	96
2006	100
2007	108
Thereafter	347
	1,912

The term loan agreement contains certain restrictive covenants including the maintenance of certain financial ratios and limitations on the redemption of capital stock of the Company. As collateral for the term loan, the lender holds a first floating charge against all assets of the Company (except as described below), subject to the first charge of the operating lender with respect to inventories and book debts and an assignment of certain licenses.

As collateral for the property term loan, the lender holds a specific charge on certain land and buildings.

As collateral for the bank loan, the lender holds a specific charge on land and buildings and a security interest over assets of a subsidiary, and other security as described in note 6. The bank loan agreement contains certain restrictive covenants including the maintenance of certain financial ratios and the limitation of capital expenditures.

Notes to Consolidated Financial Statements continued

March 31, 2002 and 2001

8. Long-Term Debt (continued)

Interest expense

Interest expense on long-term and short-term indebtedness was as follows:

	2002	2001
(in thousands of dollars)	\$	\$
Long-term	174	283
Short-term	70	202
Amortization of deferred finance charges	69	85
	313	570

9. Capital Stock

Authorized

Unlimited number of common shares

Issued and outstanding

	2002	2001
(in thousands of dollars)	\$	\$
9,295,866 common shares (2001 – 9,295,866)	20,078	20,078

Stock options

Under the Company's stock option plan, options to purchase common shares may be granted by the Board of Directors to directors, officers, employees, and persons who provide management or consulting services to the Company. Options are granted based on market price at the issue date. The maximum term of options is five years, commencing twelve months after the date the option is granted.

The Company is authorized to issue options to acquire 500,000 (2001 – 1,125,000) common shares. The Company has issued 180,000 (2001 – 925,000) of these options, of which Nil (2001 – 347,400) have been forfeited and cannot be reissued. These options expire on dates between November 2002 and March 2006. The following options have been issued:

	2002		2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
	#	\$	#	\$
Balance, beginning of the year	577,600	3.76	974,100	3.81
Issued			5,000	5.00
Forfeited	(397,600)	4.42	(401,500)	3.90
Balance, end of the year	180,000	2.28	577,600	3.76

Range of Exercise Price \$	2002				
	Options Outstanding			Options Exercisable	
	Number Outstanding #	Weighted Average Exercise Price \$	Weighted Average Remaining Contractual Life in Years	Number Exercisable #	Weighted Average Exercise Price \$
2.10-3.00	110,000	2.88	0.8	110,000	2.88
1.35	70,000	1.35	3.9	70,000	1.35
1.35-3.00	180,000	2.28	2.0	180,000	2.28

Warrants

	2002		2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
	#	\$	#	\$
Balance, beginning of the year	600,000	2.62	600,000	2.62
Expired	50,000	4.25		
Balance, end of the year	550,000	2.47	600,000	2.62

The warrants expire in November 2002.

10. Other Costs

Restructuring

Restructuring costs consist of the following:

	2002	2001
(in thousands of dollars)	\$	\$
Occupancy and other costs relating to the shutdown of the Belleville, Ontario plant		70
Management restructuring and termination		520
Legal and other costs to review the operations and resolve a dispute with the non-controlling shareholder of ZCL-USA, Inc.	98	271
	98	861

License litigation

During 2001, the Company settled a legal dispute with a licensor relating to patent infringement claims regarding certain tank products of the Company and certain territorial matters under its license. Under the settlement agreement, a portion of future royalties from the Company's licensee in the Philippines are required to be paid to the licensor.

License litigation costs of \$75,000 in 2001 related to an expired option to purchase the licensor's global licence business.

Notes to Consolidated Financial Statements continued

March 31, 2002 and 2001

11. Income Taxes

The Company's effective income tax expense has been determined as follows:

(in thousands of dollars)	2002 \$	2001 \$
Statutory federal and provincial taxes	1,268	762
Increase (decrease) in income taxes resulting from:		
Manufacturing and processing allowance	(217)	(124)
Impact of changes in tax rates	145	49
Non-deductible expenses and other items	69	57
	1,265	744

Significant components of the Company's future tax assets and liabilities are as follows:

(in thousands of dollars)	2002 \$	2001 \$
Future tax assets		
Loss carryforwards	2,212	4,302
Accounting reserves not deductible until future periods	30	328
Financing fees and other	95	168
	2,337	4,798
Future tax liabilities		
Tax amortization in excess of accounting	1,030	1,907
Net future tax assets	1,307	2,891
Less current portion	44	350
Net future tax assets – non-current	1,263	2,541

The Company and certain of its subsidiaries have accumulated losses for tax purposes of approximately \$6,474,000 which may be carried forward and used to reduce taxable income in future years.

The tax losses available for carryforward must be claimed in years ending no later than:

(in thousands of dollars)	\$
2003	22
2004	18
2005	1,507
2006	2,691
2007	1,976
2008	13
2009	247

The potential income tax benefit associated with these losses has been recognized for accounting purposes.

12. Earnings Per Share

Reconciliations for purposes of the determination of the basic and diluted per share computations for earnings before and after goodwill charges are as follows:

(in thousands of dollars)	2002 \$	2001 \$
Earnings before goodwill charges and non-controlling interest	1,828	1,190
Non-controlling interest	8	505
Convertible subordinated debenture costs, net of future tax benefit	(815)	(718)
Earnings before goodwill charges available to common shareholders	1,021	977
Net earnings after goodwill charges	1,836	1,534
Convertible subordinated debenture costs, net of future tax benefit	(815)	(718)
Net earnings after goodwill charges available to common shareholders	1,021	816
	#	#
Basic and diluted shares outstanding	9,295,866	9,295,866

Stock options and warrants are not included in the calculation of diluted shares as their exercise prices exceed the average market share price for the years.

The convertible subordinated debenture is not included in the calculation of diluted shares as the market share price at both March 31, 2002 and 2001 was below the threshold conversion price of \$3.00.

13. Discontinued Operations

The Company discontinued certain distribution operations during 1999. For reporting purposes, the results and cash flows of these operations have been disclosed separately from the continuing operations. The remaining proceeds receivable from the sale of the discontinued operations of \$236,000 were collected in 2001.

The remaining current liabilities relating to the discontinued operations are \$395,000 (2001 – \$508,000).

14. Related Party Transactions

Trucking services of \$266,000 (2001 – \$291,000) were provided by a corporation controlled by a director of the Company. Normal commercial rates were paid for these services.

These related party transactions have been recorded at their exchange amounts.

Notes to Consolidated Financial Statements continued

March 31, 2002 and 2001

15. Acquisitions

ZCL-USA Inc.

In June 2001, the Company acquired the rights, title and interest to the business assets, intellectual property and proprietary know-how of ZCL-USA, Inc. Under agreement with MSP Technologies Corporation, the former 49% non-controlling shareholder, the Company paid US\$580,000, redeemed its shares in ZCL-USA, Inc. and assigned all advances and other amounts owing from ZCL-USA, Inc. MSP Technologies Corporation, ZCL-USA, Inc., and the former President and CEO of ZCL-USA, Inc. agreed not to compete with the Company in the United States, Mexico, Canada and the Philippines.

During the year ended March 31, 2001, the non-controlling shareholder had commenced legal action against the Company, alleging breach of certain agreements and other misrepresentations. Management was confident that these claims were without merit, but they were fully resolved as part of the acquisition agreement.

The consolidated financial statements include the results of operations of the subsidiary, including non-controlling interest, to the date of the redemption of these shares. Assets and liabilities disposed of were as follows:

(in thousands of dollars)	\$
Assets	
Current assets	73
Capital assets	13
Other assets	1,364
Future tax asset	780
	2,230
Liabilities	
Current liabilities	1,114

The net investment and amounts owing from ZCL-USA, Inc. and a portion of the amount paid under the acquisition agreement were capitalized as product and market development costs and included in other assets as follows:

(in thousands of dollars)	\$
Net investment and amounts owing	1,116
Net cash consideration	946
Product and market development costs	2,062

As part of the agreement, the Company also paid \$50,000 to acquire inventories and capital assets.

Mocoat Services Inc.

Subsequent to the year-end, the Company acquired 100% of the shares of Mocoat Services Inc. pursuant to an arm's length transaction. Mocoat Services Inc. is an Alberta-based corporation that provides preventative corrosion services to the oil and gas industry in Western Canada and manufactures a proprietary patent-pending tank lining or internal secondary containment system.

The purchase price was \$1,250,000, made up of cash of \$50,000 paid on closing and 909,090 shares of the Company at a price of \$1.10, with the balance of \$200,000, subject to final adjustments, payable on October 31, 2002 in cash or shares of the Company at the option of the vendors.

16. Commitments and Contingency

License agreements

The Company has entered into license agreements which expire October 31, 2006 and December 31, 2008. The agreements give the Company exclusive rights to manufacture and sell fiberglass underground storage tanks in certain geographic areas utilizing the licensors' production processes.

These license agreements provide for the payment of royalties based on revenues from related products during the license terms. Aggregate minimum royalty payments under these license agreements are \$387,500 per annum for the next five years and approximately \$489,000 in the aggregate thereafter.

Operating leases

The minimum annual rentals under the terms of operating leases for automotive, office and other equipment, and premises are as follows:

(in thousands of dollars)	\$
2003	229
2004	174
2005	134
2006	20
2007	6
	563

17. Comparative Figures

Certain comparative figures have been reclassified to conform with the presentation adopted for the current year.

Corporate Information

Board of Directors

Gilles A. Voyer, Chairman of the Board
Venence G. Côté, Director, President and CEO
Ian Brown, Director
Raymond Désormeaux, Director
Simon Sochatsky, Director

Transfer Agent & Registrar

Computershare Trust Company
of Canada
970 Canadian Western Bank Place
10303 Jasper Avenue
Edmonton, Alberta
T5J 3N6

Annual General Meeting

1:00 pm on August 19, 2002
at The Westin Edmonton
10135 - 100 Street
Edmonton, Alberta

Auditors

Ernst & Young LLP
1801 Scotia 2
Scotia Place
10060 Jasper Avenue
Edmonton, Alberta
T5J 3R8

Corporate Office

6907 - 36 Street
Edmonton, Alberta,
Canada
T6B 2Z6

General Counsel

Parlee McLaws
Suite 1500, Manulife Place
10180 - 101 Street
Edmonton, Alberta
T5J 4K1

Common Shares Outstanding

as of June 30, 2002
Total Outstanding: 10,204,956

Investor Relations

Copies of this Annual Report
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Tony Barlott, at 780-466-6648,
or email tony.barlott@zcl.com

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

ZCL
COMPOSITES INC.



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EQUIPMENT