ZCL COMPOSITES INC.

Second Quarter 2002 Report

Report to Shareholders

Our earnings continued to grow significantly in the second quarter. Net earnings grew to $915,000 ($1.3 million for six months), and basic and diluted earnings per share increased to $0.08 ($0.10 for six months). Revenue for the second quarter decreased somewhat to $7.9 million ($14.5 million for six months) from record levels last year.

Our impressive growth in earnings for the six-month period was achieved even after additional future income tax expense in the first quarter of $145,000, or $0.016 per share ($nil last year), relating to the effect of a reduction in Provincial income tax rates. These positive results reflect the continued strength of the domestic markets over this period, and underscore our success in reducing manufacturing costs and overheads. We are now realizing the benefits of the restructuring of our operations.

Notwithstanding the current economic slowdown and uncertainty, the North American petroleum industry is expected to rebound. We have developed, and continue to explore, new markets for our products. Utilizing our technology and manufacturing expertise, a number of new products have been introduced into several market sectors.

Oil and gas companies have maintained their upgrade and new installation programs in both the upstream and downstream segments of the petroleum industry. We are privileged to have new or renewed long term alliance agreements with many of the major oil and other companies in the retail gasoline industry. These long term contracts with our customers clearly demonstrate their confidence in our products and services, and enhance our future growth and profitability.

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.

Losses of ZCL-USA, Inc. were eliminated with the acquisition of the assets and redemption of the shares in the first quarter. We are moving forward in the USA marketplace in a prudent manner, including not only tank lining but also aboveground tanks such as aquaculture, domestic fuel oil and other specialty tanks.

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

We continue to look to the future with confidence. Growth will be achieved in an overall continuing strong market for our products, and from new products introduced into the marketplace. With reduced costs and manufacturing efficiencies, we are in a stronger financial position than ever before.

Venence G. Côté
President & Chief Executive Officer

Tony G. Barlott
Vice President Finance & Chief Financial Officer

November 14, 2001

Management's Discussion and Analysis

This discussion and analysis should be read in conjunction with the Company's 2001 audited consolidated financial statements and related notes, as well as Management's Discussion and Analysis contained in the 2001 Annual Report and the Report to Shareholders included in this Second Quarter Report.

Operating Results

The operating results for the second quarter and six-month period are very positive. These significantly improved earnings reflect the substantial cost savings achieved in manufacturing processes and the benefits of the restructuring of operations.

Revenue in the second quarter decreased to $7.9 million ($14.5 million for six months) from $8.5 million ($15.0 million for six months) in 2000. Revenue was $7.5 million for the second quarter and $13.2 million for the six-month period in 1999. The petroleum industry market maintained its strength during the second quarter. Revenue from new products, such as the Protektor aboveground tank, domestic heating oil tank and septic tank, and from other sectors using our products continues to grow. Historically, the second and third quarters have the highest levels of activity.

Net earnings for the second quarter of $915,000 ($1.3 million for six months) are up significantly from earnings of $716,000 for the quarter ($941,000 for six months) last year. After adjusting for the costs of the convertible subordinated debenture, basic and diluted earnings per share for the quarter was $0.08 ($0.10 for six months) as compared to $0.06 for the quarter ($0.06 for six months) last year. 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 periods. 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.

Operating earnings before amortization, general and administration and other costs increased from \$2.2 million in the second quarter and \$3.4 million (22.7% of revenue) for six months last year, to \$2.3 million in the quarter and \$4.0 million (27.8% of revenue) for six months this year. This increase can be attributed largely to reduced losses of ZCL-USA, Inc. These losses were eliminated in the second quarter this year 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. Ongoing improvements to production processes and reductions in overhead costs have offset the effect of increased raw material and other input costs.

Amortization, excluding goodwill charges, increased to \$358,000 in the second quarter (\$647,000 for six months) from \$329,000 for the quarter (\$657,000 for six months) last year. 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. As recommended, the change has not been applied retroactively. No amortization of goodwill was recorded this year, and goodwill charges of \$40,000 in the second quarter (\$80,000 for six months) last year are recorded as a separate line item after the provision for income taxes.

General and administration expenses decreased to \$451,000 in the second quarter (\$853,000 or 5.9% of revenue for six months) this year from \$605,000 (\$1.1 million or 7.5% of revenue for six months) last year. This reduction is a result of the restructuring undertaken over the past year. Restructuring costs of \$98,000 in the first quarter of this year (\$nil last year) related to legal and other costs to review the operations and resolve the dispute with the non-controlling shareholder of ZCL-USA, Inc., including a portion of the amount paid under the acquisition agreement in June 2001. The claims and legal action commenced by the non-controlling shareholder were fully resolved as part of that agreement.

Interest decreased from $137,000 for the second quarter ($306,000 for six months) last year to $110,000 for the quarter ($203,000 for six months) this year, reflecting lower bank indebtedness and long-term debt levels and reduced interest rates. There is no loss from affiliate this year as a result of the sale of the 40% interest in ZCL Enviro Systems, Inc. last year.

Financial Position and Liquidity

Working capital increased to $7.0 million at September 30, 2001, from $4.8 million at March 31, 2001 and $3.4 million at September 30, 2000, an increase of $3.6 million over the past twelve months. This increase is related to the profitable operating results over this period, and the redemption of the shares of ZCL-USA, Inc.

Due to the timing of cash receipts and payments during the quarter, cash flows from operating activities increased to $3.6 million in the second quarter ($2.3 million for six months) this year from $155,000 for the quarter ($1.2 million for six months) last year. Cash of $322,000 for the second quarter ($643,000 for six months) used in financing activities remained at the same level as last year. Cash required for investing activities was $66,000 in the second quarter ($1.1 million for six months) this year, as compared to $85,000 for the quarter ($201,000 for six months) last year. During the first quarter of this year, assets of $996,000 were acquired from ZCL-USA, Inc.

Bank operating lines of credit of $3.2 million were drawn at September 30, 2000, as compared to cash of $688,000 at September 30, 2001 (cash of $193,000 at March 31, 2001). Long-term debt decreased to $2.3 million, from $2.6 million at March 31, 2001 and $3.0 million at September 30, 2000. Total shareholders' equity increased to $18.3 million, as a result of the earnings less the convertible subordinated debenture costs for the period.

Consolidated Financial Statements

Consolidated Balance Sheets

(Unaudited)

(in thousands of dollars)

Assets

Current

Cash

Accounts receivable

Proceeds receivable

Inventories

Prepaid expenses

Future tax asset

Capital assets

Other assets (note 2)

Goodwill (note 1)

Future tax asset (note 3)

Liabilities and Shareholders' Equity

Current

Accounts payable and accrued liabilities

Income taxes payable

Current portion of long-term debt

Convertible subordinated debenture - liability portion

Long-term debt

Government grants

Shareholders' equity

Capital stock

Convertible subordinated debenture - equity portion

Contributed surplus

Deficit

See accompanying notes

	September 30 2001 $	March 31 2001 $
	688	193
	6,517	5,501
	515	515
	4,319	4,861
	279	269
	330	350
	12,648	11,689
	7,204	7,410
	2,856	2,514
	1,926	1,926
	1,071	2,541
	25,705	26,080
	4,626	5,863
	86	76
	729	723
	200	200
	5,641	6,862
	1,546	1,911
	207	219
	7,394	8,992
	20,078	20,078
	7,279	6,962
	45	45
	(9,091)	(9,997)
	18,311	17,088
	25,705	26,080

Consolidated Statements of Earnings and Deficit

(Unaudited)

Periods ended September 30

(in thousands of dollars)

Revenue	
Manufacturing and selling costs	
Amortization	
General and administration	
Restructuring costs	
Operating earnings	
Interest	
Loss from affiliate	
Earnings before income taxes and other	
Income taxes	
Current	
Future (note 3)	
Earnings before goodwill charges and non-controlling interest	
Goodwill charges (note 1)	
Non-controlling interest	
Net earnings for the period	
Deficit, beginning of the period	
Convertible subordinated debenture costs, net of future tax benefit	
Deficit, end of the period	
Basic and diluted earnings per share (note 1):	
Before goodwill charges	
After goodwill charges	

See accompanying notes

	Three months		Six months	
	2001	2000	**2001**	2000
	$	$	$	$
	7,857	8,537	**14,464**	15,032
	5,526	6,360	**10,440**	11,626
	2,331	2,177	**4,024**	3,406
	358	329	**647**	657
	451	605	**853**	1,124
			98	
	1,522	1,243	**2,426**	1,625
	110	137	**203**	306
		65		55
	1,412	1,041	**2,223**	1,264
	7	7	**14**	13
	490	405	**915**	485
	497	412	**929**	498
	915	629	**1,294**	766
		40		80
		(127)	**(8)**	(255)
	915	716	**1,302**	941
	(9,809)	(10,764)	**(9,997)**	(10,813)
	(197)	(173)	**(396)**	(349)
	(9,091)	(10,221)	**(9,091)**	(10,221)
	$0.08	$0.06	**$0.10**	$0.07
	$0.08	$0.06	**$0.10**	$0.06

Consolidated Statements of Cash Flows

(Unaudited)

Periods ended September 30

(in thousands of dollars)

Cash Flows from Operating Activities

Cash receipts from customers

Cash paid to suppliers and employees

Interest paid

Income taxes paid

Cash flows from continuing operations

Cash flows from discontinued operations

Cash Flows from Financing Activities

Repayment of long-term debt

Convertible subordinated debenture costs

Cash Flows from Investing Activities

Collection of proceeds receivable

Acquisition of assets

Product and market development costs (note 2)

Inventory and capital assets

Purchase of capital assets

Cost of other assets

Increase (decrease) in cash

Cash (bank indebtedness), beginning of the period

Cash (bank indebtedness), end of the period

See accompanying notes

Three months		Six months	
2001	2000	**2001**	2000
$	$	$	$
7,544	5,879	**13,100**	14,235
(3,841)	(5,616)	**(10,602)**	(12,859)
(94)	(115)	**(164)**	(264)
(7)		**(4)**	(4)
3,602	148	**2,330**	1,108
(20)	7	**(46)**	54
3,582	155	**2,284**	1,162
(180)	(180)	**(359)**	(359)
(142)	(141)	**(284)**	(283)
(322)	(321)	**(643)**	(642)
	101		202
		(928)	
		(68)	
(56)	(151)	**(119)**	(348)
(10)	(35)	**(31)**	(55)
(66)	(85)	**(1,146)**	(201)
3,194	(251)	**495**	319
(2,506)	(2,948)	**193**	(3,518)
688	(3,199)	**688**	(3,199)

Notes to Consolidated Financial Statements (Unaudited)

September 30, 2001 and 2000

1. Significant Accounting Policies

These unaudited interim consolidated financial statements should be read in conjunction with the March 31, 2001 annual consolidated financial statements. The same accounting policies and methods in accordance with Canadian generally accepted accounting principles are followed as in the March 31, 2001 consolidated financial statements, except as follows:

Change in accounting policy – goodwill

Effective April 1, 2001, the Company has elected to adopt 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:

Period ended September 30, 2000 (in thousands of dollars, except per share amounts)	Three months $	Six months $
Reported net earnings for the period	**716**	**941**
Goodwill charges	**40**	**80**
Adjusted net earnings for the period	**756**	**1,021**
Basic and diluted earnings per share:		
Reported net earnings for the period	**$0.06**	**$0.06**
Goodwill charges	**0.00**	**0.01**
Adjusted net earnings for the period	**$0.06**	**$0.07**

2. Acquisition of Assets

On June 6, 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.

Last fiscal year, 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.

For reporting purposes, 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	**928**
Product and market development costs	**2,044**

3. Future Income Taxes

The provision for future income taxes for the six-month period includes $145,000 (2000 – $nil) relating to the effect on future tax assets of a reduction in Provincial income tax rates.

ZCL COMPOSITES INC.

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

www.zcl.com

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