ZCL COMPOSITES INC.

Third Quarter 2002 Report

Report to Shareholders

The Company's performance continued to be strong in the third quarter. Net earnings grew to $459,000 ($1.8 million for nine months), and basic and diluted earnings per share were $0.03 ($0.13 for nine months). Revenue for the third quarter decreased to $5.8 million ($20.2 million for nine months) from record levels last year.

Our growth in earnings for the nine-month period was achieved even after an additional future income tax expense in the first quarter of $145,000, or $0.016 per share ($nil last year), related to the effect of a change in Provincial income tax rates. These positive results underscore our success in reducing manufacturing costs and overheads and the restructuring of our operations.

Notwithstanding the current economic slowdown and uncertainty, the North American petroleum industry is expected to rebound. Low commodity prices and merger and acquisition activity have resulted in the deferral of some of the upgrade and new installation programs in both the upstream and downstream sectors of the industry. Many companies are forecasting major capital expenditures for the coming year.

We are privileged to have long term alliance agreements with many of the major companies in the retail gasoline industry, which clearly demonstrate their confidence in our products and services. Utilizing our technology and manufacturing expertise, we have introduced new products into several market sectors. We have also developed, and continue to explore, new markets for our products.

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.

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. 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 fuel oil and other specialty tanks. Losses in the United States were eliminated with the acquisition of the assets and redemption of the shares of ZCL-USA, Inc. in the first quarter.

Over the past two years, we have concentrated our efforts on restructuring our operations, reducing costs and achieving manufacturing efficiencies—these efforts have been very successful and are reflected in our strong results. We are in a stronger financial position than ever before. We now look to growth in Canada, in the USA and internationally, utilizing our strong domestic base, our proven technology, and our innovation and leadership in the industry.

Venence G. Côté
President & Chief Executive Officer

Tony G. Barlott
Vice President Finance & Chief Financial Officer

February 15, 2002

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 Third Quarter Report.

Operating Results

Cost savings achieved in manufacturing processes and from the restructuring of operations have resulted in continuing positive earnings for the quarter and nine-month period. Historically, the second and third quarters have the highest levels of activity.

Net earnings for the third quarter increased to $459,000 ($1.8 million for nine months) from $436,000 ($1.4 million for nine months) last year. After adjusting for the costs of the convertible subordinated debenture, basic and diluted earnings per share for the quarter were $0.03 ($0.13 for nine months) as compared to $0.03 for the quarter ($0.09 for nine 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 subordinate debenture is not included in the calculation of diluted shares as the market share price was below the threshold conversion price of $3.00.

Revenue in the third quarter decreased to $5.8 million ($20.2 million for nine months) from record levels of $8.4 million ($23.4 million for nine months) in 2000. Revenue was $5.7 million for the third quarter and $18.9 million for the nine-month period in 1999. Certain upgrade and new installation programs in both the upstream and downstream sectors of the petroleum industry were deferred during the period because of low commodity prices and merger and acquisition activity. The industry is expected to recover and many companies are forecasting major capital expenditures for the coming year. Revenue from new products, such as the Protektor aboveground tank, domestic heating oil tank and septic tank, and from other sectors using our products, continued to grow.

Revenue less manufacturing and selling costs decreased from $2.1 million in the third quarter last year to $1.5 million this year, but remained constant at $5.5 million for the nine-month period (increased from 23.6% of revenue last year to 27.4% of revenue this year). The decrease for the quarter is due to lower revenue. Despite lower revenue, the overall increase for the nine-month period can be attributed largely to reduced losses of ZCL-USA, Inc. These losses were eliminated in the second and third quarters of 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, with ongoing production improvements and overhead cost reductions offsetting the effect of increased raw material and other input costs.

Amortization, excluding goodwill charges, increased slightly to $332,000 in the third quarter ($979,000 for nine months) from $308,000 for the quarter ($965,000 for nine 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 third quarter ($120,000 for nine months) last year are recorded as a separate line item after the provision for income taxes.

General and administration expenses decreased to $416,000 in the third quarter ($1.3 million or 6.3% of revenue for nine months) from $471,000 ($1.6 million or 6.8% of revenue for nine 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 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. Last year, restructuring costs of $537,000 consisted of legal and other costs related to ZCL-USA and management restructuring and termination; license litigation costs of $75,000 were the costs of the expired option to purchase Xerxes Corporation's global license business.

Interest decreased from $160,000 for the third quarter ($466,000 for nine months) last year to $55,000 for the quarter ($258,000 for nine months) this year, reflecting lower bank indebtedness and long-term debt levels and reduced interest rates.

With the sale of the 40% interest in ZCL Enviro Systems, Inc. last year, there is no further equity accounting for the share of income from affiliate. Sales proceeds instalments and certain other amounts due this year have not yet been collected, and management continues to work with Enviro Systems to collect the outstanding amounts. Enviro Systems operates in the Philippines under a long term licensing agreement.

Financial Position and Liquidity

Working capital increased to $7.7 million at December 31, 2001, from $4.8 million at March 31, 2001 and $3.9 million at December 31, 2000, an increase of $3.8 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 period, cash flows from operating activities decreased to $1.2 million in the third quarter ($3.5 million for nine months) from $3.8 million for the quarter ($4.9 million for nine months) last year. Cash required for investing activities was $35,000 in the third quarter ($1.2 million for nine months), as compared to $77,000 for the quarter ($278,000 for nine months) last year. During the first quarter of this year, assets of $996,000 were acquired from ZCL-USA, Inc.

Cash was $1.5 million at December 31, 2001, as compared to $193,000 at March 31, 2001 and $180,000 at December 31, 2000. Long-term debt decreased to $2.1 million, from $2.6 million at March 31, 2001 and $2.8 million at December 31, 2000. Total shareholders' equity increased to $18.7 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)	**December 31 2001 $**	March 31 2001 $
Assets		
Current		
Cash	**1,543**	193
Accounts receivable	**5,216**	5,501
Proceeds receivable	**515**	515
Inventories	**4,172**	4,861
Prepaid expenses	**232**	269
Future tax asset	**330**	350
	12,008	11,689
Capital assets	**7,087**	7,410
Other assets (note 2)	**2,652**	2,514
Goodwill (note 1)	**1,926**	1,926
Future tax asset (note 3)	**924**	2,541
	24,597	26,080
Liabilities and Shareholders' Equity		
Current		
Accounts payable and accrued liabilities	**3,278**	5,863
Income taxes payable	**92**	76
Current portion of long-term debt	**731**	723
Convertible subordinated debenture – liability portion	**200**	200
	4,301	6,862
Long-term debt	**1,363**	1,911
Government grants	**200**	219
	5,864	8,992
Shareholders' equity		
Capital stock	**20,078**	20,078
Convertible subordinated debenture – equity portion	**7,441**	6,962
Contributed surplus	**45**	45
Deficit	**(8,831)**	(9,997)
	18,733	17,088
	24,597	26,080

See accompanying notes

Consolidated Statements of Earnings and Deficit

(Unaudited)

Periods ended December 31	Three months		Nine months	
	2001	2000	**2001**	2000
(in thousands of dollars)	$	$	$	$
Revenue	**5,772**	8,405	**20,236**	23,437
Manufacturing and selling costs	**4,250**	6,289	**14,690**	17,915
	1,522	2,116	**5,546**	5,522
Amortization	**332**	308	**979**	965
General and administration	**416**	471	**1,269**	1,595
Restructuring costs		537	**98**	537
License litigation costs		75		75
Operating earnings	**774**	725	**3,200**	2,350
Interest	**55**	160	**258**	466
Loss (income) from affiliate		(15)		40
Earnings before income taxes and other	**719**	580	**2,942**	1,844
Income taxes				
Current	**10**	13	**24**	26
Future (note 3)	**250**	210	**1,165**	695
	260	223	**1,189**	721
Earnings before goodwill charges and non-controlling interest	**459**	357	**1,753**	1,123
Goodwill charges (note 1)		40		120
Non-controlling interest		(119)	**(8)**	(374)
Net earnings for the period	**459**	436	**1,761**	1,377
Deficit, beginning of the period	**(9,091)**	(10,221)	**(9,997)**	(10,813)
Convertible subordinated debenture costs, net of future tax benefit	**(199)**	(175)	**(595)**	(524)
Deficit, end of the period	**(8,831)**	(9,960)	**(8,831)**	(9,960)
Basic and diluted earnings per share (note 1):				
Before goodwill charges	**$0.03**	$0.03	**$0.13**	$0.10
After goodwill charges	**$0.03**	$0.03	**$0.13**	$0.09

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

Periods ended December 31	Three months		Nine months	
	2001	2000	**2001**	2000
(in thousands of dollars)	$	$	$	$
Cash Flows from Operating Activities				
Cash receipts from customers	**6,950**	10,708	**20,050**	24,943
Cash paid to suppliers and employees	**(5,647)**	(6,813)	**(16,249)**	(19,672)
Interest paid	**(43)**	(146)	**(207)**	(410)
Income taxes paid	**(4)**	1	**(8)**	(3)
Cash flows from continuing operations	**1,256**	3,750	**3,586**	4,858
Cash flows from discontinued operations	**(45)**	25	**(91)**	79
	1,211	3,775	**3,495**	4,937
Cash Flows from Financing Activities				
Repayment of long-term debt	**(181)**	(180)	**(540)**	(539)
Convertible subordinated debenture costs	**(140)**	(139)	**(424)**	(422)
	(321)	(319)	**(964)**	(961)
Cash Flows from Investing Activities				
Collection of proceeds receivable		34		236
Acquisition of assets				
Product and market development costs (note 2)			**(928)**	
Inventory and capital assets			**(68)**	
Purchase of capital assets	**(21)**	(91)	**(140)**	(439)
Cost of other assets	**(14)**	(20)	**(45)**	(75)
	(35)	(77)	**(1,181)**	(278)
Increase in cash	**855**	3,379	**1,350**	3,698
Cash (bank indebtedness), beginning of the period	**688**	(3,199)	**193**	(3,518)
Cash, end of the period	**1,543**	180	**1,543**	180

See accompanying notes

Notes to Consolidated Financial Statements (Unaudited)

December 31, 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 December 31, 2000 (in thousands of dollars, except per share amounts)	Three months $	Nine months $
Reported net earnings for the period	**436**	**1,377**
Goodwill charges	**40**	**120**
Adjusted net earnings for the period	**476**	**1,497**
Basic and diluted earnings per share:		
Reported net earnings for the period	**$0.03**	**$0.09**
Goodwill charges	**0.00**	**0.01**
Adjusted net earnings for the period	**$0.03**	**$0.10**

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**

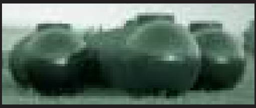
The net investment and amounts owing from ZCL-USA, Inc. and a portion of the amount paid under the acquisition agreement were capitalized as product and market development costs and included in other assets as follows:

(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 nine-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.



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