Third Quarter 2003

Report

ZCL COMPOSITES INC.

Message to Shareholders

The lower level of activity in many industry sectors, experienced in the latter part of last year and the first part of this year, continued in the third quarter. While overall business is down, we have maintained our strong market position. The acquisitions of Mocoat Services Inc. ("Mocoat") and Parabeam Industries BV ("Parabeam"), together with the increased demand for new products recently introduced, especially domestic heating oil tanks, have added to revenue. As a result, our revenues for the third quarter increased by 18.5% to $6.8 million from $5.8 million last year. For the nine-month period, revenue decreased by 3.7% to $19.5 million from $20.2 million last year.

Activity picked up somewhat in the downstream sector of the petroleum industry, but the upstream side remained sluggish with the delayed start to the drilling season and the economic and political conditions in the industry. Notwithstanding the economic conditions and uncertainty, many companies are forecasting major capital expenditures for 2003.

The reduced activity in the upstream sector, coupled with losses incurred by Mocoat and Parabeam as these operations are integrated into our overall business, has impacted earnings. Past measures taken to improve production efficiencies and cut costs have diminished the effect of the slowdown in business. Consequently, net earnings for the third quarter declined to $108,000 or $0.01 per share ($752,000 or $0.02 per share for the nine-month period) as compared to $459,000 or $0.03 per share ($1.8 million or $0.13 per share for the nine-month period) last year.

We all share a common vision for ZCL: to be the leading global provider of environmentally-friendly liquid storage solutions. To realize this vision, and attain the corresponding growth in revenue and earnings, we must maintain our position in the Canadian marketplace, as well as pursue new opportunities in related products and markets. We are focusing on the key factors to bring about these results.

Steps have been taken to reinforce and restructure our core business in Canada. Quality manufacturing processes have been implemented, operating efficiencies have been achieved, and production and overhead costs have been reduced.

The Company's financial position has been strengthened. We completed the private placement to ARC Energy Venture Fund 3 in September 2002. ARC is a major shareholder and the type of partner that understands our industry and our business, and shares our vision for the Company.

This private placement, together with the refinancing of our long-term debt with CIBC, was used to repay the subordinated convertible debenture. The elimination of the significant costs of the debenture will further contribute to positive results – in the first six months of this year before the repayment, net costs of the debenture were $461,000 or almost $0.04 per share.

We now continue to work towards finalizing the development and marketing of our tank lining technologies and new tank products. Key components and technologies have been added. In the first quarter, Mocoat's expertise and proprietary technology were acquired. In the second quarter, we completed the purchase of Parabeam to ensure the supply of this proprietary three-dimensional glass fabric that is an integral part of our double wall tanks and tank lining products.

We have a solid core business in Canada. We must now expand domestic and international markets for our tank manufacturing and lining technologies by leveraging our innovative industry leadership and customer relationships.

Venence G. Côté
President & Chief Executive Officer

Tony G. Barlott
Vice President Finance & Chief Financial Officer

February 14, 2003

Management's Discussion and Analysis

This discussion and analysis should be read in conjunction with the Company's March 31, 2002 annual consolidated financial statements and related notes, as well as Management's Discussion and Analysis contained in the 2002 Annual Report and the Message to Shareholders included in this Third Quarter Report.

Operating Results

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. Historically, the second and third fiscal quarters have the highest levels of activity, corresponding to the installation of underground liquid storage systems in Canada.

Net earnings

Net earnings for the third quarter decreased to $108,000 ($752,000 for nine months) from $459,000 in the quarter ($1.8 million for nine months) last year. After adjusting for the costs of the convertible subordinated debenture (the "debenture"), the basic and diluted earnings per share for the quarter was $0.01 ($0.02 for nine months) as compared to $0.03 for the quarter ($0.13 for nine months) last year. The debenture was fully repaid in the second quarter, and no further associated costs have been incurred.

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 debenture was also not included in the calculation of diluted shares as the market share price was below the threshold conversion price.

Revenue

Revenue increased by 18.5% in the third quarter to $6.8 million from $5.8 million last year, and decreased overall by 3.7% for the nine-month period to $19.5 million from $20.2 million last year.

The acquisitions of Mocoat Services Inc. ("Mocoat") and Parabeam Industries BV ("Parabeam"), as well as new products introduced in recent years, such as the domestic heating oil tank, contributed to revenue for the quarter and offset the impact of reduced activity in many industry sectors. In the third quarter, activity picked up in the downstream sector of the petroleum industry, but remained sluggish in the upstream side with the delayed start to the drilling season and economic and political uncertainty.

Revenue less manufacturing and selling costs

Revenue less manufacturing and selling costs decreased from $1.5 million, or 26.4% of revenue, in the third quarter ($5.5 million for nine months) last year, to $1.2 million, or 17.1% of revenue, in the quarter ($4.1 million for nine months) this year. This decrease is related largely to the acquisitions of Mocoat and Parabeam. Steps are being taken to integrate these operations into the overall liquid storage business and finalize the development and marketing of the tank lining technologies. Overall manufacturing margins have been maintained at similar levels as last year, and efforts continue to further improve production processes and reduce costs.

Amortization

Amortization increased to $497,000 for the third quarter ($1.5 million for nine months) from $332,000 for the quarter ($979,000 for nine months) last year. The increase is due to the amortization of assets from the acquisitions of Mocoat and Parabeam, and the product and market development costs relating to the purchase of the assets of ZCL-USA, Inc. last year.

The Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to accounting for goodwill effective April 1, 2001, and accordingly, no amortization of goodwill was recorded either this year or last year.

General and administration

General and administration expenses decreased to $370,000 for the third quarter ($1.2 million for nine months) from $416,000 ($1.3 million for nine months) last year. These costs have been reduced through restructuring and cost reduction efforts over the past several years.

Restructuring costs

Restructuring costs of $98,000 in the first quarter of last year ($Nil this year) related to ZCL-USA, Inc. The restructuring of operations has been completed and no additional costs are anticipated.

Interest

Interest for the third quarter increased to $110,000 ($291,000 for nine months) from $55,000 ($258,000 for nine months) last year. The increase in the third quarter is due to the higher level of long-term debt.

Over the nine-month period, bank indebtedness was lower than last year, offset by an increase in long-term and other debt associated with the acquisition of Mocoat as described in Note 2(a) and the refinancing in the second quarter as described in Note 3(b). Although the Company has taken on some additional bank term debt, the corresponding much higher costs of the debenture have been eliminated.

Income taxes

The provision for future income taxes for the first quarter last year included $145,000 ($Nil this year) relating to the effect on future tax assets of a reduction in Provincial income tax rates.

Financial Position and Liquidity

Cash was $2.9 million at December 31, 2002, as compared to $191,000 at March 31, 2002 and $1.5 million at December 31, 2001. The Company has bank operating lines of credit of $10.5 million that are not utilized.

Due to the timing of cash receipts and payments during the period, cash provided by operating activities increased to $3.3 million in the third quarter ($4.5 million for nine months) this year, from $1.2 million for the quarter ($3.5 million for nine months) last year.

Cash flows from financing activities this year reflect the $7.0 million private placement of common shares and warrants to ARC Energy Venture Fund 3 ("ARC"), the refinancing of bank term debt, and the repayment of the debenture in the second quarter as described in Note 3. Cash flows from investing activities include the acquisitions of Mocoat and Parabeam this year, and the purchase of assets of ZCL-USA, Inc. last year.

ZCL Enviro Systems, Inc. ("Enviro Systems") paid $31,000 in the third quarter ($307,000 over nine months) under the agreement receivable. The balance remaining at December 31, 2002 was $939,000, and a further $58,000 was paid in February 2003. In order to pay off these amounts, Enviro Systems has continued to take steps to improve its manufacturing operations and margins and reduce costs. Certain payments under the agreement have not been made as scheduled, and management is considering alternative terms that may further extend payments. While it is expected that this receivable will be collected in full, there is credit risk associated with the collection of this amount.

Working capital increased to $9.4 million at December 31, 2002, from $7.9 million at March 31, 2002 and $7.7 million at December 31, 2001. The increase is related to the profitable operating results over the period.

Long-term debt, excluding current portion, increased to $4.1 million from $1.2 million at March 31, 2002 with the acquisition of Mocoat and the refinancing of bank term debt. Total shareholders' equity increased to $19.1 million as a result of the issue of common shares relating to the private placement to ARC and the acquisition of Mocoat, the earnings for the period, less the repayment and costs of the debenture.

Consolidated Balance Sheets

(Unaudited)

(in thousands of dollars)	**December 31 2002 $**	March 31 2002 $
Assets		
Current		
Cash	**2,883**	191
Accounts receivable	**4,592**	5,510
Current portion of agreement receivable	**939**	1,016
Inventories	**4,968**	4,738
Prepaid expenses	**132**	186
Future tax asset	**421**	554
	13,935	12,195
Agreement receivable		230
Capital assets	**8,090**	6,951
Other assets	**3,660**	2,434
Goodwill	**1,926**	1,926
Future tax asset	**592**	753
	28,203	24,489
Liabilities and Shareholders' Equity		
Current		
Accounts payable and accrued liabilities	**3,717**	3,304
Income taxes payable	**83**	97
Current portion of long-term debt	**714**	731
Convertible subordinated debenture – liability portion (note 3c)		200
Future tax liability	**34**	
	4,548	4,332
Long-term debt (note 3b)	**4,108**	1,181
Government grants	**176**	194
Future tax liability	**295**	
	9,127	5,707
Shareholders' equity		
Capital stock (notes 2a and 3a)	**27,378**	20,078
Convertible subordinated debenture – equity portion (note 3c)		7,635
Contributed surplus (note 3a)	**745**	45
Deficit	**(9,047)**	(8,976)
	19,076	18,782
	28,203	24,489

See accompanying notes

Consolidated Statements of Earnings and Deficit

(Unaudited)

Periods ended December 31	Three months		Nine months	
(in thousands of dollars)	**2002 $**	2001 $	**2002 $**	2001 $
Revenue	**6,840**	5,772	**19,479**	20,236
Manufacturing and selling costs	**5,668**	4,250	**15,336**	14,690
	1,172	1,522	**4,143**	5,546
Amortization	**497**	332	**1,461**	979
General and administration	**370**	416	**1,151**	1,269
Restructuring costs				98
Operating earnings	**305**	774	**1,531**	3,200
Interest	**110**	55	**291**	258
Earnings before income taxes and non-controlling interest	**195**	719	**1,240**	2,942
Income taxes				
Current	**7**	10	**23**	24
Future (note 4)	**80**	250	**465**	1,165
	87	260	**488**	1,189
Earnings before non-controlling interest	**108**	459	**752**	1,753
Non-controlling interest				(8)
Net earnings for the period	**108**	459	**752**	1,761
Deficit, beginning of the period	**(9,155)**	(9,091)	**(8,976)**	(9,997)
Common share issue costs, net of future tax benefit (note 3a)			**(362)**	
Convertible subordinated debenture costs, net of future tax benefit (note 3c)		(199)	**(461)**	(595)
Deficit, end of the period	**(9,047)**	(8,831)	**(9,047)**	(8,831)
Weighted average number of shares outstanding – basic and diluted	**17,573,378**	9,295,866	**12,678,032**	9,295,866
Shares outstanding, end of the period	**17,573,378**	9,295,866	**17,573,378**	9,295,866
Basic and diluted earnings per share	**$0.01**	$0.03	**$0.02**	$0.13

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

Periods ended December 31 (in thousands of dollars)	Three months 2002 $	Three months 2001 $	Nine months 2002 $	Nine months 2001 $
Cash Flows from Operating Activities				
Cash receipts from customers	**9,637**	6,950	**21,270**	20,050
Cash paid to suppliers and employees	**(6,232)**	(5,647)	**(16,434)**	(16,249)
Interest paid	**(104)**	(43)	**(294)**	(207)
Income taxes paid	**(13)**	(4)	**(37)**	(8)
Cash flows from continuing operations	**3,288**	1,256	**4,505**	3,586
Cash flows from discontinued operations	**(1)**	(45)	**(33)**	(91)
	3,287	1,211	**4,472**	3,495
Cash Flows from Financing Activities				
Issue of long-term debt (note 3b)			**5,000**	
Finance costs (note 3b)	**(25)**		**(164)**	
Repayment of long-term debt (note 3b)	**(208)**	(181)	**(3,097)**	(540)
Issue of common shares and warrants (note 3a)			**7,000**	
Common share issue costs (note 3a)	**(20)**		**(548)**	
Repayment of subordinated convertible debenture (note 3c)			**(8,185)**	
Convertible subordinated debenture costs (note 3c)		(140)	**(348)**	(424)
	(253)	(321)	**(342)**	(964)
Cash Flows from Investing Activities				
Collection of agreement receivable	**31**		**307**	
Business acquisitions, including bank indebtedness assumed (note 2)	**(248)**		**(1,499)**	
Acquisition of assets				(996)
Purchase of capital assets	**(57)**	(21)	**(235)**	(140)
Cost of other assets	**(7)**	(14)	**(11)**	(45)
	(281)	(35)	**(1,438)**	(1,181)
Increase in cash	**2,753**	855	**2,692**	1,350
Cash, beginning of the period	**130**	688	**191**	193
Cash, end of the period	**2,883**	1,543	**2,883**	1,543

See accompanying notes

Notes to Consolidated Financial Statements

(Unaudited)

December 31, 2002 and 2001

1. Significant Accounting Policies

These unaudited interim consolidated financial statements should be read in conjunction with the March 31, 2002 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, 2002 consolidated financial statements, except as follows:

Change in accounting policy – stock-based compensation

Effective April 1, 2002 the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to stock-based compensation and other stock-based payments. As permitted under these recommendations, the Company has applied this change prospectively for new awards granted on or after April 1, 2002. The Company has chosen to recognize no compensation expense when stock options and warrants are granted to employees and directors under plans with no cash or equity settlement features. However, direct awards of shares to employees and non-employees, and awards granted to non-employees, are accounted for in accordance with the fair value method of accounting for stock-based compensation. In periods prior to April 1, 2002, the Company recognized no compensation when shares, stock options or warrants were issued.

The fair value of direct awards of shares are determined by the quoted market price of the Company's shares at the date of grant and the fair value of stock options and warrants are determined, at the date of grant, using the Black-Scholes option pricing model. The following table provides the required pro-forma measures of net earnings and earnings per share had compensation expense been recognized based on the fair value, as at the date of the grant, of the options and performance warrants granted to employees in 2002, in accordance with the fair value method of accounting for stock-based compensation:

Period ended December 31, 2002:

(in thousands of dollars, except earnings per share)	Three months $	Nine months $
Net earnings for the period	**108**	**752**
Compensation expense	**54**	**56**
Pro-forma net earnings for the period	**54**	**696**
Earnings per share:		
Reported basic and diluted earnings per share	**0.01**	**0.02**
Compensation expense per share	**0.00**	**0.00**
Pro-forma basic and diluted earnings per share	**0.01**	**0.02**

The estimated fair value of these options and performance warrants was determined using the following weighted-average assumptions, resulting in a weighted-average fair value of $0.37 per option and $0.38 per performance warrant:

Risk-free interest rate (%)	4.0
Expected hold period to exercise (years)	options 4.0 / performance warrants 5.0
Volatility in the price of the corporation's shares (%)	options 61.6 / performance warrants 56.2
Dividend yield (%)	0.0

2. Business Acquisitions

a) Mocoat Services Inc.

In May 2002, the Company acquired 100% of the shares of Mocoat Services Inc. Mocoat Services Inc. is an Alberta-based corporation that provides corrosion prevention services to the oil and gas industry in Western Canada and manufactures a proprietary patent-pending tank lining or internal secondary containment system.

As part of the approval of this acquisition, the convertible subordinated debenture holder required that the Company raise additional capital, subordinated to their position, in the amount of $550,000, and make monthly payments of $100,000 on the debenture commencing in May 2002. Certain directors of the Company loaned the $550,000 to the Company in May 2002. These amounts

2. Business Acquisitions *(continued)*

a) Mocoat Services Inc. *(continued)*

were unsecured, bore interest at the annual rate of 25% (10% paid monthly and the balance at maturity), and were due on December 1, 2002, after the repayment of the debenture. The amounts from directors and the debenture were fully repaid in September 2002.

The acquisition has been accounted for using the purchase method and the consolidated financial statements include the results of operations from May 1, 2002. The original purchase price of $1,250,000 was subsequently reduced by $200,000 pursuant to an agreement negotiated with the vendors in January 2003. This adjustment had no effect on earnings for the period.

The aggregate consideration given, including acquisition costs, and the fair value of net assets acquired, as originally determined at the time of the purchase and as subsequently amended, are as follows:

(in thousands of dollars)	Originally determined $	Adjustment $	As amended $
Cash consideration	150		150
Common share consideration	1,000		1,000
Agreement payable	200	(200)	—
Purchase price	**1,350**	**(200)**	**1,150**
Assets and liabilities acquired at fair values:			
Bank indebtedness assumed	(263)		(263)
Non-cash working capital	300		300
Capital assets	417		417
Other assets – technology	2,244	(300)	1,944
Long-term debt	(1,007)		(1,007)
Future tax liability – net	(341)	100	(241)
Net assets acquired	**1,350**	**(200)**	**1,150**

Amortization of the technology-based intangible asset is provided for on a straight-line basis over a period of 5 years.

The Company issued 909,090 common shares at a price of $1.10, for a total amount of $1,000,000, as part of the initial purchase price. In January 2003, 143,542 additional common shares were issued to the vendors, pursuant to an anti-dilution provision in the purchase agreement, whereby the price per share was adjusted to $0.95, based on the private placement described in Note 3(a). The issue of these additional shares has no effect on the purchase price or the dollar amount of capital stock of the Company.

b) Parabeam Industries BV

In September 2002, the Company acquired 100% of the shares of Parabeam Industries BV. Parabeam is based in The Netherlands and manufactures a three-dimensional glass fabric that is used by the Company in the manufacture of double wall tanks and tank lining products.

The acquisition has been accounted for using the purchase method and the consolidated financial statements include the results of operations from September 9, 2002. Cash consideration for the purchase was $1,225,000, including costs relating to the acquisition and relocation of the operations to new premises. Accounts payable and accrued liabilities at December 31, 2002 include $139,000 of accrued acquisition and relocation costs. The fair value of assets and liabilities acquired is as follows:

(in thousands of dollars)	$
Non-cash working capital	**527**
Capital assets	**1,038**
Future tax liability	**(340)**
Net assets acquired	**1,225**

Amortization of the acquired capital assets is provided for on a declining balance basis at an annual rate of 10%.

3. Financing

a) Capital Stock

In September 2002, the Company completed a private placement to ARC Energy Venture Fund 3 of 7,368,422 units (“Unit”) at $0.95 per Unit for total cash proceeds of $7,000,000.

Each Unit was comprised of one common share of the Company and 0.5 Performance Warrants (“Warrant”). Each whole Warrant entitles the holder to subscribe for one common share at a price of $0.95 for a period of up

3. Financing *(continued)*

a) Capital Stock *(continued)*

to five years subject to a performance vesting provision. The Warrants vest at one-third intervals upon the weighted-average trading price of common shares reaching thresholds, for a period of twenty trading days, of $1.90, $2.85 and $3.80 per common share. One-half of the Warrants are segregated for transfer to senior management of the Company.

Of the total cash proceeds, $700,000 was attributed to the value of the Warrants and allocated to contributed surplus. Issue costs of $548,000, less future tax benefit of $186,000, were charged to deficit.

b) Long-Term Debt

In September 2002, the Company arranged a bank term loan in the amount of $5,000,000 and repaid the majority of previous long-term debt outstanding at the time.

The bank term loan bears interest at bank prime rate plus 0.50% per annum (the interest rate applied at December 31, 2002 was 5.0%), and is repayable in quarterly instalments of $178,572 (based on a seven-year amortization) with a final payment of the full balance due in three years from the date of drawdown. It is anticipated that the repayment will be extended so that the loan will actually be repaid over seven years.

Finance costs of $209,000 were capitalized as deferred finance charges and included in other assets. These costs are amortized on a straight-line basis over a period of 7 years.

c) Convertible Subordinated Debenture

In September 2002, the convertible subordinated debenture was repaid in full. The debenture bore interest at 9.75%, plus an accretion of 8.25% per annum, and was due on November 30, 2002.

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, was payable on amounts repaid. The make-whole premium on the repayment of the debenture was $56,000.

4. Future Income Taxes

The provision for future income taxes includes $Nil (2001 – $145,000) relating to the effect on future tax assets of a reduction in Provincial income tax rates.

5. Comparative Figures

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

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

15 years of excellence 1987 – 2002

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Printed on recycled paper