

Preserving and Protecting  
the Environment for  
Future Generations



## **Q2 2018 Message to Shareholders**

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August 9, 2018

### **CEO Transition**

I am writing this letter with some truly mixed emotions. In one sense, I am sad to see my tenure as President & CEO of ZCL come to an end. I leave ZCL with a great sense of pride in what has been accomplished and with a high level of confidence in the future of this company and its people. In another sense, I am truly excited about the announcement of Ted Redmond succeeding me. Ted brings a wealth of experience to ZCL and I know he is eager to get started and that he will be a great leader for ZCL. To ensure a smooth transition, I am helping with Ted's onboarding, which has already commenced, and will remain available to provide advisory and special project services through 2019.

### **Capital Allocation Process**

ZCL has developed a consistently profitable business model. A testament to that are our 29 consecutive quarters of profitability. At the same time, we have remained disciplined and strategic in how the Company invests and distributes capital. Our balanced approach to capital allocation has allowed us to reward our shareholders, while preserving the balance sheet strength for ZCL to act on profitable growth opportunities as they arise.

We have grown shareholder value through regular and reasonable increases in the quarterly dividend, by paying special dividends, and by repurchasing ZCL shares when it made sense to do so. Cumulatively, since 2012, ZCL has returned \$100 million to shareholders in the form of cash dividends of \$91 million and share repurchases of \$9.5 million. We have been active recently in utilizing our NCIB to repurchase ZCL shares. For the second quarter of 2018, we have repurchased a total of 217,100 shares at an average price of \$9.42 per share. ZCL remains committed to rewarding shareholders in the form of cash dividends and other ways of returning capital, in step with the Company's continued profitability.

### **Q2 Review and Outlook**

In the second quarter of 2018, revenue increased compared with the first quarter of 2018, however as expected, it did not match the exceptionally strong results ZCL achieved in the second quarter of 2017. Increased resin input costs, competitive pricing pressures in certain markets, and expenditures on manufacturing and plant safety improvements, in combination with a tightening labour market, contributed to reduced profitability in the quarter compared with a year earlier.

We remain confident in meeting our 10/10/10 objectives of revenue, profit and dividend growth over the longer term, but the achievement of these goals is not guaranteed in each individual year and we do not expect to achieve these objectives in terms of revenue and profitability this year. For the full year 2018, we expect organic revenue to be comparable to 2017. However, given the slow start to the year, we do not expect to be as profitable in 2018 as we were in 2017 due to gross margin pressures experienced thus far in 2018 and that we expect will persist through the rest of the year. We expect revenue growth in our core Fuel Markets to come from the continued replacement of the aged infrastructure and new to industry construction, as well as market share gains against steel. The increased order entry we are seeing in Fuel Markets compared with a year earlier supports our expectation. In the Water & Wastewater Markets, our quote activity has also been improving and we expect the initiatives currently undertaken by our Water & Wastewater business unit will support further revenue growth in 2019 and beyond, but we expect revenues in 2018 to be comparable to 2017.

### **Water & Wastewater Business Unit**

I would like again this quarter to specifically highlight some of our views on the Water & Wastewater segment (W&WW), which is a very important part of our long term growth plans. Over the past six year period of 2012-2017, we have grown our W&WW business unit revenues at a 9% compound annual growth rate (CAGR). Although this would be considered a healthy growth rate by most businesses, it has not met our longer term objective of a 10%-20% revenue CAGR for this segment.

To accelerate growth, we have made many changes to our W&WW sales and marketing strategies and tactics over the past 12 months which are expected will help us achieve our longer term growth rates. These changes include hiring a new VP Sales for the W&WW group, expanding our marketing team with an increasing focus on e-marketing initiatives, expanding our product offerings into new market segments, expanding our field sales organization to make more customer and influencer contacts earlier in the sales cycle with a special emphasis on specification writing, and

investing in the implementation of a Customer Relationship Management (CRM) system using Salesforce. While these changes have increased ZCL's fixed cost base and reduced our profitability temporarily, we remain confident that the returns on these investments will follow soon.

In summary and to reinforce our overall views on the W&WW Market, we believe the addressable W&WW Market for ZCL's products is double the size of the Fuel Market at \$400 to \$600 million annually. What ZCL is doing in W&WW is to bring the relatively new technology of fiberglass reinforced plastic (FRP) storage vessels to the large existing market for underground storage tanks that is currently dominated by concrete. The market share for FRP in the W&WW Market is currently less than 10%, but we are confident that this market share will grow over time as the obvious advantages of FRP over concrete become more well-known and accepted. This is a similar story to the market transformation we have seen – and helped shape – as the Fuel Markets migrated to FRP from steel over the past decades.

### **Summary**

Over the past several months, we continued to make investments and changes in our operations related to manufacturing, sales and marketing, and employee safety to better position ZCL for success in the short and, more importantly, longer term. The hardest thing for any CEO or business leader to do is to stay the course of necessary change in the face of results that are not meeting expectations, and I am the first to admit that ZCL has not met expectations over the past few quarters. However, I truly believe that ZCL is on the right path and that the investments and changes we are making are needed for this company's sustainability and success over the long term. I leave ZCL proud of what we have accomplished, knowing that the company, its new leadership, and its people are prepared for ZCL's next chapter of profitable growth. I feel honored and uniquely blessed to have worked with so many great ZCL employees and stakeholders over the past 32 years, and I wish everyone I have had the chance to engage with the very best.

Sincerely,

Ronald M. Bachmeier

## Management's Discussion and Analysis

### INTRODUCTION

ZCL Composites Inc.'s ("ZCL" or the "Company") Management's Discussion and Analysis ("MD&A") of the results of operations, cash flows and financial position as at June 30, 2018, should be read in conjunction with the Company's unaudited interim condensed consolidated financial statements and related notes for the three and six months ended June 30, 2018, and the MD&A and audited consolidated financial statements for the year ended December 31, 2017. The statements are available on SEDAR at [www.sedar.com](http://www.sedar.com) or the Company's website at [www.zcl.com](http://www.zcl.com).

The Company's interim condensed consolidated financial statements are prepared in accordance with International Accounting Standard ("IAS") 34: "Interim Financial Reporting." The notes to the interim consolidated financial statements are condensed as they do not include all of the information required in the annual consolidated financial statements. All figures presented in this MD&A are in Canadian dollars unless otherwise specified.

### Forward-Looking Statements

This MD&A contains forward-looking information based on certain expectations, projections and assumptions. This information is subject to a number of risks and uncertainties, many of which are beyond the Company's control. Users of this information are cautioned that actual results may differ materially. For additional information refer to the "Advisory Regarding Forward-Looking Statements" section later in this MD&A.

### Non-IFRS Measures

The Company uses both IFRS and non-IFRS measures to make strategic decisions and to set targets. Adjusted EBITDA, adjusted EBITDA per diluted share and working capital are non-IFRS measures that are used by the Company. They do not have a standardized meaning prescribed by IFRS and may not be comparable to similar measures used by other companies. For additional information refer to the "Non-IFRS Measures" section later in this MD&A.

This MD&A is dated as of August 9, 2018.

### CORPORATE PROFILE

ZCL is North America's largest manufacturer and supplier of environmentally friendly fibreglass reinforced plastic ("FRP") underground storage tanks. ZCL has two manufacturing facilities in Canada, four in the US and one in The Netherlands.

Fuel is the Company's largest segment and serves a relatively mature market. Water & Wastewater and Oil & Gas are smaller emerging segments. The Company operates under the brands ZCL, Xerxes, ZCL|Xerxes, and Parabeam.

#### Fuel Markets

ZCL is the leading provider of Underwriters Laboratories ("UL") and Underwriters Laboratories of Canada ("ULC") listed underground fuel storage tanks for the downstream retail and commercial markets in both Canada and the US. The vast majority of tanks supplied to these markets are double wall tanks, with single wall and triple wall models also available. In addition, ZCL operates internationally through technology licensing agreements.

As an alternative to the replacement of underground storage tanks, ZCL also provides the Phoenix System®. This unique UL and ULC listed tank system allows in-situ

upgrades of steel or fibreglass tanks to either a secondary containment system or a fully self-supporting double wall tank. It is an effective alternative to tank replacement.

A key component of both ZCL's double wall tank and the Phoenix System® is Parabeam®, a three-dimensional glass fabric that is manufactured and distributed from the Company's facility in The Netherlands.

#### Water & Wastewater Markets

ZCL's lightweight, watertight and easily installed fibreglass tanks are an ideal alternative to the concrete products that have traditionally dominated this market.

Applications for ZCL's underground FRP storage tanks in the Water and Wastewater Markets include onsite wastewater treatment and municipal wastewater collection, dry hydrant cisterns and sprinkler systems, rainwater collection and storm water detention and filtration, grease, oil and solids interceptors and decontamination systems, wash down drainage and leachate treatment and potable water storage.

### *Oil & Gas Markets*

ZCL also provides products for other market segments including Oil & Gas.

Within Oil & Gas, the Company serves both midstream and upstream markets. The Company supplies tanks for pipelines (midstream markets) and for oil and gas production companies (upstream markets).

## **OVERALL PERFORMANCE & OUTLOOK**

In the second quarter of 2018, revenue increased compared with the first quarter of 2018, however as expected, it did not match the exceptionally strong results in the second quarter of 2017. Increased resin input costs, competitive pricing pressures and expenditures on manufacturing and plant safety improvements, in combination with a tightening labour market, have reduced profitability in the quarter compared to the prior year.

Order entry and quoting activity is currently stronger relative to 2017. Therefore, management expects organic growth in revenue in the second half of 2018, compared with the same period in 2017.

### *Appointment of President and Chief Executive Officer*

The Board of Directors is pleased to announce Mr. Ted Redmond has been appointed as President & Chief Executive Officer, effective September 10, 2018. The Board is confident that Mr. Redmond brings the required skills, expertise and experience to guide the Company in refreshing and updating the strategic growth plan and continuing to initiate and implement operational improvement plans. Mr. Ron Bachmeier will continue to provide advisory and special project services through 2019, and will assist the new CEO in ensuring a smooth transition.

Mr. Redmond brings 20 years of experience as President/CEO/EVP of manufacturing and energy businesses. Most recently, for the past eight years, he has been President & CEO of a North American crane and heavy haul company servicing the construction, heavy industrial and energy markets.

Throughout his career, Mr. Redmond has participated in over 15 M&A transactions, led organic growth initiatives and has implemented rigorous process improvements leading to higher margins and lower production costs. Early in his career, he also spent seven years as a strategy consultant with Boston Consulting Group where he was involved in over 40 strategy consulting assignments.

Mr. Redmond's educational background includes a degree in engineering from the University of Alberta, a masters' degree in engineering from the University of Toronto, and an MBA from Stanford University.

## **Financial Results**

### *Revenue*

Revenue from continuing operations for the second quarter ended June 30, 2018 was \$46.8 million, down \$6.5 million or 12% from \$53.3 million earned for the second quarter of 2017. North American Fuel revenue was comparable to the prior year on a source currency basis, but was negatively impacted by the translation of US dollar revenue to Canadian dollars for reporting purposes. Both Water and Oil & Gas Markets revenues were down compared with a year earlier.

### *Gross Profit*

Gross profit from continuing operations for the second quarter ended June 30, 2018 was \$8.4 million, down \$2.4 million or 29% from \$11.9 million a year earlier. Gross margin also decreased from 22% to 18% in 2018.

The gross profit and gross margin decrease relative to the second quarter of 2017 was attributable to a decrease in revenue, a continued rise in resin prices, customer sales mix and pricing pressures in certain markets and increased fixed costs relating to manufacturing expenditures. The Company has been making investments in manufacturing, sales and marketing, and employee safety to better support both short and long term targets.

Due in part to a tightening labour market, we have encountered challenges in implementing certain of the initiatives relating to manufacturing, leading to inefficiencies and reduced throughput when compared with a year earlier. The product and process standardization and productivity initiatives are taking longer to implement than initially anticipated, however we remain confident they will yield benefits over the longer term.

### *Adjusted EBITDA*

Adjusted EBITDA from continuing operations for the second quarter ended June 30, 2018 was \$6.2 million, down \$3.3 million or 35% from \$9.5 million in the second quarter of 2017. Adjusted EBITDA as a percentage of revenue was 10% for 2018, compared to 15% a year earlier.

*Net Income*

Net income for the second quarter ended June 30, 2018 was \$3.9 million, down \$1.7 million from \$5.7 million a year earlier. Earnings per share for the second quarter of 2018 was \$0.13, compared with \$0.18 per share a year earlier.

*Cash*

As at June 30, 2018, ZCL had a bank indebtedness balance of \$1.1 million compared to a cash balance of \$25.6 million as at December 31, 2017 and \$19.7 million as at June 30, 2017. The decrease in cash since December 31, 2017, was primarily due to the payment of dividends of \$20.2 million and utilization of the Normal Course Issuer Bid ("NCIB") of \$2.0 million.

*Dividends*

The Board has declared a quarterly dividend of \$0.135 per share, the same rate as the prior quarter and a 13% increase over the \$0.12 declared at the same time last year. The dividend will be paid on October 15, 2018, to the shareholders of record as of September 30, 2018.

*Normal Course Issuer Bid*

During the first quarter of 2018, the Company received approval from the TSX to conduct a NCIB and is authorized to purchase up to 1,500,000 common shares (or 5% of ZCL's issued and outstanding common shares). As of June 30, 2018, ZCL repurchased 217,100 shares through the NCIB at a cost of \$2,046,000 or an average of \$9.42 per share.

**Backlog**

Backlog is defined as the total value of orders that have not yet been included in revenue but which have a contract or purchase order specifying the scope, value and timing of an order.

*Backlog by Market*

(\$millions)	June 30, 2018	June 30, 2017	% Change
Fuel	45,921	45,573	1%
Water & Wastewater	5,839	4,806	21%
Oil & Gas/Industrial	492	1,081	(54%)
<b>Total</b>	<b>52,252</b>	51,460	2%

As of June 30, 2018, backlog was \$52.3 million, up \$0.8 million or 2% from \$51.5 million a year earlier.

In the Fuel Markets, backlog of \$45.9 million was \$0.3 million or 1% higher compared to the second quarter of 2017. The Fuel backlog increase was derived from Canadian Fuel Markets, up \$0.5 million compared with a year earlier and International markets, up \$0.4 million compared with June 30, 2017.

On a source currency basis, the US Fuel backlog was down \$0.8 million or 2% compared to the same quarter a year earlier. This decrease was partially offset by a \$0.3 million increase due to foreign exchange translation of US dollar denominated backlog.

Water & Wastewater Markets backlog of \$5.8 million, was up \$1.0 million or 21%, compared to the quarter ended June 30, 2017. US Water & Wastewater Markets were up \$0.7 million (source currency), compared with a year earlier, prior to a \$0.3 million positive impact on the conversion of US dollar denominated backlog to Canadian dollars for reporting purposes. Canadian Water & Wastewater Markets were comparable to the same quarter in 2017.

As at June 30, 2018, Oil & Gas Market backlog of \$0.5 million was down \$0.6 million from \$1.1 million a year earlier. The decline is primarily attributable to ZCL's decision in 2017 to cease offering products to Industrial & Oil Sands Markets.

On a sequential quarter basis, the total backlog increased by \$7.3 million or 16% from \$44.9 million at March 31, 2018. The increase was driven by both the Fuel Markets which were up \$5.4 million compared to a quarter earlier and Water & Wastewater Markets, up \$2.1 million. Oil & Gas Markets were down \$0.2 million compared to March 31, 2018. The increase in backlog over the prior sequential quarter was due to the normal seasonal nature of the business.

### Capital Allocation

As evidenced by our 29 consecutive quarters of profitability, ZCL has developed a consistently profitable business model from our core business, and will continue to act in a disciplined and strategic manner when it comes to investing and distributing capital. We are focused on growing shareholder value through a reasonable increase in the quarterly distributions, and at times paying a special dividend, while preserving our balance sheet strength to allow ZCL to act on profitable growth opportunities as they arise.

The key levers of our capital allocation strategy are:

1. Fund all profitable organic growth opportunities that support the objectives of our strategic plan.
2. Continue to evaluate and pursue non-organic growth opportunities.
3. Continue to distribute cash dividends to shareholders.

### Outlook

The following represents forward looking information and readers are cautioned that actual results may differ from expectations.

For the full year 2018, we expect revenue to be comparable to 2017. Revenue growth in our core Fuel Markets is expected from the continued replacement of the aged infrastructure and new to industry construction, and market share gains against steel. This is being supported by increased order entry in Fuel Markets compared with a year earlier. At this point in the year, we believe our emerging Water & Wastewater Markets revenue will be comparable with a year earlier.

We will continue to work toward our long term profitability improvement initiatives, however for the full 2018 year, we expect lower profitability relative to 2017 due to a combination of increased resin input costs, competitive pricing pressures and a temporary reduction in production efficiencies. Due in part to a tightening labour market, we have encountered challenges in implementing certain of the initiatives relating to manufacturing, leading to inefficiencies and reduced throughput when compared with a year earlier. The product and process standardization and productivity initiatives are taking longer to implement than initially anticipated, however we remain confident they will yield benefits over the longer term.

<sup>1</sup> Sources include publications from the National Association of Convenience Stores (NACS).

We remain confident in meeting our 10/10/10 objectives of revenue, profit and dividend growth over the longer term, but the achievement of these goals is not guaranteed in each individual year.

Our outlook for 2018 by segment is as follows:

#### *Fuel Markets*

The Fuel Markets are our most mature business and our largest revenue segment. We are seeing growth in sales to smaller independent retail petroleum marketers through our North American leading distributor network as well as increased orders from certain larger retail fuel marketers who deferred spending in 2017. As industry consolidation continues, larger customers are expected to integrate newly acquired stores and return to their longer term strategy of upgrading and replacing their aged infrastructure of underground storage tanks, along with construction of new to industry sites as they battle for market share.<sup>1</sup>

We continue to view industry consolidation as a long term positive for ZCL given that consolidators are committed to retail fuel and typically devote new capital to expand their operations and grow their market share. This expectation, along with our multi-year trend of increased sales to smaller independent retailers, will be a net benefit to ZCL as the industry looks for solution providers they can trust to serve them throughout the entire North American geography.

#### *Water & Wastewater Markets*

Though we have participated in the Water & Wastewater ("W&WW") Markets for several years now, we continue to view W&WW as part of our emerging business with the most potential for significant relative growth in the future. These markets are a fundamental part of our long term growth strategy.

As previously described, we completed extensive independent market research<sup>2</sup> that supports our optimism about longer term growth opportunities and indicates that the addressable market for the tanks that ZCL currently supplies, is in the range of \$400 – \$600 million annually. We continue to believe that we can take market share away from concrete, which currently dominates this space with north of 70% market share, compared with less than 10% for FRP solutions.

We have made many changes to our W&WW sales and marketing strategies and tactics over the past 12-15 months with the intent of promoting our FRP solutions as

<sup>2</sup> Source – Lucintel "Growth Opportunities for ZCL in Tanks for the Water / Wastewater Industry," July, 2017.

a superior alternative to the incumbent concrete solution. These changes, among other things, have included hiring a new VP Sales for the W&WW group, expanding our marketing team with an increasing focus on e-marketing initiatives, expanding our product offerings into new market segments, expanding our field sales organization to make more customer and influencer contacts earlier in the sales cycle with a special emphasis on specification writing, and investing in the implementation of a Customer Relationship Management (CRM) system using Salesforce.

Results of these efforts are not immediately visible as the W&WW sales cycle is much longer than that of our core Fuel Markets. Although order intake in the first half of 2018 has been lower than anticipated, it has accelerated in recent months and our agent and distribution network are currently seeing robust quoting activity. Much of this increased activity is due to our deliberate efforts on educating specifiers and the expansion of our distributor and representative networks.

### *Oil & Gas Markets*

Oil and Gas Markets comprise approximately 5% of our total revenues. Although midstream pipeline regulatory approval and other macro-economic challenges remain in this segment, there are areas of opportunity for our product portfolio, including the potential to displace incumbent steel tank providers, both at the wellhead and in pipeline infrastructure.

Specific ongoing initiatives for our Oil & Gas Markets include our Sales and Product Innovation teams collaborating to create new product designs that better address customer needs, creating an established agent and distributor network throughout North America and refocusing sales efforts to grow the share of business from existing customers.

## Management's Discussion and Analysis

### SELECTED FINANCIAL INFORMATION

(in thousands of dollars, except per share amounts)	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
	\$	\$	\$	\$
<b>Operating Results</b>				
Revenue	46,812	53,306	78,694	85,047
Gross profit	8,394	11,901	13,027	18,007
<i>Gross margin</i>	18%	22%	17%	21%
General and administration	2,779	2,515	5,369	5,271
Foreign exchange (gain) loss	(535)	(1)	106	232
Depreciation and amortization	708	783	1,408	1,604
Finance expense	84	34	128	76
Loss (gain) on disposal of property, plant and equipment	8	87	(3)	71
Income tax expense	1,429	2,452	1,613	3,803
<b>Net income from continuing operations</b>	<b>3,921</b>	<b>6,031</b>	<b>4,406</b>	<b>6,950</b>
<b>Net loss from discontinued operations</b>	<b>-</b>	<b>(374)</b>	<b>-</b>	<b>(411)</b>
<b>Net income</b>	<b>3,921</b>	<b>5,657</b>	<b>4,406</b>	<b>6,539</b>
<b>Earnings per share from continuing operations</b>				
Basic	0.13	0.19	0.14	0.22
Diluted	0.13	0.19	0.14	0.22
<b>Earnings per share</b>				
Basic	0.13	0.18	0.14	0.21
Diluted	0.13	0.18	0.14	0.21
<b>Cash dividends declared per common share</b>	<b>0.535</b>	<b>0.12</b>	<b>0.655</b>	<b>0.89</b>
<b>Adjusted EBITDA (note 1)</b>	<b>6,189</b>	<b>9,467</b>	<b>7,667</b>	<b>12,638</b>
<i>Adjusted EBITDA as % of revenue</i>	13%	18%	10%	15%
<i>Adjusted EBITDA per diluted share</i>	0.20	0.30	0.25	0.41
			<b>As at</b>	
			<b>June 30, 2018</b>	<b>Dec 31, 2017</b>
(in thousands of dollars)			<b>\$</b>	<b>\$</b>
<b>Financial Position</b>				
(Bank indebtedness) Cash and cash equivalents		(1,149)	25,556	19,655
Working capital (note 1)		37,023	52,920	53,565
Total assets		133,422	140,728	146,797
Total non-current liabilities		4,622	3,928	4,223

Note 1: Adjusted EBITDA, adjusted EBITDA per diluted share and working capital are non-IFRS measures and are defined later in the MD&A under "Non-IFRS Measures."

**RESULTS OF OPERATIONS**

**FOR THE THREE MONTHS ENDED JUNE 30, 2018**

**Revenue**

(\$000s)	Second Quarter		
	2018	2017	% change
Revenue by Market:			
Fuel	40,733	42,975	(5%)
Water & Wastewater	5,074	6,688	(24%)
Oil & Gas/Industrial	1,005	3,643	(72%)
	46,812	53,306	(12%)

Revenue for the quarter ended June 30, 2018 was \$46.8 million, down \$6.5 million, or 12% from \$53.3 million in the second quarter of 2017. The change in revenue reflects the factors noted below:

*Fuel*

Fuel revenue of \$40.7 million, was down \$2.2 million or 5%, from \$42.9 million in the quarter ended June 30, 2017. North American Fuel revenue was comparable to the same quarter a year earlier on a source currency basis. The decrease compared with 2017 was due to a negative impact from the translation of US dollar denominated revenue to Canadian for reporting purposes and a decrease in International Fuel revenue.

Canadian Fuel revenue in the second quarter of 2018 was up \$0.3 million or 5% compared to the same quarter of 2017 with increase from distributor and contractor sales compared with a year earlier.

In the US, Fuel revenue was comparable to the second quarter of 2017 prior to a \$1.4 million negative impact on the translation of US dollar sales to Canadian dollars for reporting purposes. Sales to US distributors were up by 9% while sales to retail petroleum marketers were down 5% compared to the same quarter a year earlier.

Fuel Markets also include revenue from International operations which were down \$1.0 million with the decrease related to lower Parabeam® 3-D fabric sales to licensees.

*Water & Wastewater*

Water & Wastewater revenue in the second quarter of 2018 was \$5.1 million, down \$1.6 million or 24% compared to \$6.7 million in the second quarter of 2017. The decrease in revenue was attributable to the US markets which were down \$1.0 million or 24% over the second quarter of 2017 prior to a \$0.5 million negative impact on the translation of US dollar sales to Canadian dollars for reporting purposes.

In Canada, revenue was down \$0.1 million compared with a year earlier.

From a submarket perspective, increases in water collection & conservation and industrial wastewater applications were more than offset by decreases in wastewater, fire protection applications and plumbing engineered solutions compared with the second quarter of 2017.

*Oil & Gas / Industrial*

Oil & Gas/Industrial revenue of \$1.0 million for the second quarter of 2018 was down \$2.6 million or 72% compared to \$3.6 million a year earlier. Oil & Gas revenue was down \$1.2 million and Industrial Markets revenue was down \$1.4 million compared to the second quarter of 2017.

During the third quarter of 2017, the Company decided to cease offering products to Industrial Markets, including aboveground Chemical Storage tanks used in Oil Sands applications.

**Gross Profit**

(\$000s)	Second Quarter		
	2018	2017	% change
Gross profit	8,394	11,901	(29%)
Gross margin	18%	22%	

In the second quarter of 2018, gross profit of \$8.4 million was down \$3.5 million or 29% compared to the same quarter in 2017. Gross margin also decreased from 22% to 18% in 2018.

The gross profit and gross margin decrease relative to the second quarter of 2017 was attributable to a decrease in revenue, resin price increases, customer sales mix and increased fixed costs relating to manufacturing expenditures.

The Company has been making investments in manufacturing, sales and marketing, and employee safety to better support both short and long term targets. Due in part to a tightening labour market, we have been encountering challenges in implementing certain of the initiatives relating to manufacturing, leading to inefficiencies and reduced throughput when compared with a year earlier. The product and process standardization and productivity initiatives are taking longer to implement than initially anticipated, however we remain confident they will yield benefits over the longer term.

**General and Administration**

(\$000s)	Second Quarter
2018	2,779
2017	2,515
% change	10%

General and administration (“G&A”) expense for the quarter ended June 30, 2018 was up \$0.3 million or 10% compared to the quarter ended June 30, 2017. An increase in professional fees was partially offset by reductions in incentive compensation.

**Foreign Exchange Gain**

(\$000s)	Second Quarter
2018	(535)
2017	(1)

The foreign exchange gain was the result of fluctuations in the US dollar conversion rate and the US denominated monetary assets and liabilities held by the Company’s Canadian operations.

The following table details the US dollar and euro conversion rates.

*US Dollar and Euro Conversion Rates*

Second Quarter	2018		2017		Avg. Change	Close Change
	Avg.	Close	Avg.	Close		
USD	<b>1.29</b>	<b>1.31</b>	1.35	1.30	(4%)	1%
euro	<b>1.54</b>	<b>1.54</b>	1.48	1.48	4%	4%

For additional information on the Company’s exposure to fluctuations in foreign exchange rates see the “Financial Instruments” section included later in this MD&A.

**Depreciation and Amortization**

(\$000s)	Second Quarter
2018	708
2017	783
% change	(10%)

Depreciation and amortization expense for the quarter ended June 30, 2018 was down \$0.1 million or 10% compared to a year earlier.

**Income Taxes**

Income tax expense for the three months ended June 30, 2018, represented 27% of pre-tax income, compared to 29% of pre-tax income in 2017. The decrease in the effective tax rate is primarily due to the impact of US tax reform.

**Comprehensive Income (Loss)**

Comprehensive income (loss) for each period is comprised of net income and the effects of translation of foreign operations with functional currencies denominated in US dollars and euros. For accounting purposes, assets and liabilities of these foreign operations are translated at the exchange rate in effect on the balance sheet date.

The table below details the impact of the translation of foreign operations on other comprehensive income before the impact of net income.

(\$000s)	Second Quarter
2018	1,044
2017	(2,061)

The foreign translation gain in 2018 was due to the strengthening of the US dollar relative to the Canadian dollar from 1.29 to 1.31. In the second quarter of 2017, the US dollar weakened from 1.37 to 1.29 and therefore generated a loss on the translation of foreign operations.

**FOR THE SIX MONTHS ENDED JUNE 30, 2018**

**Revenue**

(\$000s)	Six Months		
	2018	2017	% change
Revenue by Market:			
Fuel	<b>68,293</b>	69,888	(2%)
Water & Wastewater	<b>8,258</b>	10,889	(24%)
Oil & Gas/Industrial	<b>2,143</b>	4,270	(50%)
	<b>78,694</b>	85,047	(7%)

Revenue for the six months ended June 30, 2018 was \$78.7 million, down \$6.4 million, or 7% from \$85.0 million in the first six months of 2017. The change in revenue reflects the factors noted below:

*Fuel*

Fuel revenue of \$68.3 million in the first six months of 2018, was down \$1.6 million or 2%, from \$69.9 million for the same period a year earlier. The decrease in Fuel revenue compared to a year earlier was attributable to US markets.

Canadian Fuel revenue in the first six months of 2018 was up \$2.3 million or 21% compared to the first half of 2017, with the increase derived from major oil, up \$1.8 million compared to a year earlier, as well as increased distributor sales. Sales to retail petroleum marketers were comparable with the same period a year earlier.

In the US, revenue was down \$1.4 million or 4% over the first half of 2017 prior to a \$2.7 million negative impact on the translation of US dollar sales to Canadian dollars for reporting purposes. An increase in sales to distributors and contractors was partially offset by a decrease in sales to retail petroleum marketers which were down 6% over the first half of 2017.

Fuel Markets also includes revenue from International operations which were up \$0.4 million or 9% compared to the first half of 2017.

*Water & Wastewater*

Water & Wastewater revenue in the first six months of 2018 was \$8.3 million, down \$2.6 million or 24% compared to \$10.9 million in the first six months of 2017. The decrease in revenue was attributable to the US markets which were down \$2.0 million or 28% over the first half of 2017 prior to a \$0.9 million negative impact on the translation of US dollar sales to Canadian dollars for reporting purposes. In Canada, revenue was up \$0.3 million or 18% compared to a year earlier.

From a submarket perspective, increases in water collection & conservation and industrial wastewater applications were more than offset by decreases in wastewater and fire protection applications, compared with the first six months of 2017.

*Oil & Gas / Industrial*

Oil & Gas/Industrial revenue of \$2.1 million for the first six months of 2018 was down \$2.1 million or 50% compared to \$4.3 million a year earlier. A \$0.6 million decrease in Oil & Gas revenue in the first six months of 2018 was driven by decreased upstream flare knock out tanks sales compared with a year earlier.

Industrial Markets revenue was down \$1.6 million compared to the first six months of 2017. During the third quarter of 2017, the Company decided to cease offering products to Industrial Markets, including aboveground Chemical Storage tanks used in Oil Sands applications.

**Gross Profit**

(\$000s)	Six Months		
	2018	2017	% change
Gross profit	<b>13,027</b>	18,007	(28%)
Gross margin	<b>17%</b>	21%	

In the first six months of 2017, gross profit of \$13.0 million was down \$5.0 million or 28% compared to the same period in 2017. Gross margin decreased to 17% from 21% in 2017.

The gross profit and gross margin decrease relative to the first six months of 2017 was attributable to a decrease in revenue over a relatively fixed cost base, resin price increases, customer sales mix, increased fixed costs relating to manufacturing expenditures as well as closure costs related to our exit from ZCL Corrosion, that was completed during the first quarter of 2018.

The Company has been making investments in manufacturing, sales and marketing, and employee safety to better support both short and long term targets. Due in part to a tightening labour market, we have been encountering challenges in implementing certain of the initiatives relating to manufacturing, leading to manufacturing inefficiencies when compared with a year earlier. The product and process standardization and productivity initiatives are taking longer to implement than initially anticipated, however we remain confident they will yield benefits over the longer term.

**General and Administration**

(\$000s)	Six Months
2018	5,369
2017	5,271
% change	2%

General and administration (“G&A”) expense for the six months ended June 30, 2018 was comparable to the first six months of 2017. An increase in professional fees was offset by reductions in incentive compensation.

**Foreign Exchange Loss**

(\$000s)	Six Months
2018	106
2017	232

The foreign exchange loss for each period primarily related to the combination of fluctuations in the US dollar conversion rate and the US denominated monetary assets and liabilities held by the Company’s Canadian operations.

The following table details the US dollar and euro conversion rates.

*US Dollar and euro Conversion Rates*

Six Months	2018		2017		Avg. Change	Close Change
	Avg.	Close	Avg.	Close		
USD	<b>1.28</b>	<b>1.31</b>	1.33	1.30	(4%)	1%
euro	<b>1.55</b>	<b>1.54</b>	1.45	1.48	7%	4%

For additional information on the Company’s exposure to fluctuations in foreign exchange rates see the “Financial Instruments” section included later in this MD&A.

**Depreciation and Amortization**

(\$000s)	Six Months
2018	1,408
2017	1,604
% change	(12%)

Depreciation and amortization expense for the first half of 2018 was down \$0.2 million or 12% compared to the first half of 2017.

**Income Taxes**

Income tax expense for the six months ended June 30, 2018, represented 27% of pre-tax income, compared to 35% of pre-tax income in 2017. In 2017, income tax expense included a withholding tax payment on cash repatriations from the Company’s US subsidiaries that were used to fund a special dividend payment. Excluding this withholding tax expense, the effective tax rate for the first half of 2017 would have been 29%.

For 2018, the effective tax rate of 27% is lower than 2017 primarily as a result of US tax reform.

**Comprehensive Income (Loss)**

Comprehensive income (loss) for each period is comprised of net income and the effects of translation of foreign operations with functional currencies denominated in US dollars and euros. For accounting purposes, assets and liabilities of these foreign operations are translated at the exchange rate in effect on the balance sheet date.

The table below details the impact of the translation of foreign operations on other comprehensive income before the impact of net income.

(\$000s)	Six Months
2018	3,920
2017	(2,803)

The foreign translation gain in the first half of 2018 was due to the strengthening of the US dollar relative to the Canadian dollar from 1.26 to 1.31. In 2017, the US dollar weakened from 1.35 to 1.30 generating a foreign exchange loss.

**LIQUIDITY AND CAPITAL RESOURCES**
**Working Capital**

As at June 30, 2018, the Company decreased working capital (current assets less current liabilities) by \$15.9 million to \$37.0 million compared with \$52.9 million as at December 31, 2017. This decrease is primarily the result of the special dividend paid of \$12.3 million, thereby reducing cash and cash equivalents.

As at June 30, 2018, the Company had bank indebtedness of \$1.1 million (December 31, 2017 - \$25.6 million cash and cash equivalents).

Management believes that internally generated cash flows, along with the available revolving operating credit facility, will be sufficient to cover the Company's normal operating and capital expenditures for the foreseeable future.

**Credit Arrangements**

The Company's operating credit facility is provided by a Canadian chartered bank. The maximum available under this facility is \$20.0 million. The operating facility is due on demand and matures on May 31, 2020.

**Share Capital**

During the three and six months ended June 30, 2018, the Company issued 35,701 shares and 69,869 shares respectively on the exercise of stock options (66,484 and 270,106 respectively for the three and six months ended June 30, 2017). During the three and six months ended June 30, 2018, 230,600 shares were repurchased and cancelled through the Normal Course Issuer Bid ("NCIB"). No shares were repurchased and cancelled during the first six months of 2017.

**Cash Flows**

(\$000's)	Second Quarter		Six Months	
	2018	2017	2018	2017
Operating activities	<b>1,043</b>	(879)	(2,674)	3,461
Financing activities	<b>(17,160)</b>	(3,325)	(20,616)	(24,491)
Investing activities	<b>(1,134)</b>	(916)	(2,470)	(1,651)
Foreign exchange <sup>(1)</sup>	<b>(388)</b>	103	204	(389)
Discontinued operations	-	(446)	-	(483)
	<b>(17,639)</b>	(5,463)	(25,556)	(23,553)

(1) Foreign exchange gain (loss) on cash held in foreign currency.

**Operating Activities**

The cash flows from operating activities reflect the net impact of i) funds from continuing operations and ii) changes in non-cash working capital.

Funds from continuing operations totalled \$4.6 million and \$6.4 million for the three and six months ended June 30, 2018 respectively, down from \$7.3 million and \$8.6 million for the three and six months ended June 30, 2017.

Changes in non-cash working capital totalled negative \$3.6 million and negative \$9.0 million for the three and six months ended June 30, 2018, compared to negative \$8.1 million and negative \$5.1 million for the three and six months ended June 30, 2017. For the three months ended June 30, 2018, the accounts receivable grew less than in the comparable period, driving the reduction in cash from working capital changes. This increase in accounts receivable was partially offset by an increase in inventories relative to the three months ended June 30, 2017.

The reduction in cash due to changes in non-cash working capital for the six months ended June 30, 2018 was higher than the comparative period due to a larger increase in inventories, partially offset by smaller increases in accounts receivable over the same period.

**Financing Activities**

Cash flows used in financing activities were \$17.2 million for the three months ended June 30, 2018 and \$3.3 million for the three months ended June 30, 2017. The increase in 2018 compared to the prior year is due primarily to the special dividend payment of \$12.3 million and the utilization of the NCIB of \$2.0 million. In 2017, the special dividend of \$20.1 million was paid in the first quarter rather than the second quarter. Cash flows used in financing activities were \$20.6 million for the six months ended June 30, 2018 and \$24.5 million for the comparative period of 2017. The decrease in cash flows used in

financing activities in 2018 was primarily due to the decrease in the special dividends compared to a year earlier, partially offset by the utilization of the NCIB in 2018.

In April, 2018, the Company received approval from the TSX to conduct a Normal Course Issuer Bid ("NCIB") that commenced on April 11, 2018. The Company is authorized to purchase up to 1,500,000 common shares for cancellation. Management believes that from time to time the market prices of the common shares may not reflect their underlying value and at such times, the purchase of common shares for cancellation will increase the proportionate interest of, and be advantageous to, all remaining shareholders. During the second quarter and six months ended June 30, 2018, 217,100 shares were repurchased through the NCIB at a cost of \$2,046,000 or an average of \$9.42 per share. No common shares were repurchased through the NCIB during the second quarter and six months ended June 30, 2017.

*Investing Activities*

The cash flows used in investing activities were \$1.1 million and \$2.5 million for the three and six months ended June 30, 2018 compared to \$0.9 million and \$1.7 million for the three and six months ended June 30, 2017. The primary contributor in each of the periods is the purchase of property, plant and equipment.

**Contractual Obligations**

The Company has provided a letter of credit in the amount of \$0.3 million US to secure a line of credit for the same amount for our US operations. The Company has also provided three letters of credit for a total of \$1.2 million US to secure claims for the Company's US workers' compensation program. In the normal course of business, the Company provides letters of credit as collateral for contract performance guarantees. As at June 30, 2018, the performance letters of credit issued totalled \$nil.

As at June 30, 2018, ZCL's minimum annual lease commitments under all non-cancellable operating leases for production facilities, office space and automotive equipment totalled \$11.0 million.

The following table summarizes the Company's contractual obligations due over the next five years and thereafter:

(\$000s)	<b>Operating Leases</b>
2018	1,229
2019	2,012
2020	1,847
2021	1,812
2022	1,552
Thereafter	2,513
<b>Total</b>	<b>10,965</b>

**SUMMARY OF QUARTERLY RESULTS**

The table below presents selected financial information for the eight most recent quarters, which should be read in conjunction with the applicable interim unaudited and annual audited consolidated financial statements and accompanying notes.

The Company's financial results have historically been affected by seasonality with the lowest levels of activity occurring in the first half of the year, particularly in the first quarter. In addition, the Company is subject to fluctuations

in the US to Canadian dollar exchange rate since a significant portion of its revenue is denominated in US dollars. Over the past eight quarters, the US to Canadian dollar conversion rate has ranged from a low of 1.25 in the third quarter of 2017 to a high of 1.34 in the fourth quarter of 2016.

For the three months ended <i>(in thousands of dollars, except per share amounts)</i>	2018		2017				2016	
	June 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
	\$	\$	\$	\$	\$	\$	\$	\$
Revenue by Market:								
Fuel	40,733	27,560	40,354	45,536	42,975	26,914	39,030	49,664
Water & Wastewater	5,075	3,184	7,593	5,811	6,688	4,201	6,433	5,902
Oil & Gas/Industrial	1,005	1,138	2,754	1,074	3,643	626	1,139	2,319
Total revenue	46,812	31,882	50,701	52,421	53,306	31,741	46,602	57,885
Net income								
Continuing operations	3,924	485	6,114	5,357	6,031	919	5,749	7,741
Discontinued operations <i>(note 1)</i>	-	-	26	(52)	(374)	(37)	146	(1,249)
Total net income	3,924	485	6,140	5,305	5,657	882	5,895	6,492
Adjusted EBITDA <i>(note 2)</i>	6,190	1,479	9,241	9,306	9,467	3,172	9,418	12,125
Basic and diluted earnings per share								
Continuing operations	0.13	0.02	0.19	0.17	0.19	0.03	0.19	0.25
Total	0.13	0.02	0.19	0.17	0.18	0.03	0.19	0.21
Adjusted EBITDA per diluted share <i>(note 2)</i>	0.20	0.05	0.30	0.30	0.30	0.10	0.30	0.39
Dividends declared per share	0.535	0.135	0.12	0.12	0.12	0.77	0.08	0.08

*Note 1:* The discontinued operations are the ZCL Dualam operations which were exited in the third quarter of 2016, due to continued and expected future operating losses.

*Note 2:* Adjusted EBITDA and adjusted EBITDA per diluted share are non-IFRS measures and are defined later in this MD&A under "Non-IFRS Measures."

**OUTSTANDING SHARE DATA**

As at August 9, 2018, there were 30,598,747 common shares and 841,093 share options outstanding. Of the options outstanding, 310,176 are currently exercisable into common shares. In 2018, ZCL repurchased and cancelled 342,200 shares (2017 - nil) through the Normal Course Issuer Bid ("NCIB").

**FINANCIAL INSTRUMENTS**

The Company's activities expose it to a variety of financial risks including market risk (foreign exchange risk), credit risk and liquidity risk. Management reviews these risks on an ongoing basis to ensure they are appropriately managed. The Company may use foreign exchange forward contracts to manage exposure to fluctuations in foreign exchange from time to time. The Company does not currently have a practice of trading derivatives and had no derivative instruments outstanding at June 30, 2018.

**Foreign Exchange Risk**

The Company operates on an international basis and is exposed to foreign exchange risk arising from transactions denominated in foreign currencies. The Company's objective with respect to foreign exchange risk is to minimize the impact of the volatility related to financial assets and liabilities denominated in a foreign currency where possible through effective cash flow management. Foreign currency exchange risk is limited to the portion of the Company's business transactions denominated in currencies other than Canadian dollars. The Company's most significant foreign exchange risk arises primarily with respect to the US dollar. The revenues and expenses of the Company's US operations are denominated in US dollars. Certain of the revenue and expenses of the Canadian operations are also denominated in US dollars. The Company is also exposed to foreign exchange risk associated with the euro due to its operations in The Netherlands, however, these amounts are not significant to the Company's consolidated financial results. On an ongoing basis, management monitors changes in foreign currency exchange rates and considers long term forecasts to assess the potential cash flow impact on the Company.

The tables that follow provide an indication of the Company's exposure to changes in the value of the US dollar relative to the Canadian dollar, as at and for the three months ended June 30, 2018. The analysis is based on financial assets and liabilities denominated in US dollars at the end of the period ("balance sheet exposure"), which are separated by domestic and foreign operations, and US dollar denominated revenue and operating expenses during the period ("operating exposure").

Balance sheet exposure related to financial assets, net of financial liabilities, at June 30, 2018, was as follows:

(in thousands of US dollars)	\$
Foreign operations	21,174
Domestic operations	(210)
<b>Net balance sheet exposure</b>	<b>20,964</b>

Operating exposure for the six months ended June 30, 2018, was as follows:

(in thousands of US dollars)	\$
Sales	47,707
Operating expenses	41,453
<b>Net operating exposure</b>	<b>6,254</b>

The weighted average US to Canadian dollar translation rate was 1.28 for the six months ended June 30, 2018. The translation rate as at June 30, 2018 was 1.31.

Based on the foreign currency exposures noted above, with other variables unchanged, a 20% change in the Canadian dollar would have impacted net income for the six months ended June 30, 2018, as follows:

(in thousands of US dollars)	\$
Net balance sheet exposure of domestic operations	(29)
Net operating exposure of foreign operations	748
<b>Change in net income</b>	<b>719</b>

Comprehensive income would have changed \$2.7 million due to the net balance sheet exposure of financial assets and liabilities of foreign operations. The timing and volume of the above transactions, as well as the timing of their settlement, could impact the sensitivity of the analysis.

**Credit Risk**

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company is exposed to credit risk through its cash and cash equivalents and accounts receivable. The Company manages the credit risk associated with its cash and cash equivalents by holding its funds with reputable financial institutions and investing only in highly rated securities that are traded on active markets and are capable of prompt liquidation. Credit risk for trade and other accounts receivable are managed through established credit monitoring activities. The Company also mitigates its credit risk on trade accounts receivable by obtaining a cash deposit from certain customers with no prior order history with the Company, or where the Company perceives the customer has a higher level of risk.

The Company has a concentration of customers in the downstream retail oil & gas sectors. The concentration risk is mitigated by the number of customers, growth and diversification of the customer base and by a significant portion of the customers being large international organizations. As at June 30, 2018, no customer exceeded 10% of the consolidated trade accounts receivable

balance. The creditworthiness of new and existing customers is subject to review by management by considering such items as the type of customer, prior order history and the size of the order. Decisions to extend credit to new customers are approved by management and the creditworthiness of existing customers is monitored.

The Company reviews its trade accounts receivable regularly and amounts are written down to their expected realizable value when the account is determined not to be fully collectable. This generally occurs when the customer has indicated an inability to pay, the Company is unable to communicate with the customer over an extended period of time, and other methods to obtain payment have been considered and have not been successful. The bad debt expense is charged to net income in the period that the account is determined to be doubtful. Estimates for the allowance for doubtful accounts are determined on a customer-by-customer evaluation of collectability at each reporting date, taking into account the amounts which are past due and any available relevant information on the customers' liquidity and going concern status. After all efforts of collection have failed, the accounts receivable balance not collected is written off with an offset to the allowance for doubtful accounts, with no impact on net income.

The Company's maximum exposure to credit risk for trade accounts receivable is the carrying value of \$30.9 million as at June 30, 2018 (December 31, 2017 - \$27.3 million). On a geographic basis as at June 30, 2018, approximately 25% (December 31, 2017 - 24%) of the balance of trade accounts receivable was due from Canadian and non-US customers and 75% (December 31, 2017 - 76%) was due from US customers.

Payment terms are generally net 30 days. As at June 30, 2018, the percentages of trade accounts receivable were as follows:

	June 30, 2018	December 31, 2017
Aged 0 to 30 days	62%	57%
Aged 31 to 60 days	22%	22%
Aged 61 to 90 days	6%	11%
Aged 91 to 120 days	4%	7%
Aged greater than 120 days	6%	3%
Total	100%	100%

### Liquidity Risk

The Company's objective related to liquidity risk is to effectively manage cash flows to minimize the exposure that the Company will not be able to meet its obligations associated with financial liabilities. On an ongoing basis, liquidity risk is managed by maintaining adequate cash and cash equivalent balances and appropriately utilizing available lines of credit. Management believes that forecasted cash flows from operating activities, along with the available lines of credit, will provide sufficient cash requirements to cover the Company's forecasted normal operating activities, commitments and budgeted capital expenditures.

The Company has pledged as general collateral for advances under the operating credit facility a general security agreement on present and future assets, guarantees from each present and future direct and indirect subsidiary of the Company supported by a first registered security over all present and future assets, and pledge of their shares. The Company is not permitted to sell or re-pledge significant assets held under collateral without consent from the lenders.

## RISKS AND UNCERTAINTIES

The Company is subject to a number of known and unknown risks, uncertainties and other factors that could cause the Company's actual future results to differ materially from those historically achieved and those reflected in forward-looking statements made by the Company. These factors include, but are not limited to, fluctuations in the level of capital expenditures in the Fuel, Water and Wastewater, and Oil & Gas markets; drilling activity and oil and natural gas prices, environmental trends and other factors that affect demand for the Company's products and services; industry competition; the need to effectively integrate acquired businesses; the ability of management to implement the Company's business strategy effectively; political and general economic conditions; the ability to attract and retain key personnel; raw material and labour costs; fluctuations in the US and Canadian dollar exchange rates; accounts receivable risk; the ability to generate capital or maintain liquidity and credit agreements necessary to fund future operations; and other risks and uncertainties described under the heading "Risk Factors" in the Company's most recent Annual Information Form and elsewhere in other documents filed with Canadian provincial securities authorities which are available to the public at [www.sedar.com](http://www.sedar.com).

### Environmental Risks

To conduct business operations, the Company owns or leases properties and is subject to environmental risks due to the use of chemicals in the manufacturing process.

ZCL manages its environmental risks by appropriately dealing with chemicals and waste material in an environmentally safe and responsible manner, and in accordance with applicable regulatory requirements. In addition, the Company has a Health, Safety and Environment Committee that meets regularly to review and monitor environmental issues, compliance, risks and mitigation strategies. However, it is unknown whether specific environmental conditions and incidents will impact ZCL operations in the future.

The Company elects to partially self-insure against risk of environmental contamination at its production facilities as it has determined the risk to be low. The Company is not aware of any unrecorded material environmental liabilities.

## CRITICAL ACCOUNTING ESTIMATES & JUDGEMENTS

The Company's financial statements have been prepared following IFRS. The measurement of certain assets and liabilities is dependent upon future events and the outcome will not be fully known until future periods. Therefore, the preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Such estimates and assumptions have been made using careful judgments, which in management's opinion, are reasonable and conform to the significant accounting policies summarized in the December 31, 2017 annual consolidated financial statements. Actual results may vary from those estimated.

### Impairment

The Company assesses impairment at each reporting period by evaluating the circumstances specific to the organization that may lead to an impairment of assets. In addition to the quarterly assessment, the Company also performs an annual impairment test on goodwill and certain intangible assets in accordance with IAS 36: "Impairment of Assets."

Where indicators of impairment exist, and at least annually for goodwill and certain intangible assets, the recoverable amount of the asset or group of assets (cash generating units) is compared against the carrying amount. Any excess of the carrying amount over the recoverable amount will be recognized as an impairment loss in the income statement. The recoverable amount is calculated as the higher of the assets' (or group of assets) value in use or fair value less cost to sell. The actual growth rates and other estimates used in the determination of fair values at the time of impairment tests may vary materially from those realized in future periods.

### Property, Plant and Equipment, Intangible Assets and Goodwill

Property, plant and equipment and intangible assets with finite lives are recorded at cost less accumulated depreciation and amortization. Goodwill and indefinite life intangible assets are recorded at cost. The unamortized balances, or carrying values, are regularly reviewed for recoverability or tested for impairment whenever events or circumstances indicate that these amounts exceed their fair values. The valuation of these assets is based on estimated future net cash flows, taking into account current and future industry and other conditions. An impairment loss would be recognized for the amount that the carrying value exceeds the fair value.

Depreciation and amortization of property, plant and equipment and intangible assets with finite lives is based

on estimates of the useful lives of the assets. The useful lives are estimated, and a method of depreciation and amortization is selected at the time the assets are initially acquired and then re-evaluated each reporting period.

Judgment is required to determine whether events or circumstances warrant a revision to the remaining periods of depreciation and amortization. The estimates of cash flows used to assess the potential impairment of these assets are subject to measurement uncertainty. A significant change in these estimates and judgments could result in a material change to depreciation and amortization expense or impairment charges.

### Allowance for Doubtful Accounts

The Company's accounts receivable balance is a significant portion of overall assets. Credit is spread among many customers and the Company has not experienced significant accounts receivable collection problems in the past. The Company performs ongoing credit evaluations and maintains allowances for doubtful accounts based on the assessment of individual customer receivable balances, credit information, past collection history and the overall financial strength of customers. A change in these factors could impact the estimated allowance and the provision for bad debts recorded in the accounts. The actual collection of accounts receivable and the resulting bad debts may differ from the estimated allowance for doubtful accounts and the difference may be material.

### Self-insured Liabilities

The Company self-insures certain risks related to pollution protection provided on certain product sales, general liability claims and US workers compensation through Radigan Insurance Inc., its captive insurance company. The provision for self-insured liabilities includes estimates of the costs of reported and expected claims based on estimates of loss using assumptions determined by an independent actuary. The actual costs of claims may vary from those estimates, and the difference may be material.

### Warranties

The Company generally warrants its products for a period of one year after sale, and for up to 30 years for corrosion, if the products are properly installed and are used solely for storage of specified liquids. In Canada, until January 31, 2015, the Company marketed a storage system under the Prezerver® trademark that carried an enhanced protection program. The Prezerver system included an enhanced 10 year limited warranty covering product replacement, third-party pollution protection, site clean-up and defence costs up to the limits allowed under the warranty. Until December 1, 2006, the Canadian Prezerver program was

covered by insurance underwritten by a major international insurer. Effective December 1, 2006, the Company formed its own insurance captive to insure the Preserver program. Effective January 31, 2015, the Company ceased offering the Canadian Preserver program due to changing market conditions.

The Company provides for warranty obligations based on a review of products sold and historical warranty costs experienced. Provisions for warranty costs are charged to manufacturing and selling costs and revisions to the estimated provision are charged to earnings in the period

in which they occur. While the Company maintains high quality standards and has a limited history of liability or warranty problems under its standard warranties or Preserver program, there can be no guarantee that the warranty provision recorded, self-insurance provided by ZCL's captive insurance company or third party insurance will be sufficient to cover all potential claims. Excluding the enhanced Preserver warranty, the maximum exposure to the Company for warranty claims is, at the Company's sole discretion, to repair or replace the product giving rise to the claim. The actual costs of warranties may vary from those estimated, and the difference may be material.

### DISCLOSURE CONTROLS AND PROCEDURES

#### *Disclosure Controls and Procedures*

Disclosure controls and procedures ("DC&P") are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President & Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of ZCL on a timely basis so that appropriate decisions can be made regarding public disclosure.

In accordance with National Instrument 52-109: "Certification of Disclosure in Issuers' Annual and Interim Filings," the CEO and CFO have evaluated the effectiveness of the Company's disclosure controls and procedures as of the quarter ended June 30, 2018. Based on that evaluation, the CEO and CFO have concluded that the disclosure control procedures are effective and provide reasonable assurance that: (a) information required to be disclosed by the Company in its quarterly interim filings or other reports filed and submitted under applicable securities legislation is recorded, processed, summarized and reported within the prescribed time periods, and (b) material information regarding the Company is accumulated and communicated to management, including its CEO and CFO in a timely manner.

#### *Internal Controls over Financial Reporting ("ICFR")*

Management has evaluated whether there were changes in the Company's ICFR during the period ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's ICFR. No material changes were identified. There were also no material weaknesses relating to the design of ICFR at June 30, 2018, and no limitations on the scope of design of ICFRs.

While management of the Company have evaluated the effectiveness of disclosure controls and procedures and ICFR as of June 30, 2018, and have concluded that these controls and procedures are being maintained as designed, they recognize that the disclosure controls and procedures and ICFR may not prevent all errors and fraud. A control system, no matter how well conceived or operated, can only provide reasonable, not absolute assurance that the objectives of the control system are met.

### NON-IFRS MEASURES

This MD&A includes references to and uses measures and terms that are not specifically defined in IFRS and do not have any standardized meaning prescribed by IFRS. Included in non-IFRS measures is adjusted EBITDA, adjusted EBITDA per diluted share and working capital. The Company uses non-IFRS measures to make strategic decisions and set targets and believes that these non-IFRS measures are useful for providing securities analysts, investors, and other interested parties with additional information to assist them in understanding components of our financial results. This includes a more complete understanding of factors and trends affecting our operating performance. Non-IFRS measures also provide supplemental measures of operating performance, thus highlighting trends that may not otherwise be apparent when relying solely on IFRS financial measures.

Tables calculating or reconciling these non-IFRS measures, where applicable, have been included on the next page.

Adjusted EBITDA is defined as income from continuing operations before finance expense, income taxes, depreciation of property, plant and equipment, amortization of intangible assets, share-based compensation, gains or losses on sale of assets, and impairment of assets.

Adjusted EBITDA per diluted share is defined as adjusted EBITDA divided by weighted average diluted shares outstanding.

Readers are cautioned that adjusted EBITDA and adjusted EBITDA per diluted share should not be construed as an alternative to net income and net income per diluted share as determined in accordance with IFRS. The Company discloses adjusted EBITDA and adjusted EBITDA per diluted share as management considers that these measures provide additional clarity of the Corporation's operational performance to the readers of the MD&A. These adjustments to EBITDA include, among other things, non-cash gains and losses on disposal of assets, non-cash impairment charges and non-cash share-based compensation. The exclusion of these items does not indicate that they are non-recurring; management considers them to be non-operational. By removing non-operational items, readers of the MD&A will have a more complete understanding of factors and trends affecting ZCL's operating performance, thus highlighting trends that may not otherwise be apparent when relying solely on IFRS financial measures.

Working capital is defined as current assets less current liabilities. The Company discloses working capital in order to provide users of the MD&A a measure of the Company's liquidity and ability to pay current liabilities.

## Management's Discussion and Analysis

### RECONCILIATION OF NON-IFRS MEASURES

The following table reconciles net income from continuing operations in accordance with IFRS to adjusted EBITDA.

	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
(in thousands of dollars)	\$	\$	\$	\$
Net income from continuing operations	3,921	6,031	4,406	6,950
Adjustments:				
Depreciation and amortization	708	783	1,408	1,604
Finance expense	84	34	128	76
Income tax expense	1,429	2,452	1,613	3,803
Share-based compensation	39	80	115	134
Loss (gain) on disposal of property, plant and equipment	8	87	(3)	71
Adjusted EBITDA	6,189	9,467	7,667	12,638
<i>Adjusted EBITDA as a % of revenue</i>	<b>13%</b>	<b>18%</b>	<b>10%</b>	<b>15%</b>

The following table presents the calculation of adjusted EBITDA per diluted share:

	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
<b>Numerator</b> (in thousands of dollars)	\$	\$	\$	\$
Adjusted EBITDA	6,189	9,467	7,667	12,638
<b>Denominator</b> (in thousands)		#		#
Weighted average shares outstanding – basic	30,869	31,008	30,873	30,913
Effect of dilutive securities:				
Stock options	82	254	89	240
Weighted average shares outstanding - diluted	30,951	31,262	30,962	31,153
Adjusted EBITDA per diluted share	0.20	0.30	0.25	0.41

The following table presents the calculation of working capital.

	As at		
	June 30, 2018	December 31, 2017	June 30, 2017
(in thousands of dollars)	\$	\$	\$
Current assets	68,352	78,482	83,927
Current liabilities	31,329	25,562	30,362
Working capital	37,023	52,920	53,565

**ADVISORY REGARDING FORWARD-LOOKING STATEMENTS**

This document contains forward-looking statements and forward-looking information as defined under applicable securities legislation (collectively, "forward-looking statements") under the heading "Outlook" and elsewhere concerning future events or the Company's future performance. All statements other than statements of historical fact are forward-looking statements including the Company's objectives or expectations for revenue and earnings growth, income taxes as a percentage of pre-tax income, business opportunities in the Fuel, Water & Wastewater, Oil & Gas and International markets, efforts to reduce administrative and production costs, manage production levels, anticipated capital expenditure trends, activity in the fuel and other industries and markets served by the Company and the sufficiency of cash flows and credit facilities available to cover normal operating and capital expenditures. The use of any of the words such as "seek," "anticipate," "plan," "contemplate," "continue," "estimate," "expect," "intend," "propose," "forecast," "may," "will," "shall," "project," "predict," "potential," "targeting," "intend," "could," "might," "should," "believe" and similar expressions are intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. No assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this document should not be unduly relied upon.

These factors include, but are not limited to, fluctuations in the level of capital expenditures in the Fuel, Water & Wastewater, and Oil & Gas markets, drilling activity and oil and natural gas prices, and other factors that affect demand for the Company's products and services, industry competition, the need to effectively integrate acquired businesses, uncertainties as to the Company's ability to implement its business strategy effectively, political and economic conditions, the Company's ability to attract and retain key personnel, raw material and labour costs, fluctuations in the US dollar, euro and Canadian dollar exchange rates, and other risks and uncertainties described under the heading "Risk Factors" in the Company's most recent Annual Information Form, and elsewhere in this document and other documents filed with Canadian provincial securities authorities. These documents are available to the public at [www.sedar.com](http://www.sedar.com). The unaudited condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards and the reporting currency is in Canadian dollars.

In addition to the factors noted above, management cautions readers that the current economic environment could have a negative impact on the markets in which the Company operates and on the Company's ability to achieve its financial targets. Factors such as continuing global economic uncertainty, tight lending standards, volatile capital markets, fluctuating commodity prices, and other factors could negatively impact the demand for the Company's products and the Company's ability to grow or sustain revenues and earnings. Fluctuations in conversion rates of the US dollar to Canadian dollar and euro to Canadian dollar also have the potential to impact the Company's revenues and earnings.

The Company believes that the expectations reflected in the forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this report should not be unduly relied upon.

The forward-looking statements in this report speak only as of the date of this report. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by the Company or on the Company's behalf, whether as a result of new information, future events, or otherwise, except as may be required under applicable securities laws. The forward-looking statements contained in this document are expressly qualified by this cautionary statement.

**ZCL Composites Inc.**

**Interim Condensed Consolidated Financial Statements and Notes**

For the three and six months ended June 30, 2018 and 2017

(Unaudited)

## Interim Condensed Consolidated Financial Statements

### Interim Consolidated Balance Sheets

As at  
(Unaudited)

	June 30, 2018	December 31, 2017
(in thousands of dollars)	\$	\$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	—	25,556
Accounts receivable	30,943	27,633
Inventories <i>[note 4]</i>	32,320	21,285
Income taxes recoverable	3,879	2,380
Prepaid expenses	1,210	1,628
	68,352	78,482
Deferred tax assets	—	169
Property, plant and equipment	28,963	27,241
Intangible assets	910	1,155
Goodwill	35,197	33,681
<b>TOTAL ASSETS</b>	<b>133,422</b>	<b>140,728</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank indebtedness <i>[note 8]</i>	1,149	—
Accounts payable and accrued liabilities	20,357	18,042
Dividends payable <i>[note 9]</i>	4,148	3,705
Income taxes payable	7	485
Deferred revenue	4,112	1,814
Current portion of provisions	1,556	1,516
	31,329	25,562
Deferred tax liabilities	2,902	2,569
Long term portion of provisions	1,720	1,359
<b>TOTAL LIABILITIES</b>	<b>35,951</b>	<b>29,490</b>
<b>Shareholders' equity</b>		
Share capital <i>[notes 10 and 16]</i>	83,478	83,450
Contributed surplus	1,739	1,731
Accumulated other comprehensive income	10,621	6,701
Retained earnings <i>[note 16]</i>	1,633	19,356
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>97,471</b>	<b>111,238</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>133,422</b>	<b>140,728</b>

*See accompanying notes*

## Interim Condensed Consolidated Financial Statements

### Interim Consolidated Statements of Income

For the periods ended June 30,  
(Unaudited)

	Three months		Six months	
	2018	2017	2018	2017
(in thousands of dollars, except per share amounts)	\$	\$	\$	\$
<b>Revenue</b> <i>[note 5]</i>	<b>46,812</b>	53,306	<b>78,694</b>	85,047
Manufacturing and selling costs <i>[note 6]</i>	<b>38,418</b>	41,405	<b>65,667</b>	67,040
Gross profit	<b>8,394</b>	11,901	<b>13,027</b>	18,007
General and administration	<b>2,779</b>	2,515	<b>5,369</b>	5,271
Foreign exchange (gain) loss	<b>(535)</b>	(1)	<b>106</b>	232
Depreciation and amortization	<b>708</b>	783	<b>1,408</b>	1,604
Finance expense	<b>84</b>	34	<b>128</b>	76
Loss (gain) on disposal of property, plant and equipment	<b>8</b>	87	<b>(3)</b>	71
	<b>3,044</b>	3,418	<b>7,008</b>	7,254
Income before income taxes	<b>5,350</b>	8,483	<b>6,019</b>	10,753
Income tax expense (recovery)				
Current <i>[note 7]</i>	<b>1,491</b>	2,147	<b>1,174</b>	3,967
Deferred	<b>(62)</b>	305	<b>439</b>	(164)
	<b>1,429</b>	2,452	<b>1,613</b>	3,803
<b>Net income from continuing operations</b>	<b>3,921</b>	6,031	<b>4,406</b>	6,950
<b>Net loss from discontinued operations</b> <i>[note 12]</i>	<b>—</b>	(374)	<b>—</b>	(411)
<b>Net income</b>	<b>3,921</b>	5,657	<b>4,406</b>	6,539
<b>Earnings per share from continuing operations</b> <i>[note 13]</i>				
Basic	<b>\$0.13</b>	\$0.19	<b>\$0.14</b>	\$0.22
Diluted	<b>\$0.13</b>	\$0.19	<b>\$0.14</b>	\$0.22
<b>Loss per share from discontinued operations</b> <i>[note 13]</i>				
Basic	<b>—</b>	(\$0.01)	<b>—</b>	(\$0.01)
Diluted	<b>—</b>	(\$0.01)	<b>—</b>	(\$0.01)
<b>Earnings per share</b> <i>[note 13]</i>				
Basic	<b>\$0.13</b>	\$0.18	<b>\$0.14</b>	\$0.21
Diluted	<b>\$0.13</b>	\$0.18	<b>\$0.14</b>	\$0.21

See accompanying notes

## Interim Condensed Consolidated Financial Statements

### Interim Consolidated Statements of Comprehensive Income

For the periods ended June 30,  
(Unaudited)

(in thousands of dollars)	Three months		Six months	
	2018	2017	2018	2017
	\$	\$	\$	\$
Net income	3,921	5,657	4,406	6,539
Translation of foreign operations	1,044	(2,061)	3,920	(2,803)
Total items that will be reclassified subsequently to net income	1,044	(2,061)	3,920	(2,803)
<b>Comprehensive income</b>	<b>4,965</b>	<b>3,596</b>	<b>8,326</b>	<b>3,736</b>

### Interim Consolidated Statements of Shareholders' Equity

For the six months ended  
(Unaudited)

(in thousands)	Common Shares #	Share Capital \$	Contributed Surplus \$	Accumulated Other Comprehensive Income \$	Retained Earnings \$	Total \$
<b>Balance, December 31, 2017 [note 16]</b>	<b>31,162</b>	<b>83,450</b>	<b>1,731</b>	<b>6,701</b>	<b>19,356</b>	<b>111,238</b>
Share-based payments [note 11]	—	—	115	—	—	115
Shares purchased through normal course issuer bid [notes 10 and 16]	(508)	(582)	—	—	(1,464)	(2,046)
Shares issued on exercise of stock options [note 10]	70	503	—	—	—	503
Reclassification of fair value of stock options previously expensed	—	107	(107)	—	—	—
Translation of foreign operations	—	—	—	3,920	—	3,920
Dividends declared [note 9]	—	—	—	—	(20,665)	(20,665)
Net income	—	—	—	—	4,406	4,406
<b>Balance, June 30, 2018</b>	<b>30,724</b>	<b>83,478</b>	<b>1,739</b>	<b>10,621</b>	<b>1,633</b>	<b>97,471</b>
Balance, December 31, 2016 [note 16]	30,774	81,211	1,987	12,166	38,731	134,095
Share-based payments [note 11]	—	—	134	—	—	134
Shares issued on exercise of stock options [note 10]	270	1,758	—	—	—	1,758
Reclassification of fair value of options previously expensed	—	391	(391)	—	—	—
Translation of foreign operations	—	—	—	(2,803)	—	(2,803)
Dividends declared [note 9]	—	—	—	—	(27,511)	(27,511)
Net income	—	—	—	—	6,539	6,539
<b>Balance, June 30, 2017 [note 16]</b>	<b>31,044</b>	<b>83,360</b>	<b>1,730</b>	<b>9,363</b>	<b>17,759</b>	<b>112,212</b>

See accompanying notes

## Interim Condensed Consolidated Financial Statements

### Interim Consolidated Statements of Cash Flows

For the periods ended June 30,  
(Unaudited)

	Three months		Six months	
	2018	2017	2018	2017
(in thousands of dollars)	\$	\$	\$	\$
<b>CASH FLOWS FROM CONTINUING OPERATIONS</b>				
Net income from continuing operations	3,921	6,031	4,406	6,950
Add (deduct) items not affecting cash:				
Depreciation and amortization	708	783	1,408	1,604
Deferred tax (recovery) expense	(62)	305	439	(164)
Share-based compensation expense <i>[note 11]</i>	39	80	115	134
Loss (gain) on disposal of property, plant and equipment	8	87	(3)	71
<b>Funds from continuing operations</b>	<b>4,614</b>	<b>7,286</b>	<b>6,365</b>	<b>8,595</b>
Changes in non-cash working capital:				
Increase in accounts receivable	(5,264)	(13,065)	(2,839)	(4,326)
(Increase) decrease in inventories	(1,743)	3,037	(10,060)	(4,235)
Decrease in prepaid expenses	579	267	463	797
Increase in accounts payable, accrued liabilities and provisions	2,111	4,286	2,163	4,977
Increase (decrease) in deferred revenue	1,136	(543)	2,443	(163)
Decrease in income taxes payable	(390)	(2,147)	(1,209)	(2,184)
<b>Total changes in non-cash working capital</b>	<b>(3,571)</b>	<b>(8,165)</b>	<b>(9,039)</b>	<b>(5,134)</b>
<b>Cash flows from (used in) operating activities</b>	<b>1,043</b>	<b>(879)</b>	<b>(2,674)</b>	<b>3,461</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Issue of common shares on the exercise of stock options <i>[note 10]</i>	254	392	503	1,758
Dividends paid <i>[note 9]</i>	(16,517)	(3,717)	(20,222)	(26,248)
Repurchase of shares through Normal Course Issuer Bid <i>[note 10]</i>	(2,046)	—	(2,046)	—
Advance of bank indebtedness	1,149	—	1,149	—
<b>Cash flows used in financing activities</b>	<b>(17,160)</b>	<b>(3,325)</b>	<b>(20,616)</b>	<b>(24,490)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Purchase of property, plant and equipment	(1,134)	(873)	(2,489)	(1,618)
Disposal of property, plant and equipment	—	27	40	37
Purchase of intangible assets	—	(70)	(21)	(70)
<b>Cash flows used in investing activities</b>	<b>(1,134)</b>	<b>(916)</b>	<b>(2,470)</b>	<b>(1,651)</b>
Foreign exchange (loss) gain on cash held in foreign currency	(388)	103	204	(390)
Cash flows used in discontinued operations <i>[note 12]</i>	—	(446)	—	(483)
<b>Decrease in cash and cash equivalents</b>	<b>(17,639)</b>	<b>(5,463)</b>	<b>(25,556)</b>	<b>(23,553)</b>
Cash and cash equivalents, beginning of the period	17,639	25,118	25,556	43,208
<b>Cash and cash equivalents, end of the period</b>	<b>—</b>	<b>19,655</b>	<b>—</b>	<b>19,655</b>

See accompanying notes

## Notes to the Interim Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2018

### 1. CORPORATE INFORMATION

ZCL Composites Inc. (the “Company”) is a public company incorporated and domiciled in Canada and its common stock trades on the Toronto Stock Exchange. The address of the Company’s registered office is 1420 Parsons Road S.W., Edmonton, Alberta, Canada, T6X 1M5. The Company is principally involved in the manufacturing and distribution of liquid storage systems, including fibreglass storage tanks and related products and accessories. The Company also produces and sells in-situ fibreglass tank and tank lining systems and three dimensional glass fabric material.

### 2. BASIS OF PRESENTATION

The interim condensed consolidated financial statements are reported in Canadian dollars which is the functional currency of the reporting entity, ZCL Composites Inc.

#### *Statement of Compliance*

The interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34: “Interim Financial Reporting” as issued by the International Accounting Standards Board (“IASB”) and do not include all of the information required for full annual financial statements. The same accounting policies were followed in the preparation of these interim condensed consolidated financial statements as were followed in the preparation of the annual consolidated financial statements for the year ended December 31, 2017. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2017.

The interim condensed consolidated financial statements were authorized for issue by the Board of Directors on August 9, 2018.

#### *Basis of Consolidation*

The interim condensed consolidated financial statements of the Company include the accounts of ZCL Composites Inc. and its subsidiaries including Parabeam Industries BV, Radigan Insurance Inc., ZCL International SRL, ZCL-Dualam Inc., Troy Mfg. (Texas), Inc. and Xerxes Corporation.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values. Any excess of the cost over the fair values of the identifiable net assets acquired is recognized as goodwill. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company using consistent accounting policies. All intra-group balances, income and expenses, unrealized gains and losses and dividends resulting from intra-group transactions are eliminated in full.

### 3. NEW ACCOUNTING STANDARDS

The Company has adopted IFRS 15: *Revenue from Contracts with Customers* effective January 1, 2018 using the modified retrospective method. The adoption of this standard did not result in a material change to the balances reported on December 31, 2017 or the balances that would have been reported under the previous standard for March 31, 2018. Below is a summary of the Company’s revenue streams, the accounting policy in effect under the new IFRS 15 standard and the changes that resulted from adoption of the new standard:

#### (A) *Sale of tanks and related products:*

Revenue from the sale of tanks and related products is recognized when all of the performance obligations identified in the customer contract, typically consisting of a purchase order, are satisfied. The performance obligations in a typical customer purchase order are the manufacture of a tank and related accessories and delivery of the tank and related accessories.

## Notes to the Interim Condensed Consolidated Financial Statements (Unaudited)

There are circumstances where the customer requests their products be stored on ZCL premises beyond normal inventory storage timelines due to construction site delays or other factors. In these cases, the prolonged storage of tanks would not constitute a separate performance obligation of the original customer purchase order, but would constitute a performance obligation of a separately negotiated storage contract. Revenue from the manufacture and delivery obligations would be recognized upon the signing of a storage contract which includes the following clauses:

- The products are being stored on ZCL premises at the customer's request.
- The products are separately identifiable as belonging to the customer, segregated from stock inventory.
- The products are ready to immediate transfer to the customer upon the customer's request.
- The Company does not have the ability or legal authority to transfer the products to another customer.

The effects of the adoption of this policy have no impact on the financial statement lines or opening balances.

(B) *Pre-buy orders with bill and hold arrangements – tank storage:*

The Company regularly enters into pre-buy agreements with major customers where the customers place orders in the winter months. ZCL manufactures the product during the seasonally slower winter month periods, invoices the customers upon completion of the manufacturing and then stores the tanks until the spring and summer months when the customer requires their product.

In addition to the performance obligations of delivery and manufacturing of the customer order, an additional performance obligation of tank storage is present in a pre-buy arrangement. The transaction price of the customer purchase order is allocated over the three separate performance obligations, manufacturing, delivery and storage of the products. As the customer purchase order does not specifically identify product storage as a negotiated purchase price, the Company allocates the typical monthly storage fee to the tank storage performance obligation, with the remainder of the customer purchase order value allocated to the manufacture and delivery of the product. Revenue on the product manufacturing and delivery is recognized upon the signing of a storage contract and revenue from the storage of the products is recognized over the expected term of storage for the products

The effects of the adoption of this policy are not material to the Interim Condensed Consolidated Financial Statements, and as such, no adjustments to opening financial statement line items have been recognized.

(C) *Royalty revenue:*

Royalty revenue from the third party use of the Company's technology is recognized at the later of the licensees selling the licensed product and when all of the Company's performance obligations are met.

The effects of the adoption of this policy have no impact on the financial statement lines or opening balances.

#### 4. INVENTORIES

As at	June 30, 2018	December 31, 2017
(in thousands of dollars)	\$	\$
Raw materials	8,477	7,597
Work in progress	4,470	4,154
Finished goods	19,373	9,534
	<b>32,320</b>	<b>21,285</b>

## Notes to the Interim Condensed Consolidated Financial Statements (Unaudited)

### 5. REVENUE

For the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2018	2017	2018	2017
	\$	\$	\$	\$
Fuel	40,733	42,975	68,293	69,888
Water & Wastewater	5,074	6,688	8,258	10,889
Oil & Gas	1,005	3,643	2,143	4,270
	<b>46,812</b>	<b>53,306</b>	<b>78,694</b>	<b>85,047</b>

### 6. MANUFACTURING AND SELLING COSTS

For the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2018	2017	2018	2017
	\$	\$	\$	\$
Raw materials	15,746	16,908	30,282	30,464
Labour costs	8,096	8,086	15,637	15,298
Other costs	15,679	14,788	29,903	26,338
Net change in inventories of finished goods and work in progress	(1,103)	1,623	(10,155)	(5,060)
	<b>38,418</b>	<b>41,405</b>	<b>65,667</b>	<b>67,040</b>

### 7. INCOME TAXES

During the six months ended June 30, 2018, the Company paid a total of \$nil (2017 - \$525,000 USD) in withholding taxes on the repatriation of cash into Canada from a US subsidiary.

### 8. BANK INDEBTEDNESS

Bank indebtedness consists of amounts drawn under available credit facilities and cheques issued in excess of related cash and cash equivalent balances. The Company has a maximum of \$20 million of available credit under this operating credit facility. The operating credit facility is repayable on demand and expires on May 31, 2020 and is typically renewed on an annual basis with the Company's primary lender. The rate of interest charged on the borrowings under the operating credit facility for Canadian dollar balances is prime plus 25 basis points. The rate of interest charged on the borrowings under operating credit facility for US dollar balances is US prime plus 25 basis points.

The Company has pledged as general collateral for advances under the operating credit facility a general security agreement on present and future assets, and an unlimited guarantee supported by a general security agreement from Xerxes Corporation, the Company's subsidiary. The Company is not permitted to sell or re-pledge significant assets held under collateral without consent from the lenders. The Company is required to meet certain covenants as a condition of the debt agreements. At June 30, 2018, the Company was in compliance with all restrictive covenants relating to the operating credit facility.

## Notes to the Interim Condensed Consolidated Financial Statements (Unaudited)

### 9. DIVIDENDS

Dividends declared for the six months ended June 30,

(in thousands of dollars,  
except per share amounts)

2018				2017			
Declared	Per share	Paid to shareholders	Total \$	Declared	Per share	Paid to shareholders	Total \$
March 7, 2018	\$0.135	April 16, 2018	4,172	March 8, 2017	\$0.65	March 31, 2017	20,069
May 3, 2018	\$0.40	June 15, 2018	12,345	March 8, 2017	\$0.12	April 17, 2017	3,717
May 3, 2018	\$0.135	July 16, 2018	4,148	May 3, 2017	\$0.12	July 17, 2017	3,725
	\$0.67		20,665		\$0.89		27,511

As at

	June 30 2018 \$	December 31 2017 \$
(in thousands of dollars)		
Payable, beginning of period	3,705	2,462
Declared	20,665	34,953
Paid in cash	(20,222)	(33,710)
Payable, end of period	4,148	3,705

On August 9, 2018, the Company's Board of Directors declared a dividend of \$0.135 per common share to be paid on October 15, 2018 to the shareholders of record as of September 30, 2018.

### 10. SHARE CAPITAL

#### Authorized

Unlimited number of common shares with no par or stated value.

#### Issued and outstanding

During the three months ended June 30, 2018, the Company issued 35,701 common shares (2017 – 66,484) at an average rate of \$7.12 per share for options exercised resulting in cash proceeds to the Company of \$254,000 (2017 - \$392,000). During the six months ended June 30, 2018, the Company issued 69,869 common shares (2017 – 270,106) at an average rate of \$7.20 per share for options exercised resulting in cash proceeds to the Company of \$503,000 (2017 - \$1,758,000).

In March 2018, the Company refreshed the Normal Course Issuer Bid ("NCIB") with the ability to re-purchase and cancel up to 1,500,000 shares from the open market. During the three months ended June 30, 2018, the Company purchased and cancelled a total of 217,100 shares (2017 - nil) at an average price of \$9.42 per share. During the six months ended June 30, 2018, the Company cancelled 507,600 shares (2017 – nil) at an average price of \$10.28 per share.

As at June 30, 2018, the Company had 30,723,847 common shares outstanding (June 30, 2017 – 31,044,061).

**11. SHARE BASED PAYMENTS**

**a) Stock-options**

The Black-Scholes option pricing model, used by the Company to calculate the values of options, as well as other currently accepted option valuation models, was developed to estimate the fair value of freely-tradable, fully-transferable options without vesting restrictions. These models require assumptions, including future share price volatility and expected time until exercise, which affect the calculated values.

For the six months ended June 30,

	2018		2017	
	Stock options	Weighted average exercise price	Stock options	Weighted average exercise price
Balance, as at January 1	699,823	9.78	841,581	6.82
Awarded	—	—	297,869	13.29
Exercised	(34,168)	7.27	(203,622)	6.71
Forfeited	(9,734)	11.05	(20,170)	7.36
Balance, as at March 31	655,921	9.89	915,658	8.94
Awarded	257,591	10.20	—	—
Exercised	(35,701)	7.12	(66,484)	5.90
Forfeited	(36,718)	11.65	(18,500)	8.87
Balance, as at June 30	841,093	10.03	830,674	9.18

Share based compensation expense of \$39,000 (2017 - \$80,000) during the three months ended June 30, 2018, and \$115,000 (2017 - \$134,000) during the six months ended June 30, 2018 was recorded in manufacturing and selling costs and general and administration expenses in the interim condensed consolidated statements of income relating to stock options.

**b) Performance share units**

Under the Company's 2015 Incentive Plan, named executive officers may be awarded Performance Share Units ("PSU") equal to the cash equivalent of one common share of ZCL stock. These PSUs vest over a three year period and are contingent on the Company achieving certain performance objectives. For the PSUs that vest, the unit holders will receive a cash payment based on the closing price of the Company's common shares on the expiry date of the units. Dividend equivalent rights are granted in tandem with the PSUs. During the three months ended June 30, 2018, the Company awarded 4,676 PSUs (2017 - nil) and a \$77,000 recovery of compensation expense (2017 - \$36,000 expense) was recognized in general and administrative expenses. For the six months ended June 30, 2018, the Company awarded 4,676 PSUs (2017 - 11,912) and a recovery of \$47,000 of compensation expense (2017 - \$83,000 expense) was recognized in general and administrative expenses. As at June 30, 2018, the amortized fair value of the PSUs on the Company's balance sheet was \$76,000 (December 31, 2017 - \$215,000).

**c) Deferred share units**

Under the Company's 2017 Incentive Plan, directors may be awarded Deferred Share Units ("DSU") equal to the cash equivalent of one common share of ZCL stock. The DSUs vest on their grant date and are paid in cash to the holder upon retirement from the Company based on the market value of ZCL stock on the date of their retirement. Dividend equivalent rights are granted in tandem with the DSUs. During the three months ended June 30, 2018, the Company awarded 18,441 DSUs (2017 - nil), no DSUs were exercised (2017 - 10,492 for \$145,000) and an expense of \$44,000 (2017 - \$149,000 recovery) was recognized in general and administrative expenses. For the six months ended June 30, 2018, the Company awarded 18,441 DSUs (2017 - 15,909), no DSUs were exercised (2017 - 10,492 for \$145,000) and \$44,000 of compensation expense (2017 - \$109,000 expense) was recognized in general and administrative expenses. As at June 30, 2018, the fair value of the DSUs on the Company's balance sheet was \$724,000 (December 31, 2017 - \$648,000).

**12. DISCONTINUED OPERATIONS**

On September 30, 2016, the Company disposed of the property, plant and equipment, assets held for sale and inventory held in the former ZCL Dualam operations for total consideration of \$2,508,000 including cash proceeds of \$2,071,000. The revenues and costs shown in the discontinued operations schedule below include only those revenues and costs directly attributable to the business units for which operations have ceased and do not include any cost allocations or costs indirectly attributable to the discontinued operations.

**a) The results of the discontinued operations are as follows:**

For the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2018	2017	2018	2017
	\$	\$	\$	\$
<b>Revenue</b>	—	—	—	5
Manufacturing and selling costs	—	299	—	422
Gross loss	—	(299)	—	(417)
Foreign exchange loss	—	123	—	135
	—	123	—	135
Loss before income taxes	—	(422)	—	(552)
Income tax recovery	—	(48)	—	(141)
<b>Net loss from discontinued operations</b>	<b>—</b>	<b>(374)</b>	<b>—</b>	<b>(411)</b>

**b) Cash used in discontinued operations are as follows:**

For the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2018	2017	2018	2017
	\$	\$	\$	\$
Net loss from discontinued operations	—	(374)	—	(411)
Add (deduct) items not affecting cash:				
Deferred tax recovery	—	(72)	—	(72)
<b>Cash used in discontinued operations</b>	<b>—</b>	<b>(446)</b>	<b>—</b>	<b>(483)</b>

## Notes to the Interim Condensed Consolidated Financial Statements (Unaudited)

### 13. EARNINGS PER SHARE

The following table sets forth the net income available to common shareholders and weighted average number of common shares outstanding for the computation of basic and diluted earnings per share:

For the periods ended June 30,

	Three months		Six months	
	2018	2017	2018	2017
Numerator (in thousands)	\$	\$	\$	\$
Net income from continuing operations	3,921	6,031	4,406	6,950
Net loss from discontinued operations	—	(374)	—	(411)
Net income	3,921	5,657	4,406	6,539

	Three months		Six months	
	2018	2017	2018	2017
Denominator (in thousands)	#	#	#	#
Weighted average shares outstanding - basic	30,869	31,008	30,873	30,913
Effect of dilutive securities:				
Stock options	82	254	89	240
Weighted average shares outstanding - diluted	30,951	31,262	30,962	31,153

### 14. FINANCIAL INSTRUMENTS

#### Foreign exchange risk

The Company operates on an international basis and is subject to foreign exchange risk exposures arising from transactions denominated in foreign currencies. The Company's objective with respect to foreign exchange risk is to minimize the impact of the volatility related to financial assets and liabilities denominated in a foreign currency, where possible, through effective cash flow management. Foreign currency exchange risk is limited to the portion of the Company's business transactions denominated in currencies other than Canadian dollars. The Company's most significant foreign exchange risk arises primarily with respect to the US dollar. The revenues and expenses of the Company's US operations are denominated in US dollars. Certain of the revenue and expenses of the Canadian operations are also denominated in US dollars. The Company is also exposed to foreign exchange risk associated with the euro due to its operations in The Netherlands, however these amounts are not significant to the Company's consolidated financial results. On an ongoing basis, management monitors changes in foreign currency exchange rates as well as considers long term forecasts to assess the potential cash flow impact on the Company. During the three and six months ended June 30, 2018, the Company converted US dollar cash to Canadian dollar cash to help mitigate foreign exchange exposures resulting from fluctuations in exposed monetary assets and liabilities. The Company continues to monitor its foreign exchange exposure on monetary assets.

The tables that follow provide an indication of the Company's exposure to changes in the value of the US dollar relative to the Canadian dollar as at and for the three and six months ended June 30, 2018. The analysis is based on financial assets and liabilities denominated in US dollars at the end of the period ("balance sheet exposure"), which are separated by domestic and foreign operations, and US dollar denominated revenue and operating expenses during the period ("operating exposure").

Balance sheet exposure as at June 30, 2018,

(in thousands of US dollars)	Foreign Operations	Domestic Operations	Total
	\$	\$	\$
Cash and cash equivalents	7,038	1,512	8,550
Accounts receivable	17,844	2,496	20,340
Accounts payable and accrued liabilities	(6,788)	(1,138)	(7,926)
Trade balances between foreign and domestic operations	3,080	(3,080)	—
Net balance sheet exposure	21,174	(210)	20,964

## Notes to the Interim Condensed Consolidated Financial Statements (Unaudited)

Operating exposure for the six months ended June 30, 2018,

(in thousands of US dollars)	\$
Sales	47,707
Operating expenses	41,453
Net operating exposure	6,254

The average US to Canadian dollar translation rate was 1.28 for the six months ended June 30, 2018. The translation rate as at June 30, 2018 was 1.31.

Based on the Company's foreign currency exposures noted above, with other variables unchanged, a twenty percent decrease in the Canadian dollar would have impacted net income as follows:

For the six months ended June 30, 2018,

(in thousands of US dollars)	\$
Net balance sheet exposure of domestic operations	(29)
Net operating exposure of domestic operations	748
Change in net income	719

Other comprehensive income would have changed \$2,710,000 if the value of the Canadian dollar fluctuated by 20% due to the net balance sheet exposure of financial assets and liabilities of foreign operations. The timing and volume of the above transactions as well as the timing of their settlement could impact the sensitivity analysis.

### Fair value of financial instruments

The Company holds financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and dividends payable.

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, dividends payable and accrued liabilities and provisions approximates their fair value due to their short term nature.

**15. SEGMENTED INFORMATION**

Operating segments are defined as components of the Company for which separate financial information is available that is evaluated regularly by the chief operating decision maker in allocating resources and assessing performance. The chief operating decision maker of the Company is the Chief Executive Officer. Based on management's judgement and applying the aggregation criteria in IFRS 8.12, the Company's operations fall under a single reportable segment.

**a) Information about major customers**

The Company has contracts and alliance arrangements with many of the major oil and gas companies and provides products for distributors and retail oil and gas companies. For the three and six months ended June 30, 2018 and 2017, no single customer exceeded 10% of total revenue or accounts receivable.

**b) Information about geographic areas**

Revenue for the periods ended June 30,

(in thousands of dollars)	Three months		Six months	
	2018	2017	2018	2017
	\$	\$	\$	\$
Canada	8,540	10,260	16,685	15,380
United States	36,249	40,078	57,584	65,674
International	2,023	2,968	4,425	3,993
	<b>46,812</b>	<b>53,306</b>	<b>78,694</b>	<b>85,047</b>

As at	Total assets		Property, plant and equipment, intangible assets and goodwill	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
(in thousands of dollars)	\$	\$	\$	\$
Canada	37,648	28,445	18,066	18,121
United States	94,244	109,868	46,723	43,629
International	1,530	2,415	281	327
	<b>133,422</b>	<b>140,728</b>	<b>65,070</b>	<b>62,077</b>

**16. PRIOR YEAR RECLASSIFICATION**

Certain of the prior years' and comparative balances were reclassified from share capital to retained earnings to conform to the current period's presentation.