

A  
Commitment  
to Quality.



### Financial Highlights

<u>Three months ended</u>	<u>June 30, 2002</u>	<u>May 31, 2001</u>
	\$	\$
Revenues	7,331,453	9,597,461
Net earnings for the period	229,444	657,081
Basic earnings per share	0.02	0.06
EBITDA **	571,062	1,383,139
EBITDA ** per share	0.05	0.14
<u>Six months ended</u>	<u>June 30, 2002</u>	<u>May 31, 2001</u>
	\$	\$
Revenues	20,525,844	13,786,153
Net earnings for the period	1,641,414	811,435
Basic earnings per share	0.15	0.08
EBITDA **	3,248,066	1,797,178
EBITDA ** per share	0.30	0.18

\*\*EBITDA represents earnings before interest, taxes, depreciation and amortization

Enerchem International Inc. is an oilfield services company providing specialty chemical and hydrocarbon based fluid solutions to oil and gas production problems.

## President's Message

The company's record performance for the six months ended June 30, 2002 has been overshadowed by the unexpected length of oilfield inactivity during the last three months. The extended seasonal slowdown in oilfield services work and the cautious return to oil and gas exploration and development programs by oil and gas producers has, in fact, continued into the third quarter of this year. As a result, revenues for the second quarter of 2002 declined by 24% to \$7,331,000 from \$9,597,000 for the 2001 comparative quarter. While we remained profitable for the quarter with net earnings of \$229,000 or \$0.02 per share, the significant decline in drilling and well completion activity resulted in a corresponding drop in demand for our hydrocarbon based fracturing and drilling fluids.

We do not believe, however, that the present downturn will continue. We are encouraged by recent forecasts and supporting trends that suggest a gradual return in oilfield activity during the latter part of the third quarter and a return to more seasonal levels of activity in the fourth quarter, continuing into the first quarter of 2003.

## Management's Discussion and Analysis

Management's discussion and analysis ("MD&A") of the consolidated financial condition and interim results of operations for the period ended June 30, 2002 should be read in conjunction with the audited financial statements and MD&A for the four month period ended December 31, 2001. Statements throughout this interim report that are not historical facts may be considered "forward looking statements". Such statements are based on current expectations that involve risks and uncertainties which could cause actual results to differ from those anticipated.

### Revenues

Revenues for the three months ended June 30, 2002 decreased by 24%, or \$2,266,000, to \$7,331,000 compared with revenues of \$9,597,000 for the three months ended May 31, 2001. The decrease in revenues reflects the impact of a significant drop off in oilfield activity precipitated in part by an extended seasonal slowdown in oilfield services work and to a larger extent by a cautious return to oil and gas exploration and development programs by oil and gas producers in western Canada. On a year to date basis, revenues were up by \$6,740,000 or 49% to \$20,526,000 from \$13,786,000 for the comparative six months last year. Revenues for the comparative period ended May 31, 2001 include the acquisition of Trysol Canada Ltd. effective April 1, 2001.

### Gross Profit

Gross profit as a percentage of revenues was 46% for the quarter ended June 30, 2002 compared with 41% for the comparative quarter ended May 31, 2001. The increase in gross profit as a percentage of revenues resulted from a shift in product mix during the current quarter as revenues were more heavily weighted to sales of higher margin specialty chemicals and solvents. On a year to date basis, the gross profit as a percentage of revenues was 43% in each of the comparative periods.

### Expenses

Salaries and employee benefits decreased moderately to

The company's infrastructure is now in place in order to capitalize on the anticipated increase in activity. The Sundre fractionation plant along with the addition of the Slave Lake fractionation plant allows the company to produce a much larger volume of specialty hydrocarbon fluids for the oil and gas industry. Up until the Slave Lake plant was operational, production constraints did not allow the company to pursue additional markets. The increased capacity at the Nisku blend plant and the addition of the expanded laboratory also allows the Specialty Chemicals Group to pursue markets that were previously not available.

The company is well capitalized and will also continue to pursue acquisition opportunities that are accretive and represent a logical fit with our operations.



L.B. Phillips  
President and Chief Executive Officer

\$1,334,000, or 18% of revenues, for the three months ended June 30, 2002 compared with \$1,411,000, or 15% of revenues, for the three months ended May 31, 2001. This decrease was primarily influenced by the decline in sales volumes. For the six months ended June 30, 2002, salaries and employee benefits were \$2,857,000, or 14% of revenues, compared with \$2,183,000, or 16% of revenues for the comparative period last year. The higher total cost structure for the current period is acquisition related.

Selling, general and administration expenses were \$1,492,000 or 20% of revenues for the three months ended June 30, 2002 compared with \$1,181,000 or 12% of revenues for the three months ended May 31, 2001. For the six month period ended June 30, 2002, selling, general and administrative expenses were \$2,929,000 or 14% of revenues compared to \$2,037,000 or 15% of revenues for the same period last year. The higher total cost structure for the current period is acquisition related.

The increase in depreciation expense for the current quarter and on a year to date basis when compared with last year's comparative figures is primarily acquisition related. During the current quarter ended June 30, 2002 the expansion of the Nisku blend plant was substantially completed. As a result, the allocation of the cost of this expansion commenced during the current quarter.

### Net Earnings and Earnings Per Share

Net earnings for the three months ended June 30, 2002 were \$229,000 or \$0.02 per share compared with \$657,000 or \$0.06 per share for the three months ended May 31, 2001. Net earnings for the first six months of 2002 were \$1,641,000 or \$0.15 per share, compared with net earnings of \$811,000 or \$0.08 per share for the six months ended May 31, 2001.

### Fractionation Plant

At June 30, 2002, the Slave Lake fractionation plant was substantially completed and available for productive use commencing with the third quarter of 2002. Construction

## Management's Discussion and Analysis (continued)

costs incurred to June 30, 2002 totaled \$13,342,000 which represented a 10% increase over the original forecast of \$12,104,000. The additional costs incurred over the original forecast were primarily due to changes in the design and scope of the project.

### Liquidity and Capital Resources

The company's earnings before interest, taxes, depreciation and amortization ("EBITDA") for the three months ended June 30, 2002 were \$571,000 compared with \$1,383,000 for the three months ended May 31, 2001. For the six months ended June 30, 2002 EBITDA improved to \$3,248,000 from \$1,797,000 for the comparative period last year. During the three months ended June 30, 2002, total investing activities used \$4,292,000 of cash compared with \$10,646,000 for the three months ended May 31, 2001. Net cash used in investing activities for the six months ended June 30, 2002 totaled \$7,224,000 compared with \$11,021,000 for the six months ended May 31, 2001. Net cash used for investing activities

during the current year were primarily directed to the construction of the Slave Lake fractionation plant. Net cash inflows from financing activities for the second quarter ended June 30, 2002 totaled \$17,090,000 compared with \$8,205,000 for the three months ended May 31, 2001. For the six months ended June 30, 2002 net cash inflows totaled \$20,078,000 compared with \$8,218,000 for the six month period ended May 31, 2001. On June 24, 2002 the company issued 3,000,000 common shares by private placement. The net proceeds will be used for general corporate purposes including the repayment of bank debt, financing capital expenditure programs and working capital requirements.

At June 30, 2002, the company had cash on hand of \$11,166,000 and working capital of \$6,417,000 (see note 2 - Long-term debt) compared with bank indebtedness of \$1,402,000 and working capital of \$2,660,000 at December 31, 2001.

## Consolidated Balance Sheet (unaudited)

As at	June 30, 2002	December 31, 2001
Assets	\$	\$
Current assets		
Cash	11,166,095	-
Accounts receivable	8,923,868	8,916,164
Inventories	3,857,019	3,633,197
Prepaid expenses and deposits	571,657	499,608
	<b>24,518,639</b>	13,048,969
Property, plant and equipment	22,688,042	15,861,816
Goodwill (note 3)	6,049,530	6,049,530
Other assets	898,779	901,573
Future income taxes	276,000	-
	<b>54,430,990</b>	35,861,888
Liabilities		
Current liabilities		
Bank indebtedness (note 2)	12,980,637	1,402,160
Accounts payable and accrued liabilities	4,132,225	6,396,501
Income taxes payable	874,850	1,693,276
Current portion of obligations under capital leases	90,000	-
Current portion of long-term debt (note 2)	-	896,605
	<b>18,077,712</b>	10,388,542
Obligations under capital leases	883,418	-
Long-term debt (note 2)	-	6,471,758
Future income taxes	-	92,000
	<b>18,961,130</b>	16,952,300
Contingent liabilities (note 5)		
Shareholders' equity		
Share capital (note 4)	25,850,741	10,955,828
Retained earnings	9,619,119	7,953,760
	<b>35,469,860</b>	18,909,588
	<b>54,430,990</b>	35,861,888

**Consolidated Statement of Earnings and Retained Earnings** (unaudited)

	For the three months ended		For the six months ended	
	June 30, 2002	May 31, 2001	June 30, 2002	May 31, 2001
	\$	\$	\$	\$
<b>Revenues</b>	<b>7,331,453</b>	9,597,461	<b>20,525,844</b>	13,786,153
<b>Cost of sales</b>	<b>3,972,151</b>	5,627,839	<b>11,626,728</b>	7,760,397
<b>Gross profit</b>	<b>3,359,302</b>	3,969,622	<b>8,899,116</b>	6,025,756
<b>Expenses</b>				
Salaries and employee benefits	1,333,551	1,411,082	2,857,077	2,183,297
Selling, general and administration	1,492,214	1,181,056	2,929,173	2,036,718
Depreciation and amortization	228,278	204,264	414,498	327,043
Interest on long-term debt	20,745	50,106	112,215	50,268
Other interest	12,679	25,745	30,439	35,384
	<b>3,087,467</b>	2,872,253	<b>6,343,402</b>	4,632,710
<b>Earnings before other income (expense)</b>	<b>271,835</b>	1,097,369	<b>2,555,714</b>	1,393,046
<b>Other income (expense)</b>				
Other	24,015	16,500	121,716	(6,560)
Gain (loss) on disposal of property, plant and equipment	13,510	(10,845)	13,484	(2,003)
	<b>37,525</b>	5,655	<b>135,200</b>	(8,563)
<b>Earnings before income taxes</b>	<b>309,360</b>	1,103,024	<b>2,690,914</b>	1,384,483
<b>Provision for income taxes</b>	<b>79,916</b>	445,943	<b>1,049,500</b>	573,048
<b>Net earnings for the period</b>	<b>229,444</b>	657,081	<b>1,641,414</b>	811,435
<b>Retained earnings, beginning of period</b>	<b>9,365,730</b>	5,640,501	<b>7,953,760</b>	5,486,147
<b>Retained earnings, end of period</b>	<b>9,595,174</b>	6,297,582	<b>9,595,174</b>	6,297,582
<b>Earnings per share</b>				
Basic	<b>0.02</b>	0.06	<b>0.15</b>	0.08
Diluted	<b>0.02</b>	0.06	<b>0.14</b>	0.08
<b>Weighted average shares outstanding</b>				
Basic	<b>11,187,050</b>	10,174,223	<b>10,997,131</b>	9,751,827
Diluted	<b>12,144,945</b>	10,547,372	<b>11,887,055</b>	10,047,215

## Consolidated Statement of Cash Flows (unaudited)

	For the three months ended		For the six months ended	
	June 30, 2002	May 31, 2001	June 30, 2002	May 31, 2001
	\$	\$	\$	\$
<b>Operating activities</b>				
Net earnings for the period	229,444	657,081	1,641,414	811,435
Items not affecting cash -				
Depreciation and amortization	228,278	204,264	414,498	327,043
Loss (gain) on disposal of property, plant and equipment	(13,510)	10,845	(13,484)	2,003
Future income taxes	(368,000)	-	(368,000)	-
	76,212	872,190	1,698,373	1,140,481
Changes in non-cash components of working capital				
Change in current assets	1,619,722	3,435,792	(303,575)	2,779,721
Change in current liabilities	(3,340,395)	(4285,922)	(3,058,757)	(3,814,700)
Net cash flow (used in) from operations	(1,644,461)	22,060	(1,687,904)	105,502
Net change in non-cash components of working capital - discontinued operations	-	20,292	-	29,965
Net cash (used in) provided by operating activities	(1,644,461)	42,352	(1,687,904)	135,467
<b>Investing activities</b>				
Purchase of property, plant and equipment	(4,367,005)	(317,788)	(7,341,789)	(715,751)
Proceeds on disposal of property, plant and equipment	72,460	64,122	114,549	87,185
Acquisition of subsidiary	-	(10,157,248)	-	(10,157,248)
Decrease (increase) in other assets	2,794	(234,796)	2,794	(234,796)
	(4,291,751)	(10,645,710)	(7,224,446)	(11,020,610)
<b>Financing activities</b>				
Issue of common shares	14,690,261	3,745,914	14,894,913	3,777,569
Net increase in bank indebtedness	1,449,335	-	4,235,176	-
Increase in obligations under capital leases	973,418	-	973,418	-
Increase in long-term debt	-	4,500,000	-	4,500,000
Repayment of long-term debt	(23,132)	(40,578)	(25,062)	(59,869)
	17,089,882	8,205,336	20,078,445	8,217,700
<b>Increase (decrease) in cash</b>	<b>11,153,670</b>	<b>(2,398,022)</b>	<b>11,166,095</b>	<b>(2,667,443)</b>
<b>Cash - beginning of period</b>	<b>12,425</b>	<b>2,817,642</b>	<b>-</b>	<b>3,087,063</b>
<b>Cash - end of period</b>	<b>11,166,095</b>	<b>419,620</b>	<b>11,166,095</b>	<b>419,620</b>

## Notes to Interim Consolidated Financial Statements

For the six months ended June 30, 2002

### 1. Basis of presentation

The accompanying unaudited interim consolidated financial statements of Enerchem International Inc. have been prepared by management in accordance with accounting principles generally accepted in Canada. These unaudited interim consolidated financial statements include the accounts of the parent company and its wholly owned subsidiary Enerchem International Corporation. All significant inter-company balances and inter-company transactions have been eliminated. The unaudited interim financial statements follow the same accounting policies and methods as the audited consolidated financial statements for the four month period ended December 31, 2001, except as described in note 2. The unaudited interim consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in Enerchem's Annual Report for the four month period ended December 31, 2001 and year ended August 31, 2001.

Certain comparative period amounts of the prior year have been reclassified in the accompanying unaudited interim consolidated financial statements for consistent presentation to current period amounts.

### 2. Change in accounting policies

#### Stock based compensation

Effective January 1, 2002, the company adopted the new recommendations of Section 3870 of The Canadian Institute of Chartered Accountants "Stock Based Compensation and Other Stock Based Payments." This standard establishes financial and reporting standards for stock based employee compensation plans. The recommendations encourage, but do not require, the use of the fair value method of accounting for all employee based stock compensation plans. Under this method, compensation cost must be measured at the grant date based on the fair value of the award and must be recognized over the related service period. The company has two stock based compensation plans.

## Notes to Interim Consolidated Financial Statements (continued)

For the six months ended June 30, 2002

### 2. Change in accounting policies

#### Stock based compensation (continued)

a) The company has reserved 2,700,000 common shares for issuance pursuant to an approved stock option plan ("Option Plan") granted to directors, management and employees of the company or affiliated companies. Options granted under the Option Plan are generally exercisable after one to three years and expire 5 years after the grant date. Option exercise prices represent the closing market price for the common shares on the last business day prior to the date of the option granted. The company has elected to not adopt the fair value method of accounting for compensation awards issued under its Option Plan and will therefore be required to include in its financial statements pro forma disclosures of net earnings and earnings per share as if the fair value method of accounting had been applied to stock based compensation awards granted after January 1, 2002. Pro forma disclosure is not required for awards granted prior to January 1, 2002.

Continuity of stock options	Number of options #	Average exercise price \$
Outstanding at January 1, 2002	1,639,500	2.49
Granted	235,000	5.15
Exercised	156,500	1.71
Expired/cancelled	15,000	3.04
<b>Outstanding at June 30, 2002</b>	<b>1,703,000</b>	<b>2.92</b>
Options exercisable at June 30, 2002	1,356,000	2.53

#### Options not exercisable at June 30, 2002

Exercise price (\$)	Number outstanding at June 30, 2002	Weighted average remaining contractual life (years)	Weighted average exercise price (\$)
5.15	235,000	4.9	5.15
3.04	112,000	0.8	3.04
3.04 to 5.15	347,000	3.6	4.47

Had the company determined compensation costs on this Option Plan based on the fair value at the grant dates for those share options consistent with the fair value method of accounting for stock based compensation, the company's net earnings and earnings per share would have been reduced to the pro forma amounts indicated below:

Net earnings	For the three months ended June 30, 2002	For the six months ended June 30, 2002
	\$	\$
Net earnings as reported	229,444	1,641,414
Less stock based compensation costs	34,989	34,989
Pro forma earnings for the period	194,455	1,606,425
<b>Pro forma earnings per share</b>		
Basic	0.02	0.15
Diluted	0.02	0.14

The fair values of the options included in the pro forma amounts presented above have been estimated using the Black-Scholes Option Pricing Model. The assumptions used in the pricing model are as follows:

Weighted average fair value per option	\$2.68
Risk free interest rate	4.50%
Expected life of options	5 years
Expected volatility	55%

b) The company has reserved 970,000 common shares for sale to employees of the company under the Employee Share Purchase Plan ("Plan"). Employees electing to participate in the Plan may contribute a minimum of two percent to a maximum of five percent of monthly salaries. The employees' contributions are matched equally by the company. The share purchase price is equal to the weighted average of the trading prices of the common shares of the company on the Toronto Stock Exchange for the five days on which the shares traded on or before the last day of the month for which contributions were remitted. Common shares acquired under the Plan vest with the employee upon purchase and are distributed to the employees, at least, on an annual basis. The company's contributions to the plan are recorded as compensation costs in the month incurred and totaled \$88,657 for the six months ended June 30, 2002. During the six months ended June 30, 2002, 37,098 shares were issued under the Plan totaling \$177,314.

#### Long-term debt

Effective January 1, 2002, the company adopted the new recommendations of EIC 122 of The Canadian Institute of Chartered Accountants "Balance Sheet Classification of Callable Debt Obligations and Debt Obligations Expected to be Refinanced". As a result of adopting these recommendations, loan agreements that specify the company's repayment terms but enable the creditor, at its discretion, to demand payment at any time are now presented as a current liability under the caption bank indebtedness. Prior to the adoption of the new recommendations the company presented the demand loans as long-term on the basis that the bank had indicated it was not its intention to demand repayment within one year provided that there was no adverse change in the financial condition of the company.

## Notes to Interim Consolidated Financial Statements

For the six months ended June 30, 2002

### 3. Goodwill

The pro forma effect of the discontinuance of goodwill amortization on net earnings and earnings per share for the periods presented is as follows:

Net Earnings	For the three months ended		For the six months ended	
	June 30, 2002	May 31, 2001	June 30, 2002	May 31, 2001
	\$	\$	\$	\$
Net earnings for the period	229,444	657,081	1,641,414	811,435
Amortization of goodwill	-	28,183	-	33,650
Adjusted net earnings for the period	229,444	685,264	1,641,414	845,085
<b>Earnings per share</b>				
Basic	0.02	0.07	0.15	0.09
Diluted	0.02	0.06	0.14	0.08

### 4. Share capital

On June 24, 2002, the company completed a private placement of 3,000,000 common shares for net proceeds of \$14,082,033.

### 5. Contingent liabilities

In the normal course of business, the company is party to various claims and legal proceedings. While the final outcome with respect to the claims and legal proceedings pending, as at June 30, 2002, cannot be determined with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the company's financial position or results of operations.

### 6. Segmented information

The company operates in one industry which encompasses blending, manufacturing and distributing a wide variety of specialty products to the oil and gas industry. Inter-segment revenues are accounted for at prices comparable to open market prices for similar products and services. Summarized financial information concerning the industry segment and geographic segments in which the company operated at June 30, 2002 and May 31, 2001 are as follows:

#### As at June 30, 2002 (unaudited)

	Oilfield Chemicals		Total Oilfield Chemicals	(Eliminations) Adjustments	Total Operations
	Canada	United States			
	\$	\$	\$	\$	\$
Revenues	19,920,119	605,725	20,525,844	-	20,525,844
Inter-segment revenues	-	725,149	725,149	(725,149)	-
	19,920,119	1,330,874	21,250,993	(725,149)	20,525,844
Depreciation	382,034	32,464	414,498	-	414,498
Interest on long-term debt	112,215	-	112,215	-	112,215
Earnings from operations	2,361,276	177,689	2,538,965	16,749	2,555,714
Other income (expense)	149,071	(5,206)	143,865	(8,665)	135,200
Income taxes	986,837	62,663	1,049,500	-	1,049,500
Net earnings for the period	1,523,510	109,820	1,633,330	8,084	1,641,414
Property, plant and equipment	22,155,668	532,374	22,688,042	-	22,688,042
Goodwill	6,049,530	-	6,049,530	-	6,049,530
Identifiable assets	51,829,662	1,496,092	53,325,754	1,105,236	54,430,990

#### As at May 31, 2001 (unaudited)

	Oilfield Chemicals		Total Oilfield Chemicals	(Eliminations) Adjustments	Total Operations
	Canada	United States			
	\$	\$	\$	\$	\$
Revenues	13,308,531	477,622	13,786,153	-	13,786,153
Inter-segment revenues	-	790,065	790,065	(790,065)	-
	13,308,531	1,267,687	14,576,218	(790,065)	13,786,153
Depreciation and amortization	251,368	52,959	304,327	22,716	327,043
Interest on long-term debt	50,429	(161)	50,268	-	50,268
Earnings (loss) from operations	1,461,123	(83,172)	1,377,951	15,095	1,393,046
Other income (expense)	(75,307)	62,740	(12,567)	4,004	(8,563)
Income taxes	553,800	19,248	573,048	-	573,048
Net earnings (loss) for the period	832,016	(39,680)	792,336	19,099	811,435
Property, plant and equipment	7,195,188	618,204	7,813,392	-	7,813,392
Goodwill	6,067,016	-	6,067,016	-	6,067,016
Identifiable assets	30,969,348	1,576,866	32,546,214	(4,216,148)	28,330,066

Our mission is to enhance shareholder value through the marketing of specialty chemicals and hydrocarbon based well servicing fluids to the oil and gas industry in a safe and environmentally conscious manner.

## Corporate Information

### Head Office

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### Oilfield Chemical Operations

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### Directors and Officers

Larry B. Phillips	President and Chief Executive Officer, Director
Brian M. Zubach, CMA	Chief Financial Officer
J. Barrie Brookman	Vice President, Operations
Kenneth A. Klein	Director
Hugh L. Planche	Director
David F. Potter	Director
Fred Pheasey	Director

### Registrar and Transfer Agent

CIBC Mellon Trust Company  
Toronto, Ontario

### Principal Bank

HSBC Bank Canada  
Edmonton, Alberta

### Legal Counsel

Chamberlain Hutchison  
Edmonton, Alberta

### Auditors

PricewaterhouseCoopers LLP  
Edmonton, Alberta

### Stock Exchange Listing

Toronto Stock Exchange	United States - Over the Counter: 12g-3-2(b)
Trading symbol "ECH"	

## Investor Information

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