
Operator

At this time, I would like to turn the conference over to Darren Seed, Vice President of Capital Markets and Communications. Please go ahead.

DARREN SEED speaking

Vice President, Capital Markets and Communications, Westport Innovations Inc.

Thank you and good afternoon everyone. Welcome to our third quarter conference call for Fiscal 2014. It's being held to coincide with the disclosure of our financial results earlier this afternoon. For those who haven't seen the release and financial statements yet, they can be found on Westport's website at www.westport.com.

Speaking on behalf of the Company will be Westport's Chief Executive Officer, David Demers; with Westport's Chief Financial Officer, Ashoka Achuthan; and Westport's President and Chief Operating Officer, Nancy Gougarty. Attendance at this call is open to the public and the media, but for the sake of brevity we are restricting questions to analysts.

You are reminded that certain statements made in this conference call and our responses to various questions may constitute forward-looking statements within the meaning of US and applicable Canadian securities law, and such forward-looking statements are made based on our current expectations and involve certain risks and uncertainties. Actual results may differ materially from those projected in the forward-looking statements. Information contained in this conference call is subject to and qualified in its entirety by information contained in the Company's public filings, and except as required by applicable securities laws, we do not have any intention or obligation to update forward-looking information after this conference call. You are cautioned not to place undue reliance on any forward-looking statements.

Now, I will turn the call over to David Demers.

DAVID DEMERS speaking

Chief Executive Officer,
Westport Innovations Inc.

Thank you Darren. Good afternoon everyone and thanks for your interest in Westport. Q3 was a challenging quarter on several fronts as we continue the market transition plan that we've been working through over the past year. I'll go through some of these short-term conditions that have affected our business, and then of course Ashoka and Nancy will highlight changes that we're going to be making as a result. That said, I want to make it clear that we do not believe the long-term strategy for our business has been impacted and we're making good progress on our strategic plan, so these are course corrections, not fundamental changes in direction or speed.

As we reported today, Westport direct sales in the third quarter fell sharply year-over-year and sequentially from Q2. On an apples-to-apples basis, if we adjust Q3 revenues to a baseline excluding R&D milestone payments and removing discontinued product such as the Westport 15-litre, we see year-over-year revenue decline of 24%. This is still disappointing when we were looking for strong growth and we need to work to improve results.

Our joint venture in China, Weichai Westport saw reasonable growth, particularly as we look at the year-to-date performance, and it's on pace for a solid beat of last year's unit sales and revenue. Cummins Westport had a much better quarter than in Q2 and we're optimistic about our position on warranty expenses for the ISL G engine going forward, which has dampened earnings in that business over the past six quarters.

Now, we're looking hard at the market dynamics that delivered this result and whether this is a one-time blip or a new factor that we need to build into our plans going forward. We haven't completely finished this analysis of course but I'll run you through some of our preliminary deductions and Nancy will weigh in with her thoughts later on the call.

Now, obviously we've been impacted by oil prices and we don't know where oil prices are going. Consensus today seems to be flat to slightly down through next year,

although the differential between natural gas and oil prices remains intact in most markets. Since gas prices are down, the overall incentive to migrate to a new fuel is weakened in markets where there are no incentives. In general, European alternative fuel products have been hit hard by reductions in government incentives, by the decline in oil prices, which as I said, reduces incentives to look for change, but also generally softened economic conditions across Europe which have reduced shipments of new cars. This has reduced demand for our systems and components for many OEMs in Europe; however China and India remain strong and growing markets, and in North America we think leading fleets are moving forward and doing well. So add this up and we see a mix of stronger and weaker markets and we're rebalancing our resources to take better advantage of the best opportunities.

This sudden and frankly unanticipated drop in our product sales this quarter, and our restructuring costs hit Adjusted EBITDA and our operating business fell from a \$1 million positive Adjusted EBITDA profit last quarter, which we had celebrated as a major milestone for us in our transition plan, this took us down to negative \$5.4 million this quarter. We took immediate action in October to reduce operating expenses. We had a staff reduction of about 9% globally which will take effect in Q4. Executives across the Company have also accepted, on average, a 12% salary cut as of January 1st, plus dropping 2014 earned bonuses and 2015 cash bonus program completely in return for restricted stock units which will vest over the next three years. For the record, Nancy, Ashoka, and I led this process with a 15% salary cut. The executive compensation cuts will have a positive impact of about \$7.4 million in cash savings next year. This combined with staff reductions and other immediate control measures, add up to approximately \$13 million in 2015.

Now, independent of this short-term reaction, as we've been telling you over the past year, Westport has been continuously adjusting our long-term product development investments and prioritizing our program spending based on market timing signals and partner readiness. We're still working with key global OEMs despite recent confusion in the capital markets around Westport and what's happening, and we will continue to develop leading edge natural gas technology and products, however we can focus and prioritize our investment spending to enhance our returns, as does any business, given the current situation in the energy markets.

Now we'll see less net spending on new product investments in 2015; there's three factors at play here. We're completing some major product programs such as our next generation engine for Volvo cars which we expect will move from expense to revenue generation mode in 2015. We're seeing strong engagement and interest from several prospective partners to co-invest with us on some new programs, which will reduce the need for Westport to invest our own cash and enhance our returns. Third, we are postponing retiming or simply not making proposed investments where we think the market timing doesn't match up. For example, the Off-Road business remains a compelling long-term opportunity for us, but we believe Westport can look to partners and customers for more support as this market develops over the next few years. The timing of product adoption is going to be paced by long-term investments in LNG fuel supply, so we're going to get a reasonably good read at how fast this is going. We just recently shipped the fourth LNG rail tender earlier this month and we'll be working with customers to develop new orders in this area.

Now, during the quarter we did announce two major updates to our long-term product investment programs. First, we announced our new, enhanced spark ignition engine, called ESI, which has been presented to several global OEMs over the past few months with the intention of developing medium duty dedicated natural gas vehicles with significantly higher performance and fuel economy than we see from conventional spark ignition engines in the marketplace today. Response to date has been encouraging. We're seeking risk-sharing commercialization arrangements with prospective manufacturing partners now.

We also announced a major shift in our HPDI programs with most OEMs as Westport and Delphi rolled out our jointly developed HPDI fuel injection system at the Hanover Trade Fair last month. This next-generation system, which we first announced in March of this year, will provide higher performance, durability, and scalable manufacturing. I think this is an exciting development that will encourage wider adoption of HPDI as a path to high-performance natural gas vehicles.

Now this year we've seen continued growth in infrastructure development around the world and we've seen a very significant growth in the number of fleets who actually have some natural gas trucks in operation. Anecdotally, they tell us they intend to buy more next year. We've also recently seen publication of long-term performance and operating costs from some of our early fleets such as Vedder Transport in BC. They reported

three years of operation showing significant fuel cost savings, no impact on reliability or service costs, and strong confidence in the future of natural gas in their trucking operations. Of course they recommended that fleets need to do their homework.

The message from all this that we and our OEM customers are hearing is simple: natural gas is here to stay. Customers are asking OEMs to expand their natural gas product offerings to match the wide variety and the specialized features that are offered today in diesel and gasoline vehicles. More infrastructure is needed and customers are going to want a big expansion in services and support as they make this transition to this new cleaner and cheaper fuel.

So overall, we see no reason to shift our views on the five-year market opportunity, although clearly the path forward is not a straight line. The industry is still growing beyond expectations of just a few years ago, and I firmly believe that Westport and our shareholders are in the right place to take advantage of this new opportunity.

Thank you for your support and interest. I'll turn the call over to Ashoka to run through the financials, and then Nancy will discuss some of operational priorities. Ashoka.

ASHOKA ACHUTHAN speaking

Chief Financial Officer, Westport Innovations Inc.

Thank you, David. Good afternoon everyone. For the quarter ended September 30th, 2014, we recorded consolidated revenue of \$25.3 million compared with \$46.5 million in the prior year period. The breakdown of this \$25.3 million is 18.2 for Applied Technologies; 6.6 for On-Road Systems; \$0.3 million for Off-Road Systems, and \$0.2 million for corporate and technology investments.

As David mentioned however, it's important to compare apples-to-apples here and last year we had a significant payment from an OEM which we showed as service revenue, and we also had sales from our first generation HPDI system. When you offset this service and HPDI revenue, the comparison is \$22.4 million for Q3 of this year compared to \$29.3 million for Q3 of last year.

Continued market uncertainty around our natural gas components, the discontinuation of the first generation Westport HPDI system, and lower sales of Westport WiNG power system products have impacted our revenue for the third quarter of 2014.

Westport revenue, unlike that of our joint ventures, includes a wide portfolio of products sold in widely disparate markets including different geographies. We see considerable variation in results across the portfolio and different sensitivities to external factors such as oil prices that affect diesel and gasoline prices at the pump. China is developing well and India shows strong promise now that diesel subsidies there are shrinking. We have seen significant impact on our business with OEMs in Russia due to the decline of the rouble and the complexity of compliance with sanctions. That said, we have new products coming online in 2015 which may turn that story around.

I'm also happy to report that our Volvo car business grew year-over-year and achieved positive operating income for the first time since its acquisition.

In the US, Ford sales are visibly affected by the decline in gasoline prices to the lowest level in four years. Although it is true that there is still a big gap between gasoline and CNG prices, the incentive to aggressively shift to CNG is simply not as strong.

The Westport iCE PACK product revenue, which we expected would rise to replace and exceed the Westport 15-litre HPDI revenue, has been slower than anticipated to get market traction and a major order was excluded from our guidance.

I also want to point out that for the period ended June 30th, 2014, the Company corrected the accounting for a portion of the On-Road Parts revenue that came to us with the BAF acquisition last year. As a result, and in consultation with our auditors, the Company made an immaterial adjustment to reduce total revenue for the six-month period ended June 30th, 2014, by \$4.1 million from \$82 million to \$77.9 million. Offsetting this revenue reduction is a corresponding reduction in cost of revenue for the same period by \$4.1 million from \$56.1 million to \$52 million. In addition, the Company combined Parts revenue with Product revenue for all periods presented.

I want to stress here that the adjustments have no impact whatsoever on our revenue guidance, the consolidated balance sheet, statement of cash flows, net loss, or basic and diluted loss per share for all periods presented.

Our consolidated gross margin and gross margin percentage for the third quarter was \$8 million and 31.6% compared with \$16 million and 34.4% in the prior year period. This decrease in gross margin and gross margin percentage for the quarter is primarily due to product mix and a reduction in high-margin service revenue.

Research and development expenses were \$17.6 million for the third quarter compared with \$23.5 million in the prior-year period. Selling, general, and administrative expenses were \$15.6 million for the third quarter compared to 19.4 in the prior year period. These operating expenses decreased primarily as a result of our exiting production of our first generation Westport HPDI system and consolidation of facilities. Our R&D and related investment spending will be closely monitored and should decrease as certain programs come to their successful completion and we continue to prioritize investments with the pace of market adoption and partner readiness.

For the third quarter of 2014, our net loss was \$25.5 million or \$0.40 per share as compared to a net loss of \$30.2 million or \$0.53 per share in the prior year period, an improvement of 16%.

Moving to our joint ventures, Cummins Westport Inc., or CWI, generated \$70.6 million in revenues during the quarter on delivery of 2,171 units, which is a 10% decrease in volume over the prior-year period. However, this decrease is primarily due to the timing of shipment of the ISL G for refuse applications and lower ISL G volumes in North American trucking applications in the quarter. When you compare CWI engine shipments year-to-date, it increased by 11% to 7,130 units compared to the prior-year period. This is mainly driven by higher shipments in North America for trucking applications which increased 35% year-to-date as a result of the launch of the ISX12 G.

During the third quarter, CWI's operating performance was impacted by \$1.1 million of warranty-related adjustments, primarily related to the 8.9-litre engine. This compares to the \$15 million charge we had in the first quarter and the \$10.2 million charge in the second quarter of this year. Excluding this warranty impact, our portion of CWI's net income would have been approximately \$1.4 million instead of the \$900,000 as recorded.

Clearly, the trend on warranty is headed in the right direction and the CWI team has made remarkable progress in identifying and resolving the warranty issues, and we expect continued improvement in gross margins and net income in the upcoming quarters.

Weichai Westport Inc., or WWI, generated \$179.3 million in revenues during the quarter on delivery of 14,587 units, which is an increase of 61% over the prior-year period. This is primarily due to Weichai Westport's aggressive efforts in market creation activities. The gross margins are still indicatable for margin creation phase and incentive-based pricing, but this is a market where we see significant growth in natural gas vehicle sales and we will seek to leverage other technologies and products such as HPDI to derive better financial returns going forward.

As of September 30th, 2014, our cash, cash equivalents, and short-term investment balance was \$130.2 million. During the third quarter, cash used in operations was \$31.4 million compared with \$28.9 million in the second quarter of this year. This increase of \$2.5 million is primarily due to margin impact of lower sales. The Company's cash usage excluding changes in working capital is \$25.3 million for the quarter.

We continued to make progress towards our goal of consolidated Adjusted—positive Adjusted EBITDA by the end of 2015. To help us achieve this goal, we are doing the following: One, aligning investments and expenses to the pace of market adoption and partner readiness. This means carefully prioritizing our investment programs including deferral of non-core programs, and methodically allocating capital to products and technologies designed to deliver attractive returns in the future. Two, rightsizing the business structure and reducing expenses including executive salary reductions. The results of these efforts is a cost saving of more than \$13 million in 2015. Three, increased contributions from Westport's operating business units. We expect to launch a number of new products such as the Westport 3.8-litre industrial engine and a spark-ignited natural gas system using the WP580 ECU for a Russian OEM. We also expect higher iCE PACK sales and component sales to new OEM customers in the upcoming quarters. Four, we expect to generate higher income from both our joint ventures next year; and five, we expect to earn additional service revenue from our development partners.

To conclude, we are reiterating our revenue guidance for the year to be between \$130 million and \$140 million. We recognize that we are now at a new level in our business and revenue and have been adjusting our operations accordingly. We continue to firmly believe in our strategy, remain confident in our ability to execute against it, and expect our business model will deliver great value to shareholders as the shift to natural gas inevitably plays out.

Thank you, and I will now pass the call on to Nancy.

NANCY GOUGARTY
speaking

President and Chief
Operating Officer, Westport
Innovations Inc.

Thank you, Ashoka. Good afternoon everybody. My focus will be on the operating units for this call and then I'm going to pass the call back to the Operator for questions. So with that, let me get started on the On-Road systems.

Westport continues to have successful demonstration programs on our Westport iCE PACK LNG tank system with fleets in the US and especially for companies like American Protein which has resulted in sales orders. Furthermore, we have had customers that we've had—Hoopes Trucking LLC continues to purchase iCE PACKs for their natural gas fleet and expected delivery and operational activities by the end of this year.

The Ford business, this is where Westport is the largest QVM, has faced some challenges due to lower gas prices, however, fleet management companies still have a very strong focus on our products. During the quarter in fact, Westport delivered 40 shuttle buses powered by Westport WiNG system to the Dallas/Ft. Worth International Airport. Westport now offers fleets interesting—fleets interested in the Ford Transit Van with the Ford WiNG system, a free demonstration up to three months [should be weeks], designated to give the experience and the benefits of operating on CNG. Our Ford Canada activities have also started showing some traction with the oil and gas fleets.

As mentioned earlier, while starting from a small base, our Volvo car revenue has increased over last year and is helping to offset some of the reductions we've had in our Ford business, primarily due to the launch of the Volvo [V60] bi-fuel vehicle plus our continuing offering of the V70 bi-fuel.

As we move into the Applied Technology, in Italy, we are focusing on lean activities and improving our cost structures. We have seen some markets around the world present new challenges while other pockets are

growing. We covered our headwinds in our near-term financial update a month ago so I'm not going to focus on that. So, we're—let me take it from here.

Earlier this month, Russia's OEM, GAZ, unveiled their new generation CNG Euro-5 vehicles. One of the models is the GAZon Next CNG Truck, has the new CNG YaMZ-534, which was co-developed with Westport and was manufactured by GAZ's engine plant. The start of series production is planned for the second half of calendar year '15 despite geopolitical issues in the country. In addition, GAZ has awarded Westport to supply their LPG system for their new GAZelle vehicle which will meet the requirements of Euro-5 emission standards.

Westport began delivering Westport P [WP]580 engine management system—controller is perhaps another term for that—to the companies in the US that specializes in after-market natural gas-powered engines. The first five medium duty trucks were converted and are now running in Texas. In addition, the integration of the WP580 EMS system is in the Tata Motor's 3.8-litre and 5.7-litre engines and is going as planned.

With a bit of focus here on Off-Road, the fourth and final LNG tender was shipped to Canadian National Railways in early October. The tenders and the two EMD dual-fuel locomotives are expected to transition to Edmonton in the fourth quarter where they will begin their redeployment in running between Edmonton and Ft. McMurray. Our long-term program with EMD continues and recently at the high horsepower convention proved ample evidence that this market is moving to natural gas over the next many years.

On to some core program development activities. Weichai Westport HPDI 12-litre engine recently received China V Emission Certification and is ready for customer field testing. We have the HPDI units ready for shipment and are working with the trucking OEM; in specific, we are working with Shaanxi Heavy Truck—or Heavy Duty Automotive to produce the trucks.

Volvo HPDI trucks were recently tested in cold and winter—and hot testing and the system performed well.

Development of the next generation HPDI injectors with Delphi continues and the second set of prototype injectors will be delivered to us at the end of November.

The investment in the 3.8-litre industrial engine is moving along and we are expecting customer trials in Q4. This is an example of some of our Off-Road activity.

Our portfolio technologies such as Westport HPDI and enhanced sparked technology enables high performance vehicle makers to lead natural gas products. We have led—we have the lead in technology and strong brand to stay ahead.

These challenging times have given us an opportunity to reprioritize our business and product development efforts to maximize our near-term success. Our strategic priorities for the near term through '15 are clear. Although the path may not be linear, the opportunities can be transformative for the Company.

With that, I will close and pass it back to the Operator to open for questions.

Operator

Thank you. We will now begin the question and answer session. If you would like to ask a question, please press star, and one on your touchtone phone. You will hear a tone to indicate you're in queue. For participants using a speakerphone, it may be necessary to pick up your handset before pressing any keys. If you wish to remove yourself from the question queue, you may press star, and two. There will be a brief moment while we poll for questions.

The first question today is from Ann Duignan of JP Morgan. Please go ahead.

Ann Duignan - JP Morgan

Hi there. Good evening. Can you talk about the outlook into '15 and beyond if oil prices stay where they're at or even trend lower, which we believe they could do.

David Demers - Westport Innovations, Chief Executive Officer

Everybody's looking at me, Ann, so I guess I get to take it. The—yes, it's been really interesting watching the traction on oil prices and obviously what is more important in our space is the differential between gas and

oil, which seems to be pretty intact in most of our markets. It hasn't changed a lot because gas has been drifting down too, as you know. What does change is the, call it the psychological urgency around moving. So I think that we are definitely seeing immediate impact on fleets like Ford pick-up trucks with gasoline approaching \$3, it's just not as urgent a priority, so sales are off but they're not going to zero either. I think what I was trying to allude to in my speech is that the fleets that are moving to natural gas and that have natural gas I think are quite determined to proceed ahead because it's clear they're going to be making money, and so I think that discipline is going to push ahead. It might be the pace of attracting new adopters that's going to slow down.

So, we're certainly moderating our expectations on the frenzy going forward, but I think we were always trying to downplay some of the hype we heard a couple of years ago. There's always been barriers to immediate adoption in this market. I think this is just going to continue to carry on with people that are looking to save money.

It's a very different dynamic in places like China and India where the opposite's happening; China's got some very strict directives so we see that accelerating pretty much as planned. India is removing diesel subsidies. I think they're quite relieved that they're seeing some opportunity for cover on this one. So there's markets where we are seeing the focus on natural gas be enhanced as well.

So, on balance, where we're going to go is put our resources and our focus on the markets where we're seeing the most demand. I don't think that's too radical.

Darren Seed - Westport Innovations, Vice President Capital Markets and Communications

I think Ann I might add we usually do issue our annual guidance in February, so I think we probably take the next two months, look into some of the more commodity markets and see where it is an impact and come our conference call for year end and outlook for '15 in February, we'll have a better position to give you then.

Ann Duignan - JP Morgan

Okay. That's helpful, thank you. Then just more of a philosophical question. I know you talked about eliminating some non-core projects, et cetera, but, you know, as I just listened to all of the activities that are going on globally, it does seem like the business is still very fragmented and not really focused on what it wants to be when it grows up. I know it's not an easy question to answer but when we hear about rail cars and we hear about LNG tanks, European automotive components, then we hear about activity in Russia and India and China, can you talk a little bit just about, you know, five years out, assuming oil prices stay where they are, I mean, what is Westport going to look like five years from now?

Ashoka Achuthan - Westport Innovations, Chief Financial Officer

Yes, let me take that, Ann. As I mentioned in my talk, that like our joint ventures our products are sold in disparate markets and different geographies and each have their own set of parameters and influences that impact the business. We know, for instance, that China is a tremendous opportunity for us and it'd be foolish for us not to have a sizeable presence there. So it's just—the way I see it, it's a nature of the beast. We are monitoring geographies. We are monitoring technologies very closely, so that we'll be in a position to place our bets when—at the right time and on the right technology and in the right geography.

Do you want to add anything?

David Demers - Westport Innovations, Chief Executive Officer

Yes, let me just jump on that a bit, Ann. I think that what we've been trying to convey, which if it isn't clear, our customers are the OEMs, right? We're talking about vehicle OEMs who make things that have wheels, generally, and our focus has been on people who make

commercial vehicles, not passenger cars. So when you say we're unfocused, it kind of gets my, you know, my question up. Look, there's only a few dozen people who make those vehicles and we go where they tell us. If they think their market for their customers, like Volkswagen says, "Our customers are in China and we want to do this product," that's our customer. So it's not, I think, a strategy where we're all over the world doing things. We're working with customers like Ford or Volvo or Volkswagen. They've all got different views of where natural gas makes the most sense for them and we do what they tell us; that's kind of it.

Now, we happen to believe that virtually everybody in the world is going to need to paint their product line with natural gas over the next few years. They're all going to get it there eventually, but right now our focus is on working with the people who are working with us today, or who show up at our door saying, "I have a great idea," and if that happens to be GAZ in Russia or Tata in India, we see them as great customers and try to make them happy.

I think the question about where we are in five years. We've always said we think material market penetration does take a couple of product generations probably. So, you know, our forecast for trucking in the US, which is a bellwether that people continue to wave around, is 7 to 10% market penetration by 2020. We think there's been good work on scenarios that suggest that's realistic and that the pace of infrastructure is realistic and that the spread of the idea across fleets of various kinds makes some sense. Rail is one. Honestly, it wasn't our idea but actually a very interesting business. Fairly concentrated, we've got a very engaged and excited customer at EMD and full-on let's go. Now, the part that we're playing with EMD is supplying the fuel because we have the pump technology that is necessary for those high performance locomotives to move. Obviously we don't build railcars; we work with people who make railcars, but our contribution is the LNG intelligence and the fuel technology that can keep up with a locomotive.

So it might look fragmented but at heart it's, as I say, pretty straightforward. There's a few dozen major manufacturers of things—of engines that will use natural gas and that's what we're trying to turn into a business.

Ann Duignan - JP Morgan

Okay. In the interest of time I'll get back in line. I did have one other one if there's time at the end, I'd like to take it up. Thanks.

Darren Seed - Westport
Innovations, Vice President
Capital Markets and
Communications

Okay. Catch you later, Ann.

Operator

The next question is from Rob Brown with Lake Street Capital Markets. Please go ahead.

Rob Brown - Lake Street
Capital Markets

Good afternoon.

Rob Brown - Lake Street
Capital Markets

I was just kind of wondering if you could really update us on where you're at, clarify where you're at with Volvo Truck. I know you've said things have been delayed. We've heard Volvo say they've really pushed that out or cancelled that in the US. Can you just give us some colour on really where you see the Volvo program at right now?

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

Well, having just come back from Gothenburg, let's see. I would say that we continue to work with them as I mentioned in my short words that I gave, that we are proceeding both on the power train side as well as on the truck development. We have completed the hot and cold test fleets with them and we continue to work with them in terms of readying the product for market. I think that, you know, from a North America market perspective, as you mentioned, they—at this point in time our focus has really turned to Europe. We think that that's a great place to launch the product and to move it forward. So that's been the focus at this moment in time and as mentioned, also, we are now working hand in hand with some other industry players such as Delphi to enhance the technologies and make sure that we've got the best product that we can head to market here on the HPDI offering.

Rob Brown - Lake Street
Capital Markets

Okay, and on Delphi, could you just remind us again sort of when that product gets ready, the production line is set up and when the production line product will be ready and sort of your latest thinking there?

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

Well, we've got several products with Delphi already, so I mean we're in production on a couple of variances and I mentioned that on the Phase 3 we have some parts that are coming here in the November timeframe. So we've got two variance that we're relatively far along on and the other one that we're getting now, a sample on so that's progressing quite rapidly as well.

Rob Brown - Lake Street
Capital Markets

Great, thank you. I'll turn it over (cross talking).

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Darren Seed - Westport
Innovations, Vice President
Capital Markets and
Communications

(Cross talking), Rob, we made about a month ago talking about the new injectors coming with Delphi, that's still probably another year or so out before those ones are ready for production, to answer your question.

Rob Brown - Lake Street
Capital Markets

Okay, thanks. I'll turn it over.

Operator

The next question is from Jerry Revich of Goldman Sachs. Please go ahead.

Matt Rybak - Goldman
Sachs

Good morning, it's—sorry, good evening. It's Matt Rybak on behalf of Jerry. I'm wondering if you can talk about order trends in the wholly-owned business and specifically whether or not you think they can ramp off the challenging third quarter level.

Darren Seed - Westport
Innovations, Vice President
Capital Markets and
Communications

Just to clarify Matt, do you mean on the component level of our Applied Technologies business? Is that...?

Matt Rybak - Goldman
Sachs

That would be helpful to start.

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

This is Nancy again, I would say that our operations in Italy is really the core to the business at this point in time. What we're finding is we've had really successful growth in several regions. Our regions in South America, India and China are growing significantly. What we're finding is some of our traditional markets and even the markets that have geopolitical issues, whether it be Thailand or Russia, are a bit at this point in time in quandary to us as we're trying to understand exactly what to do.

In Ashoka's comments he mentioned even in Russia what we're finding is the rouble to the euro is one deterrent and just the uncertainty relative to some of these markets. So at this point in time in the high growth markets, we are getting our position increased and in some of our traditional markets, we're at a point where we're looking at those businesses and supporting them and trying to make sure that we are getting the—our share of the business but I would say at this stage of the game in calendar year '14 we've had to take some of the challenges on and that's why last month as we talked in that report on our near-term financing that our near-term financial projections we did make some changes to that.

Matt Rybak - Goldman
Sachs

Thank you. Then switching gears a little bit to the iCE PACK tank systems, any update you can provide us on

where the customer stands on the orders you mentioned which were going to be delayed?

Nancy Gougarty - Westport Innovations, President and Chief Operating Officer

At this point in time I'm not going to comment on those. We're still working through opportunities on those, so we need to continue to understand what that is. My guess is as we get that clarified we'll send some signals out to the market as appropriate.

Matt Rybak - Goldman Sachs

Perfect. Then lastly, if you could just maybe touch a little bit on what drove the reduction in the Cummins Westport warranty adjustment in the quarter and then maybe what gives you confidence that these levels are sustainable here?

Nancy Gougarty - Westport Innovations, President and Chief Operating Officer

I'll give it over to Ashoka and he can talk to that.

Ashoka Achuthan - Westport Innovations, Chief Financial Officer

Yes. As I mentioned, there was a significant, a very significant reduction in warranty charge this year, and if I remember the numbers, we had \$15 million in Q1, 10 in Q2 and \$1 million in Q3. If you recollect, it's all almost entirely related to the 8.9-litre engine which had been seeing some significant quality issues.

We have identified the root cause of the issues. The solution has been developed and the solution is actively being rolled out to the truck population out there on the roads, and the feedback we are getting from those customers who had these repairs done and changes installed is that the problems have been addressed and management is extremely confident that the worst is behind them, and we expect to see a year of hardly any warranty adjustments related to this product going forward.

Matt Rybak - Goldman Sachs

Thank you very much.

Operator

The next question is from Laurence Alexander with Jefferies. Please go ahead.

George D'Angelo - Jefferies & Company

Hi. This is George d'Angelo sitting in for Laurence. So, 2015 is another transition year and I know you guys talked about this a bit but are there R&D programs that can be paired back and can you just quantify the degree of flexibility left on the cost side?

Darren Seed - Westport Innovations, Vice President Capital Markets and Communications

Yes. I mean, I think I'll start then David or Ashoka can jump in, but I think you should—George, you should see the effect on R&D into 2015 as some of these programs come to completion, some of the prioritization of

investments. So, it's reasonable to expect R&D as an operational expense to see that impact.

George D'Angelo - Jefferies & Company

Okay.

Nancy Gougarty - Westport Innovations, President and Chief Operating Officer

I was going to say the 580 is a perfect example that most of that R&D work is being done this year, so the rollout of both the GAZ and the Tata vehicles is an example of that. We've got some other rollouts of other product portfolio as well.

So, with that, by the time we close this year, the 3.8-liter industrial engine's another example of that. So most—a lot of those projects are closing out this quarter and early part of next quarter, and so our '15 R&D expense will be reduced by that load.

David Demers - Westport Innovations, Chief Executive Officer

I just want to clarify that the R&D expense is net. When we talk about reduced R&D expense, we mean independent investment by Westport, and I think what we want to see, and what we are seeing, other programs where we have partners or customers who are funding some of this R&D or all of the R&D, so although you might look at our gross R&D number of, call it \$80 million this year, I'm not saying that we will cut to something like 20 or 30 next year from 80 but you may see a lot more service revenue or service contribution that takes our net down to something that is sustainable.

Obviously, we're not going to hit positive EBITDA by the end of next year with the current R&D run rate that we continue to invest on our own at this pace, so, it has to be

a combination of programs that end and new revenue and gross margin coupled with more investment by other people in those programs where we're doing R&D effectively as part of a partnership or on contract.

So, we can't give you an awful lot more detail than that. We'll obviously give you some more insight at the start of the year as to what we think 2015 will unload at, but obviously there's got to be a pretty dramatic change in the nature of our R&D investment next year if we're going to hit the goal what we've been shooting for.

George D'Angelo - Jefferies & Company

Okay, thanks, and just a little follow-up. You talked about a 12% salary cut across the Company. Have you seen any—particularly in your engineering staff, have you seen any attrition because of that? Thanks.

David Demers - Westport Innovations, Chief Executive Officer

Sorry if we misstated that. It wasn't across the Company. It's across the executive team, so call it Vice President level and above.

George D'Angelo - Jefferies & Company

Okay.

David Demers - Westport Innovations, Chief Executive Officer

For exactly that reason. I think we've got to be very cautious that we've got a lot of people working very hard and we can do all kinds of things around working

conditions but cutting salaries in a competitive industry is usually a recipe for seeing higher attrition, which isn't what we need.

So this was a proposal to the executive team. I was really pleased and gratified that absolutely everybody stepped up and agreed, and for the period in 2015 I think everybody's heads down on achieving our financial goals. So, there we are.

George D'Angelo - Jefferies
& Company

Thank you very much.

Operator

The next question is from Eric Stine with Craig-Hallum. Please go ahead.

Eric Stine - Craig-Hallum
Capital Group

Hi everyone. Thanks for taking the questions.

Eric Stine - Craig-Hallum
Capital Group

Just to clarify still on the warranty charge. I mean so that is a catch-up of accruals of systems in the field, is that right? Is that how we should think about it?

Ashoka Achuthan - Westport
Innovations, Chief Financial
Officer

Correct. That's how you think about it.

Eric Stine - Craig-Hallum
Capital Group

Okay, and then just curious on visibility into when going forward you see taking lower accruals per unit, you know, and just thoughts of when you think it's possible getting back to that 30% plus gross margin for CWI.

Ashoka Achuthan - Westport
Innovations, Chief Financial
Officer

We are going to see the ongoing decline in warranty accruals, there's no doubt about that. Matter of fact, we are seeing it already this year and we are gratified by the results of the changes that had been made by the engineering team at CWI and I think the next few quarters will be ample evidence of improved warranty performance.

Eric Stine - Craig-Hallum
Capital Group

So—but you seem to be getting close to the end of the catch-ups, right, for what is in the field?

Ashoka Achuthan - Westport
Innovations, Chief Financial
Officer

Yes, and in terms of gross margins, you know, it's product mix. I mean that makes a big difference in the gross margin performance of the CWI business.

Eric Stine - Craig-Hallum
Capital Group

Okay. Maybe just turning to China, just curious how the pipeline's developing for the WP12 as you get close to getting test systems in the field, and then just curious with NS4 standards coming on January 1st, just initial thoughts on pricing versus diesel trucks in the field.

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

Let me take the first half. I'm not sure I have an answer for the second half for you, but I would say that we're really pleased that through the Tianjin Engine Centre that we were able to get our HPDI 12-litre validated for the Euro V [should be China V] which right now, as you mentioned, they're looking to go to a China IV version for regulating. So to get all the way to China V does put us ahead of the curve and we're pleased about that.

I would say in terms of your last question, I'm just not in a position to comment on that. I'm not—the China market and where they are relative to pricing and I'll say fuel, et cetera, that's—I'm just not—I'm not I'll say schooled enough on that particular item.

Darren Seed - Westport
Innovations, Vice President
Capital Markets and
Communications

But I think we do—Eric, to answer all your questions, we still expect to have HPDI systems rolling around China this year in China.

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

Yes, that's correct.

Eric Stine - Craig-Hallum
Capital Group

Okay. Maybe last one from me. Just on marine, you know this is an area that last year you identified as—would be ideal for HPDI. Just curious whether we should look for something there or whether that's one of the R&D programs that maybe is being put aside.

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

I would say that we continue to talk and in some cases we have teamed up with some other companies to understand exactly where we could go on the marine. One area is, for some of our customer interest for our iCE PACK, we are looking at using that technology to—for the marine industry. I would say some efforts are going into that to understand exactly how we can do fuelling bunkers and those kinds of things. So I would say more of that as we roll into calendar '15, as that product gets more defined.

Eric Stine - Craig-Hallum
Capital Group

Okay. Thank you.

Operator

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The next question is from Noah Kaye with Northland Capital Markets. Please go ahead.

Noah Kaye - Northland
Capital Markets

Thank you very much. So you mentioned a 9% headcount reduction that will start to impact in fourth quarter. Just in terms of the accounting, are you going to be recognizing any kind of restructuring or severance expenses in the fourth quarter associated with that, and how do we think about that rolling through to next year?

Ashoka Achuthan - Westport
Innovations, Chief Financial
Officer

Yes, we will account for most of it in the—almost all of it in the fourth quarter, so that's where you'll see it.

Noah Kaye - Northland
Capital Markets

So you will take a charge.

Ashoka Achuthan - Westport
Innovations, Chief Financial
Officer

Sorry?

Noah Kaye - Northland
Capital Markets

So you will—you do plan to take a charge.

Ashoka Achuthan - Westport
Innovations, Chief Financial
Officer

Yes, that is correct.

Noah Kaye - Northland
Capital Markets

Okay, and sort of above and beyond that, I think you've alluded to it in several different programs winding down, but how much do you think you can really reduce out of pocket R&D over the next 12 months?

Ashoka Achuthan - Westport
Innovations, Chief Financial
Officer

When you talk out of pocket R&D, I mean you're talking net R&D there, right?

Noah Kaye - Northland
Capital Markets

Net R&D, exactly.

Ashoka Achuthan - Westport
Innovations, Chief Financial
Officer

Yes, and then David mentioned it's—there are a number of factors that play into it. One, of course we have programs coming to their successful completion which will terminate. Two, we are prioritizing and calling, if you

will, certain programs that we aligned with the pace of market development. Three, most significantly, we will have partners contributing to our R&D programs in a significant way.

Noah Kaye - Northland Capital Markets

Right. Just to revisit the introduction of the HPDI 1.0, I guess, program into China, can you talk a little bit about how we should think in terms of a pricing delta for this, which is obviously going to be a higher performance system but likely higher priced than what's currently being offered through the JV, and how to think about an incremental payback on that.

Nancy Gougarty - Westport Innovations, President and Chief Operating Officer

From a HPDI 2.0, because that's what we're launching in China, so just to make sure that it's—1.0 is what the 15-litre was that we sunsetted last year, so this is a 2.0 system which is very comparable to what we're offering to other OEMs worldwide. At this point in time for the first units that we're shipping out and we're looking to do, those are obviously under special pricing circumstances so at this point in time we are—we're in I'll say prototype pricing scenarios and working that because there's a lot of obviously development costs, et cetera, in those and low-volume tooling.

So at this point in time we're going to make sure that those products are running and sufficient and getting on down the road as we then will continue to work on what we think series production pricing is.

Noah Kaye - Northland Capital Markets

Sure. Thanks for that, Nancy, but just to clarify, you say HPDI 2.0. Are these using the new generation of Delphi injectors or are these the legacy injectors?

Nancy Gougarty - Westport Innovations, President and Chief Operating Officer

They're using Delphi injectors but they are using a—not what we call the Phase 3 but they're using a variant that is I'll say a current generation of them, and it is a product that is produced for Westport by Delphi. So we have been using the Delphi injectors even in HPDI 1.0, and Delphi has been our sole partner relative to the injector system for the HPDI units.

Darren Seed - Westport Innovations, Vice President Capital Markets and Communications

To clarify even further I guess, Noah, is that the 2.0, the next generation Delphi injectors, those are co-developed and those are the ones that still are some time out before they become to commercial production. I think somebody asked that earlier on the call but just wanted to clarify that the current generation is built by Delphi but it is really under our Westport specs.

Nancy Gougarty - Westport Innovations, President and Chief Operating Officer

Yes, and that's the one that we used in the validation of the China V variant.

Noah Kaye - Northland Capital Markets

Okay, thank you so much for the colour. Appreciate it.

Operator

As a reminder, if you would like to ask a question, please press star, and one on your touchtone phone. The next question's from John Quealy of Canaccord Genuity. Please go ahead.

Chip Moore - Canaccord Genuity

Hey folks, it's Chip Moore for John. For iCE PACK, outside of the big order that got taken out of guidance, it sounds like you're starting to see some better traction. Can you just talk a little bit about how that product's performing, where we stand in terms of deployments, and then how we should be thinking about profitability? Thanks.

Nancy Gougarty - Westport Innovations, President and Chief Operating Officer

Yes, I would—several things I would comment is, is that we are definitely seeing traction. What our traction is coming from folks that we have been working with over time and as I mentioned, Hoopes Trucking is a company that has bought 15-litre HPDI 1.0 engines from us in the past and has had a good experience with us, so therefore we have—continue to work with them. So they are what I'll call them an early adopter that is working with us and they see the continued value. But then we have customers on the other hand such as Kroger's and American Protein that are, I'll say now new adopters that are coming in and seeing very positive results. Not only do we work with them obviously to output the truck but one of the things we have been doing is working with them on routings and those kind of things in order for them to ensure that they get the efficiency relative to the fuel. So what we're finding is, is that our relationship with the OEM truck builders to get it on the truck, but also with the fleet owners in order to maximize it has been really the key to our success there. So this close, integrated relationship is something that we're going to

continue and we think is going to have continued results in a positive way for us at Westport.

Darren Seed - Westport Innovations, Vice President Capital Markets and Communications

Chip, there's also been an expansion on effectively application. The systems we've been largely selling to-date have been for on-road and I think there are some off-road. Nancy alluded to marine as an application potentially earlier, so there are other applications that should provide some growth on a year-over-year basis into '15.

Chip Moore - Canaccord Genuity

Okay. That's helpful. Appreciate it. Just last question from me: on the new enhanced spark engine for medium duty, maybe you can just talk a little bit more about go to market for that and milestones we should be looking for.

Nancy Gougarty - Westport Innovations, President and Chief Operating Officer

Okay. On that, as we've mentioned we've got several OEMs that are interested. It's a product that since we did our press release which was in the mid-September timeframe, we've really had virtually every corner of the earth come back to us and ask, so we have been successfully marketing in obviously major markets: China and Japan, Europe and North America. At this point in time I think we're—our discussions are now in I'll say where we've had multiple meetings with several of them and that we would, you know, hope that—we're quite hopeful that we'll be able to enter into a development phase with one of them. But I think that the interesting side for this product is that it is the amount of interest we

have because of the performance characteristics as we outlined in our press release has really gotten people's interest and there is a lot of opportunity in the medium duty space which is where we think that this product fits the niche.

Chip Moore - Canaccord
Genuity

Thank you.

Operator

We have a follow-up question from Ann Duignan with JP Morgan. Please go ahead.

Ann Duignan - JP Morgan

Yes, hi. Thanks. Just on that very topic, just to be clear, this new spark-ignition or ESI that you're developing, that's—you would be selling just the spark ignition system or not the spark plugs but whatever enhanced spark plug system you have developed? It's not—you're not selling an engine with the spark ignition.

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

Ann, we're—our work would be with an OEM that would allow us to outfit the engine with a spark-ignited system but it would—in our product offering we would be offering the componentry; we would be offering the control system and in some cases OEMs will want to do it in their own production facility and run it down their production line, and so in that case we will be working them in terms of outfitting the truck, outfitting the engine, and then potentially even kitting parts to them in order for them to do the assembly. In other cases, customers have thoughts of how they would like to do it differently, so.

Ann Duignan - JP Morgan

Okay, and how would this compete or fit in with Westport's joint venture products?

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

CWI? I would say that this would be a competitive product with some of the offerings they have. At this point in time, this particular product, as we said in the release, has some characteristics that have performance attributes that could get significant performance and allow it—a smaller size engine to behave more like a larger engine. So we think that that is really the value proposition that we're putting forward on that.

Darren Seed - Westport
Innovations, Vice President
Capital Markets and
Communications

But conversely, it would be available to many OEMs. If any of our existing joint venture partners were interested, there's no reason that we wouldn't engage with them. I think it's just a function of first come, first served.

Nancy Gougarty - Westport
Innovations, President and
Chief Operating Officer

Yes.

Ann Duignan - JP Morgan

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Sure, and I appreciate that this would be available to particularly integrate those engine manufacturers to sell. Okay, good. Thank you. I appreciate the clarification.

Operator

There are no more questions at this time. I will now hand the call back over to Mr. Seed for closing comments.

Darren Seed - Westport
Innovations, Vice President
Capital Markets and
Communications

Thanks very much everyone for your attendance and we look forward to seeing everybody in February for the fourth quarter and year-end conference call.

Operator

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.