

Operator

Thank you for standing by. This is the Conference Operator. Welcome to the Westport Fuel Systems 2016 Q3 Financial Results Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star, and zero.

I would now like to turn the call over to Caroline Sawamoto, Manager, Investor Relations and Communications. Please go ahead.

CAROLINE SAWAMOTO, speaking Manager Investor Relations and Communications, Westport Fuel Systems Inc.

Thank you and good afternoon. Welcome to our third quarter 2016 conference call which is 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 our website at www.westport.com. In addition, we have also posted on our website a short presentation specific to this conference call that our speakers will be referring to.

On today's call, speaking on behalf of Westport Fuel Systems is Chief Executive Officer, Nancy Gougarty, Chief Operating Officer of the Automotive and Industrial Group, Andrea Alghisi, as well as our Chief Financial Officer, Ashoka Achuthan.

Attendance at this call is open to the public and to media, but questions will be restricted to the investment community. 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 U.S. 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, so you are cautioned not to place undue reliance on these statements. Information contained in this conference call is subject to and qualified in its entirety by information contained in the Company's public filings.

I will now turn the call over to Nancy.

NANCY GOUGARTY speaking Chief Executive Officer, Westport Fuel Systems Inc.

Okay. Good afternoon. Welcome and thank you for your continued interest in Westport Fuel Systems. Since we spoke last in early August, we have been very active taking the necessary steps to make Westport Fuel Systems a profitable and sustainable Company; a Company that can deliver to its customers, its employees, and its shareholders. I have been in meetings with customers and suppliers, but most of my time has been spent at our facilities around the world, working with the Westport Fuel Systems team to ensure that the combined Company is on track.

My immediate priorities remain unchanged from last quarter. They continue to be; complete and strategic review of our portfolio, align our costs with revenue, and lastly, get us cash flow positive. We are making progress on all three. We are working with a strong sense of urgency to make decisions that make sense in the long term.

Our portfolio review continues and the cost revenue alignment is a key part of this process. As we stated previously, our portfolio review will be complete by year-end, with a determination of core versus non-core assets. Our objective is to ensure that we're getting the most value out of our business for our shareholders. We are making good progress this quarter and when it is clear that there is not a fit, we are divesting. I can tell you that we see strong interests from third parties and are in discussions with potential buyers.

That said, we will determine in due course when it is best to put these assets to market as our focus is to ensure that we are maximizing Shareholder value. These actions will not only be meaningful cash to our balance sheet, which is important given the debt due later this year—next year, but also result in a more focused and targeted Company with long-term profitability. Of course, the decisions of these will be finalized and when they are, we will communicate more about this.

We are moving forward on our cost cutting and business rationalization actions as well. We have just begun to see the results and expect to see more in our financial results in coming quarters. We recognize that our performance is not where it needs to be and there is still a lot of work to be done. I can ensure you that our Board and Senior Leadership Team is aligned and clear about what is needed.

On that note, I have asked Andrea Alghisi to join our call today. Andrea is our Chief Operating Officer for our Automotive, Industrial division. I want him to speak about our financial performance and you might remember Andrea from his former Fuel Systems days. With that, over to you Andrea.

ANDREA ALGHISI speaking

Chief Operating Officer, Automotive and Industrial division

Westport Fuel Systems Inc.

Thank you, Nancy and good afternoon. As Nancy pointed out, we have been working on aligning our cost base to revenues. I would like to provide you more details on our operational efficiencies, margin improvement, and integration effort. First of all, we completed the transition to one public Company that should result in annual savings of approximately \$4.4 million per year. Second, in terms of footprint optimization and operational effectiveness, we are looking at every element so that no stone is left unturned.

So, to give you some more color, we consolidated U.S. automotive operations into one location along with a reduction in head count which would result in \$4.9 million in savings on an annual basis. We also restructured the corporate and technology group in Vancouver that should result in savings of approximately \$2.5 million per year. We exited almost 10% of our total facilities' capacity so far. We consolidated, closed, or reduced future facilities' commitment in several locations including Argentina, China, and North America. It will allow us to avoid cost of approximately \$4.5 million per year.

Another work stream we are working on is the direct material cost reduction activities. This is the bread and butter of automotive industry. These initiatives are exploiting both technical levers like product redesign, buy to make, and commercial levers like strategic sourcing and supplier negotiation to improve product competitiveness. We are starting to see improvements and expect to realize more benefits in the coming quarters. Our overall efforts since the merger have achieved approximately \$16 million in annual savings to date.

On the global integration front, I would like to talk about just one example. In August, we formed a global purchasing supply chain group to capture synergies, streamline the supply chain organization, reduce cash requirements needed for inventory, and implement standard metrics for inventory management and inventory aging. As part of this, we identified business and location specific inventory reduction goals, waste back reduction in material floor space as well as significantly lower inventory level to operate our businesses.

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Last but not least, to give you some better insight into the operational performance of the automotive and industrial segment, the combined Adjusted EBITDA was approximately \$2.4 million for the quarter. These segments are net contributors to the business and we are continuing to take more steps to improve their contribution.

In closing, actions to reach our cost reduction targets are already well underway and I expect full realization of savings by the end of 2017. I'll now turn the call back over to you Nancy.

NANCY GOUGARTY speaking Chief Executive Officer, Westport Fuel Systems Inc.

Thank you, Andrea. As indicated by what Andrea has just shared with you, to be clear, this is not about incremental steps, it's about moving with a sense of urgency and working with the necessary experts to make the right changes big and small and aligning our costs with our revenue. The Senior Leadership team is united and we're working together with the necessary urgency to make the necessary changes such that our cost is aligned with our revenue. I want to take a few minutes because always of interest is HPDI 2.0, so let me go through some elements on this side.

Our program with our initial launch partner is on schedule and on budget. We are meeting our milestones and our performance goals. We expect to ship our first commercial component to that OEM in calendar year 2017. Ashoka will talk more about this later, but we expect that our development cost will decline following commercial launch. While HPDI is important to us, I want to make clear it is more than just HPDI injectors, it's a fully integrated system.

We also have expertise in cryogenics which we have in-house capabilities to develop and test various cryogenic applications for our customer program. We are capitalizing on this expertise just as strong as on the on-engine HPDI technology. Our knowledge, our expertise, and experience along with a deep patent portfolio is what makes Westport Fuel Systems the leader in this space.

In fact, one development that we're excited about is that we can offer a non-fossil fuel solution for the heavy-duty transportation sector. For example, an HPDI 2.0 truck can run completely on 100% renewable fuel. In addition, as the transportation alternate fuel mix continues to diversify, we are exploring more opportunities for new, low carbon fuels such as hydrogen. Of interest, today, we are providing high pressure hydrogen components for material handling and bus applications. We also have recently entered into a licensing arrangement for our cryogenic pump to be used in hydrogen fueling stations.

In closing my comments today, before I turn over the call to Ashoka, I want to reiterate a couple items. There is still much work to be done in transforming Westport Fuel Systems to a sustainable profitable Company. We have lots of momentum and we're taking the necessary steps to deliver the change that is required. There is a strong support across the team for the changes that we're making, and I can see progress in the work the team is doing. I am confident in the process that we are following, the decisions that we're making, and the immediate actions that we're taking to accomplish our vision.

With that, thank you and over to you, Ashoka.

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems Inc.

Thank you, Nancy. Good afternoon everyone. I will be providing you with some of the highlights for our third quarter and discussing our financial results under the post-merger segment reporting format.

Let us start with the automotive segment on Slide 8. As you can see, this shows the third quarter results quarter-over-quarter as well as the results for the second quarter 2016 which included one month of Fuel System Solution results. Please note that the Fuel System Solutions figures in the third quarter of 2015 are from their 10-Q filing and are provided for comparative purposes only.

The end markets for our automotive businesses continue to be challenged with low oil prices, currency and market specific weakness, notably in Argentina, the U.S., and Europe. Overall, we have seen some market consolidation among suppliers and we have increased our share in certain markets as weaker players exit the industry. However, these share gains have not been enough to offset the overall weakness in our end markets.

Gross margins for the automotive segment were impacted by inventory obsolescence charges as well as the amortization of the write-off of inventory to fair market values at the merger. Excluding these, the gross margins for the segment would have been 20%. We have been taking several actions in this business including consolidating, manufacturing, and distribution footprints, improving inventory and working capital management, and discontinuing some of our operations and product lines. While we have already begun to see the impact of these actions, it will in some cases take a few quarters for the benefits to be fully realized due to the timing of factory moves or finishing out of customer contracts. We will continue to take whatever steps are necessary to realign this segment.

Moving on to Slide 9 our Industrial segment, which to remind everyone is essentially the industrial group of the former Fuel System Solutions business. We continue to see solid performance here led by the auxiliary power unit or APU business in North America, fuel system components in India, and the mobile and fleet management businesses in Europe. Industrial segment gross margins for the quarter included \$900,000 for merger related inventory amortization without which it would have been 28%. Our focus here continues to be operational footprint alignment and working capital improvements.

Moving to our JV, Cummins Westport or CWI on Slide 10, CWI continues to face multiple headwinds from a weakening truck market in the U.S. and lower diesel prices worldwide. We still see solid demand from the transit bus sector and expect the ISL G Near Zero Engine, which will launch in the fourth quarter of this year to support further penetration in this market. Additionally, the new 6.7-litre engine which was launched in the second quarter of this year is already making an impact in the school bus market.

CWI gross margins in the quarter did improve on higher parts sale and lower warranty cost, but R&D costs were higher than the prior year due to quality improvements being made to current engines, the launch of the Near Zero product and work related to regulatory compliance for 2018 and beyond.

Moving on to Slide 11 which shows SG&A by segment. As Nancy and Andrea mentioned, we have made significant cost reductions across the Company such as closing of our New York corporate offices and headcount reductions in Vancouver. We expect to see the full benefits of these cost cutting actions in the upcoming quarters and we will continue to reduce our overhead spending to be aligned with the revenues of our businesses.

Turning to Slide 12 which shows our R&D expenses, again by segment, you will see a decline on the Westport Automotive R&D which is the result of our being significantly more targeted in our engineering programs. But the bulk of our R&D spending continues to be on our HPDI program. As Nancy stated, we did achieve a key customer milestone this quarter for which we will receive a payment of \$2 million. This program continues to be on schedule and on budget for commercial release to our OEM launch partner in 2017. We expect to see similar R&D spending levels for the next few quarters, but then drop off considerably after we reach commercial launch. Moreover, we do not expect to see the R&D costs ramp up again, as new development programs come on stream, as these will be fully funded by our OEM customers as well as government agencies and other industry advancement groups.

Turning to the next slide, Slide 13 which shows the walk of our cash from the second to the third quarter. Starting with the bar on the left, our cash balance at the end of the second quarter was \$70.3 million. We received cash inflows from the sale of our Plymouth facility, the sale or part of our ownership in Weichai Westport joint venture, and dividends from our joint ventures. On the outflow side, we spent \$2.6 million of cash in restructuring costs such as lease terminations and severance payments, we had capital expenses of \$3.1 million related to the HPDI launch and we paid down \$2.4 million on our credit lines. We ended the quarter with \$57.8 million of cash.



Conference Call Transcript

Third Quarter 2016 Financial Results: November 9, 2016

Do note that these numbers do not include the remaining \$3.6 million from the Weichai sale which we received in October or the \$2 million milestone payment from our HPDI launch partner.

It goes without saying that cash is a major focus and as you have heard, we are continuing to take all actions that will get us to Adjusted EBITDA breakeven and then on to full profitability. To reiterate what Nancy said, we are taking quick action on every front.

On the debt coming due in 2017, we are on parallel paths, both in discussions with the existing debt holders to refinance their obligations and working on other refinancing options as well. To this end, we have engaged advisors to help us with all options available to us. We are also in negotiation to sell some of our assets that are non-core to us. Some of these are much farther along than others, but we are clearly comfortable saying that there is strong interest from third parties and when these sales are complete the cash proceeds will improve our cash position.

So, to conclude, we are making significant progress, but there is more work to be done, but we are confident that we are on the right track and look forward to provide you with more results of our efforts in the upcoming quarters.

One last thing to note before we open the call to questions is that effective tomorrow morning, our ticker symbol on the Toronto Stock Exchange will change to WPRT, consistent with our ticker symbol on the NASDAQ. With that, Operator, you may now open the call for questions.

Operator

We will now begin the question-and-answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. We will pause for a moment as callers join the queue.

The first question comes from Rob Brown with Lake Street Capital Markets. Please go ahead.

Rob Brown - Lake Street Capital Markets

Good afternoon.

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

Hi, Rob.

Andrea Alghisi - Westport Fuel Systems Inc. - Chief Operating Officer, Automotive and Industrial

Hey, Rob.

Rob Brown - Lake Street Capital Markets

On the asset sales, you gave a good sense of may be timing coming up here. But what sort of gives you a sense of the—or what gives you confidence that the asset sales can make a difference relative to your balance sheet needs and I mean what's the range of value of those assets that you're thinking?

Ashoka Achuthan - Westport Fuel Systems Inc. - Chief Financial Officer

Rob, could you repeat that question? You, kind of faded off towards the second half.

Rob Brown - Lake Street Capital Markets

Yes, sorry for that. What really gives you comfort that the asset sales that you're working on can make a difference relative to your balance sheet and may be a range of expectations of what those assets can be worth?

Ashoka Achuthan - Westport Fuel Systems Inc. - Chief Financial Officer

Well, all I can tell you at this point, Rob is that we are much farther along on some of the sales than we are on others. We are reasonably confident that when these do close, they will have a meaningful impact on our cash position.

Rob Brown - Lake Street Capital Markets

Okay, okay, thank you. Then on your HPDI program, you talked about one getting close to launch here. Where you at in the other programs, sort of how many are going at this point and your sense of timing and kind of marketplace interest?

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

I would tell you Rob, that there is still significant interest obviously with the focus on getting our initial launch partner done. You can see that we are making good progress there that helps us easily translate this product with other customers. So, those discussions are underway. You can also see us now taking our capability and competency and moving it over into some other areas that are positioned to use high pressure components such as what we mentioned with the hydrogen fueling stations and some other elements like this.

So, I'm quite comfortable that we're getting some positive reaction relative to the heavy-duty truck market, but very pleased to see some adjacency industries that are also interested in the high pressure direct injection. I think, that also to mention that as we look into the medium and heavy duty, even on the light duty side, some of our enhanced spark ignited products

are also in current dialogues. So, feel quite pleased that from the component side all the way up through full system solutions, that we've got really a lot of active dialogue going on across the Company whether it's in Europe or whether it's in the U.S. or even in China.

Rob Brown – Lake Street Capital Markets

Okay, thank you. Then on the R&D expense, obviously, that would come down when you did launch the OEM program, give us a sense of what that amount would be or the delta could be.

Ashoka Achuthan - Westport Fuel Systems Inc. - Chief Financial Officer

All I can say at this point Rob is we expect the drop off will be significant after launch. As I mentioned, most of our current R&D spend is related to the HPDI program. So, it stands to reason that once that program is launched, we will have a significant drop off for the reasons I mentioned in my talk.

Rob Brown - Lake Street Capital Markets

Okay, thank you. I'll turn it over.

Operator

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

Eric Stine - Craig-Hallum

Hi everyone. Just wanted to start with the balance sheet, to follow up on the previous question and thank you for providing the quarterly cash chart there. But can you give more clarity into the operating cash usage? I haven't had a chance to run the numbers, but that nearly \$24 million seems higher than what is implied in results. So, I mean maybe is that working capital and how do you see that trending going forward?

Ashoka Achuthan - Westport Fuel Systems Inc. - Chief Financial Officer

That is, as I mentioned, Eric, our absolute primary focus and that is the operating cash, which includes everything other than the individual items that we have separately shown, which is the sale of our Weichai interest, the sale of Plymouth, and our restructuring cost. So, a substantial portion of that is related to our ongoing engineering spend and the trend for that will be as I mentioned declining.

Eric Stine - Craig-Hallum

Okay. So, I mean working capital, any way to quantify, or we can talk about it offline or I can take a look but I mean just...

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

May be just on working capital, it's been a focus, and I would say that we have seen some positive trends relative to inventory in this quarter. I'm looking right now through the press release, but there was...

Andrea Alghisi - Westport Fuel Systems Inc. - Chief Operating Officer, Automotive and Industrial

There was a reduction of \$10.5 million in inventory.

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

Yes \$10.5 million in our inventory, as Andrea had mentioned.

Andrea Alghisi - Westport Fuel Systems Inc. - Chief Operating Officer, Automotive and Industrial

\$98.1 million to \$87.6 million.

Eric Stine - Craig-Hallum

Okay. Well, I guess we can take that offline. May be just moving to HPDI, the 2.0 obviously, good to hear your growing confidence there but, sticking with the existing program that you're working towards for 2017, are there critical steps that you can point to or that you plan to share with the market, whether it'd be in fourth quarter or 2017 that are critical to getting to that stage where you're providing components to that OEM or how should we think about that?

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

Well, Eric I would say that the evidence that Ashoka mentioned is the fact that we got a progress payment of \$2 million this past quarter. I think that that's a strong indicator that we are making progress with that. I think that as we trend into the last quarter this year, and as we move into next year, there are quite a bit of engagements in those kinds of things that are happening, both in the customer program gates as well as in our program gates. But we are—at this stage of the game, I would say that we're hoping that as we move into calendar year '17 that we can provide more clarity relative to exactly where we are and exactly what's going on in HPDI. But right now, I think the takeaway at the moment is the \$2 million that we got for passing a key milestone.

Eric Stine - Craig-Hallum

Yes, understood. May be last one for me just to clarify, so you talked about having the capabilities to operate non-fossil fuels or a solution there. I mean is that a—are there added capabilities to the engine, or are you just referring to if one operates that on RNG?

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

Well, I think it's RNG but also what we're finding is that we can use a, what they call hydro treated vegetable oil as the pilot fuel versus other fuel alternatives such as diesel. So, one of the things that we're looking for is a total green solution here. So, being able to reuse RNG but it's also stepping out and making sure that we have solutions that are non-fossil related to the pilot as well.

Eric Stine - Craig-Hallum

Got it. Okay, thanks for that.

Operator

The next question comes from Amit Dayal with Rodman & Renshaw. Please go ahead.

Amit Dayal - Rodman & Renshaw

Thank you. So, looking at the gross margins for the Company going forward, one, what kind of impact will HPDI 2.0 have on this potentially? Are you shooting for any range with these asset sales that you guys are considering where we can come in for 2017? Any colour on that would be helpful. Thank you.

Ashoka Achuthan - Westport Fuel Systems Inc. - Chief Financial Officer

Yes, let me answer your second question first, Amit. As I mentioned, we are farther along on some of those sales than we are on others, and obviously, this is a result of the portfolio review that we said we will be undertaking and we are undertaking across our businesses. But, I can tell you this much that when the sale does complete, it will be a meaningful impact on our cash position.

Going back to your first question, the first part of your question which is the margins on HPDI, I'm not at liberty to disclose specific margins that we will have going forward in HPDI, but you are probably aware that the way the asset light structure that we have brings us revenue on two dimensions. One is they're all related to the sale of each engine and the second is the sale of components which will be directly shipped from our third-party manufacturers to the engine OEM. We expect that to meaningfully contribute to our gross margins as the launch is complete and we go ahead with—the OEM goes ahead with full production.

Amit Dayal - Rodman & Renshaw

Right. Understood. Thank you for that. Just one more from my side, with this HPDI 2.0 launch coming up, your comments Ashoka, it seemed that the macro environment is still not as strong as you would like. Does this impact the HPDI 2.0 plans in any fashion? Are you seeing any developments that could have moved faster may be not move as fast as because of potentially weaker macro environment?

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

So, Amit maybe I will try to tackle this one and Ashoka can add some comments. I think that what we're finding in the heavy-duty truck market and in general even with what's going on with the Paris Accord, as well as the EPA ruling that have now come out with this reduction that needs to take place from 2017 to 2027 that HPDI is perfectly—the perfect product that can address a lot of that activity and get us really big step changes relative to that. So, I think that as we are talking about market, some of the things that we are seeing are obviously the currency as well as fuel pricing. But, I think that with the overhang and the push towards greenhouse gas and CO2 emissions, HPDI is really one of the solutions that we have.

Even as we move more into renewable fuels and non-fossil solutions that will even make bigger contributions to that. So, I think that the value proposition for HPDI is not only vehicle performance, but is also what we can do to contribute to some of the regulations that are coming on board here.

Amit Dayal - Rodman & Renshaw

Right. Thank you. That's all I have guys. Thank you so much.

Operator

Once again if you have a question please press star then one. The next question comes from Mike Baudendistel with Stifel. Please go ahead.

Michael Baudendistel - Stifel Nicolaus

Thank you. You talked a lot about getting to cash flow positive, sort of as soon as possible, you're taking lot of cost out of R&D, interest expenses. Are you confident that you can get there in the next few quarters without any improvement in demand in the end markets which don't seem to be getting much better?

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

Let me start out, and I'll have Ashoka put some additional colour on this and Andrea. I think that's why Mike, we have been spending so much time in trying to get our cost aligned with our revenue. It is our belief that if we can get the cost aligned with our revenues, then as the market recovers in those kinds of things that we can build back in outcomes. But, at this point in time I would say that we are working on lots of different aspects, whether—as Andrea mentioned, all our activity on working capital, you can see that we have taken some significant restructuring here in terms of how we are trying to lean-up even corporate offices and those kinds of things and closing down facilities. This is—it's all about in our view that we can get after a lot of things, and yes we can wait for the economy to come back but it's our belief that there are levers that we have now that we can enact in order to get towards our cost and to make positive progress. If the market comes back that's bonus dollars for us. Andrea, any other thoughts or Ashoka?

Ashoka Achuthan - Westport Fuel Systems Inc. - Chief Financial Officer

No, the only thing I would add is it's all about aligning cost to the anticipated revenues and that has been our focus and that is our direction. So, I would agree with Nancy 100% that's what will help us get there.

Andrea Alghisi - Westport Fuel Systems Inc. - Chief Operating Officer, Automotive and Industrial

Yes, I confirm that our objective is to align cost structure with revenues and I can say that if we look at the aftermarket all over the world, also the market is very much different from region to region and from country to country. There are regions and countries where the market decreased by 70%, seven-zero percent, other countries that are growing even in this let's say difficult and troubled environment given this let's say low oil price. So, in India for example, we are growing by 30%. So, there are geographical areas that we just need to exploit let's say the growth drivers and we are doing that all over the world. This is the strength of this combined Company, Westport plus Fuel Systems to be able to reach clients all over the world.



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Michael Baudendistel - Stifel Nicolaus

Great. Thanks for the detail. That's all I had for this afternoon. Thank you.

Nancy Gougarty - Westport Fuel Systems Inc. - Chief Executive Officer

Thanks, Mike.

Operator

Once again, if you have a question, please press, star then one. This concludes the question-and-answer session. I would like to turn the conference back over to Caroline Sawamoto for any closing remarks.

Caroline Sawamoto - Westport Fuel Systems Inc. - Manager Investor Relations and Communications

Thank you, everyone for joining us today. If you have any follow-up questions, please feel free to reach out to the Investor Relations team. Thanks again for your interest in Westport Fuel Systems.

Operator

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