

Operator

Welcome to the Westport Fuel Systems First Quarter 2018 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 conference over to Ms. Caroline Sawamoto, Manager of Investor Relations and Communications for Westport Fuel Systems. Please go ahead.

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

Thank you and good morning. Welcome to Westport Fuel Systems First Quarter 2018 Conference Call, which is being held to coincide with the press release containing Westport Fuel Systems financial results that went out last night. On today's call, speaking on behalf of Westport Fuel Systems is Chief Executive Officer, Nancy Gougarty, and 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 over the call over to Nancy.

NANCY GOUGARTY speaking Chief Executive Officer, Westport Fuel Systems

Perfect. Thank you, Caroline. Good morning and thank you for joining us at Westport Fuel Systems First Quarter Results Conference Call.

We continue to see a rapid transition in the transportation industries towards environmentally friendly fuels and technologies. Traditional fuels are decreasing in the market, especially diesel. In the first quarter of 2018, the European Union diesel car registration fell 17% compared to the same period last year, while the market for natural gas, propane and ethanol had a 12% increase year-over-year. This only means that there is a tremendous opportunity in front of us. Consumers demand clean vehicles and there's a greater urgency for market-ready solutions.

We still need to stay focused on deploying alternative fuel solutions for transportation vehicles. One way is to continue to review our portfolio and look to divest non-core businesses; however, today, I am going to focus on our core business. If you would please turn to slide 2.

Westport Fuel Systems has a complete product offering that addresses a broad range of alternative fuels, including LPG or propane, natural gas and hydrogen. We have LPG and CNG kits for the aftermarket conversion, and we have 25% of the global market share. Our kits include a complete range of products, including our most advanced system for direct injection engines. For the aftermarket business, Westport Fuel Systems continues to invest in targeted R&D to stay paced with new

technologies introduced by transportation OEMs and their engineering evolutions. We have zero kilometre conversion or delayed OEM solutions for LPG and CNG conversions. This is a great solution for our OEM partners to provide alternative fuel vehicles in their showrooms. In some countries like Italy, Turkey and Sweden, Westport Fuel Systems has a dominant market share.

If we look at the OEM light-duty solutions, LPG and CNG components and complete systems are available, and again, Westport Fuel Systems has a leadership position in the supply of CNG off-engine components such as tank and fill valves for the light-duty market. On the medium-duty transportation solutions side for OEMs, including CNG components and complete systems, with a strong presence in India and Eastern Europe. As I had mentioned before, last year alone, more than 20,000 natural gas engines in India had Westport Fuel Systems ECUs, engine management systems, regulators and more than half of the vehicles are using our injector solution. Westport's HPDI 2.0™, our fully-integrated solution for heavy-duty, long haul customers is launched. Our no compromise technology is providing a positive environmental impact in performance efficiencies, which our customers need. The industry sources have reported that LNG trucks could take up to 10% of the European truck market in the near term and 20% using LNG by 2030. In addition, our joint ventures, Cummins Westport and Weichai Westport, who produce natural gas engines, dominate their respective local markets in North America and China.

As for our hydrogen product line, Westport Fuel Systems is able to offer a very competitively priced hydrogen component. Our OEM focused development and validation process are also used for hydrogen components, making them a robust solution today for fuel cell applications. Westport Fuel Systems is poised now to serve the market needs for clean energy products, and the good news is that all the alternative fuel solutions that we have are able to be used with renewable fuel sources. For example, Clean Energy's renewable natural gas called Redeem, or HVO, a diesel equivalent made from vegetable oil that is chemically identical to fossil diesel. When renewable fuels are paired with near zero engines, like the Cummins 12-litre engine, the result is an emissions level that is equivalent to battery electric vehicles. With government incentives and innovative leasing programs such as the one that Clean Energy and Total announced yesterday, we expect an increase in the adoption of Cummins Westport 12-litre engines in North America.

Now that you have heard about our diverse product portfolio, I'm going to conclude with our key priorities of the year. These priorities are built squarely around our customers and their needs. They are simply focused on broadening our product offering, deploying market-ready solutions, managing cash and increasing engagement with key OEMs and industry partners. We are continuing to have active discussions with our Chinese joint venture partner and OEMs on HPDI. These discussions are progressing and moving in a positive direction, but as I have said before, we need the right attributes to protect our intellectual property and other aspects of our business. We will continue down this path until we have negotiated the right agreement for the Company and our shareholders, and when we get it done, we will then announce it.

With that, I will turn the call over to Ashoka to provide our Q1 financial details.

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

Thank you, Nancy. I'll begin with slide 3, which provides a summary of our first quarter 2018 performance.

On a consolidated basis, we ended the quarter with \$67.6 million in revenues and an Adjusted EBITDA loss of \$3.5 million. Our gross margin for the quarter was impacted by costs related to the HPDI 2.0™ product and significantly lower engineering service revenues compared to what we had, both in the first and the fourth quarters of 2017. As expected, our operating expenses continue to decline, primarily on account of lower R&D expenses for the HPDI 2.0™ program. We are well on track to achieve positive consolidated Adjusted EBITDA during the second quarter of 2018, as stated in our last earnings call. Please note that we have now realigned our reporting segments into Transportation, CWI and Corporate.

Turning to slide 4, which shows our Transportation segment, revenues for the quarter improved by \$7.6 million compared to the same period last year. This was on account of the relative strength of the euro versus the U.S. dollar, sales of our HPDI 2.0™ product and stronger European independent aftermarket and OEM, or delayed OEM demand, offset by lower engineering service revenues. As stated earlier, gross margins were impacted by costs related to our HPDI 2.0™ product

and lower engineering service revenue this quarter. As expected, however, we have a significant drop in our R&D expenses, as much as 25% over the first quarter of 2017 and 24% sequentially. Our SG&A costs trended lower as well. Our Adjusted EBITDA for the quarter was a loss of \$0.6 million, a significant improvement over a loss of \$2.4 million in the first quarter of 2017 and a loss of \$4 million in the fourth quarter of 2017.

Turning to slide 5, which shows the results of CWI, our joint venture with our partner Cummins. As expected, first quarter revenues were lower on account of significant pre-buy activity that we saw in the fourth quarter of 2017, ahead of January 1, 2018, OBD, or onboard diagnostic compliance requirements and vehicle readiness activities at the OEM level. Gross margins were lower on account of the lower revenue, as well as a negative warranty adjustment this quarter compared to a positive adjustment in the first quarter of 2017. Without these adjustments, we would in fact have had a slight increase in current quarter gross margins due to higher parts revenues.

With substantially all of the R&D spend on near zero NOx engines and OBD compliance behind us, we are beginning to see a sharp reduction in R&D expenses by as much as 44% this quarter. SG&A costs are tracking lower as well. We closed the quarter with net income of \$3 million versus \$3.5 million in the first quarter of 2017, aided by the lower U.S. federal income tax rate.

Turning to slide 6, which shows our corporate segment, note that the R&D costs we show here are related to costs associated with protecting our intellectual property, including maintaining our patent and trademark portfolios. We had an increase in SG&A costs for the quarter as compared to the prior period quarter on account of legal fees, offset by a decline in stock-based compensation costs.

Turning to slide 7, which shows our cash walk, starting with a beginning balance of \$71.8 million, we had a net use of cash from operations and working capital of \$9.5 million, mainly on account of working capital requirements for the HPDI 2.0™ product and performance bonus and legal fee payments in the quarter. We had cash restructuring expenses of \$2.9 million, primarily related to the exit of certain lease commitments, and capital expenditures of \$3.6 million. With the HPDI capital expenditures largely behind us, we expect that current year capital expenses will be less than half of that in 2017.

We had a release of the holdback related to the sale of our industrial business last year of \$3.6 million, and debt and interest payments of \$4.2 million, and we ended the quarter with a cash balance of \$55.2 million. We expect to achieve full year 2018 revenue from continuing operations to be between \$255 million and \$275 million. As stated earlier, we also expect to achieve consolidated positive Adjusted EBITDA during the second quarter of this year.

With that, I would like to turn it over to the Operator for questions.

Operator

Thank you. We will now begin the question-and-answer session. Analysts who wish to join the question queue may press star, then one on their 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.

Our first question comes from Eric Stine of Craig-Hallum Capital Group.

Eric Stine - Craig-Hallum Capital Group

Good morning, Nancy. Hi, Ashoka.

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ASHOKA ACHUTHAN speaking
Chief Financial Officer, Westport Fuel Systems

Hi, Eric.

Eric Stine - Craig-Hallum Capital Group

So let me start on just a two-part question on HPDI now that you've launched, you've got trucks on the road in Europe. Just curious how the OEM pipeline has come together or has changed as a result of that? Then when you look at what those OEMs are looking for, I mean any clarity you can give on whether those are skewed more towards a similar engine to what is now in the market, or are they looking for more of a unique solution and just what that would mean in terms of time to market or development?

NANCY GOUGARTY speaking
Chief Executive Officer, Westport Fuel Systems

Well, let me try to answer the first part first, and that—in terms of the reception to the product in Europe, I think that it has been quite good. We're very pleased. As you know, as any time you're launching a new product with new technology, we've got to make sure that the entire system is ready and up and running, and so I think that all of those attributes are getting in place and you're starting to see country by country more and more vehicles on the road, and that will continue throughout the calendar year '18.

In terms of the second part of your question, Eric, in terms of what are people looking for, I would say there's different customers that have different approaches to the market. Some people are very comfortable with me-too products, which mean that it would be minor innovations and quick-to-market solutions, and in some cases, maybe even, I'll say some delayed OEMs modifications and others are looking for differentiating products and technologies, and obviously, those would take us longer to get to market.

Eric Stine - Craig-Hallum Capital Group

Got it. I mean, is it fair to say that now that it's 2.0, part of that is with the goal that you can get to market quicker, if it is more of that, as you put it, me-too version that it's 18 to 24 months...

NANCY GOUGARTY speaking
Chief Executive Officer, Westport Fuel Systems

Oh, absolutely.

Eric Stine - Craig-Hallum Capital Group

Maybe just turning away from HPDI a little bit, I mean I know that gets a great deal of the focus, as it should, but just curious about your high efficiency spark programs there as well. Just curious where that stands, about how you'd

characterize the interest levels, and is that something where you potentially—and I know you're not in charge of this; it's the OEM, but there's potentially some news flow on that front in 2018.

NANCY GOUGARTY speaking Chief Executive Officer, Westport Fuel Systems

Well, I would say that, again, what we're finding, regardless of whether it's on the trucking side or on the automotive side is that these market-ready solutions or things that can go fast to market, I think that a lot of OEMs are finding that they don't have a full portfolio in certain markets, whether in cars or trucks, and the spark ignited product, it does great in the medium-duty space, and I think that that's where we're going to see most interest. But what I would say is what we're finding now is the fact that we can move to market so rapidly, and as I mentioned in my speech and Ashoka mentioned in his speech, also the upswing that we've seen in the delayed OEM or zero kilometre conversions that we've seen, we're seeing that that's a great way for the OEMs really to speak quickly to their product portfolio, and I think that with the enhanced spark ignited, that's going to be one of those products that can come to market in a more rapid fashion.

Eric Stine - Craig-Hallum Capital Group

Yes. Yes, okay, that's great. Maybe just last one for Ashoka, just in terms of CWI, I know you had the warranty adjustment there which impacted margins. I mean, is that something that we should kind of view one-time in nature, or is that something that you'll have that for a little bit now that you've launched the 12-litre near zero?

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

Yes, Eric, I don't want to make too big a deal about that warranty adjustment. Bear in mind, we had significantly lower revenues this quarter than we had in the first quarter of 2017, or for that matter, any quarter last year, so there was an impact there as well. But yes, we did have a warranty adjustment. No reason to believe that that's going to be an ongoing issue and that did impact our margins slightly. But net-net, as I mentioned, if it weren't for those adjustments, our quarter—gross margins for our current quarter would have actually been higher than the corresponding gross margin in the prior period quarter.

Eric Stine - Craig-Hallum Capital Group

Yes, okay. Thanks a lot.

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

Yes.

Operator

Our next question comes from Rob Brown of Lake Street Capital Markets.

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NANCY GOUGARTY speaking

Chief Executive Officer, Westport Fuel Systems

Good morning, Rob.

Rob Brown - Lake Street Capital Markets

Sticking to CWI for a second, maybe could you give us some colour on the cadence of the unit shipments as the year goes on? After the kind of pull forward last quarter, how does that recover throughout the year?

ASHOKA ACHUTHAN speaking

Chief Financial Officer, Westport Fuel Systems

No, I think we are beginning to see recovery already, Rob, and the pull forward last year was essentially on two grounds. One, the fact that we had fleet owners who wanted to pre-buy before the OBD compliance requirements kicked in; and also because there's a fair amount of vehicle integration work that needs to be done once you have these OBD compliant engines installed in your trucks. So there was some, shall we say—that's what I meant when I said vehicle readiness issues in the first quarter. That is largely behind us and what we are seeing now is a very strong recovery, or a pickup in volumes, so we are reasonably confident that we are looking towards a strong year in 2018 at CWI.

Rob Brown - Lake Street Capital Markets

Okay, great. Then what's your view on the demand growth that can come from the new lease program that Clean Energy discussed yesterday?

ASHOKA ACHUTHAN speaking

Chief Financial Officer, Westport Fuel Systems

Oh, absolutely. Of course, we are not counting too much on that front this year because we would expect that it would be third quarter or early fourth quarter by the time the mechanics of the lease program are in place. But we are extremely encouraged by the developments at Clean Energy, the investments by Total and more importantly, the financing, the \$100 million financing program that they plan to put in place. So we expect to see the effect of that more in real late 2018 and 2019 and beyond, but irrespective of that, with the extremely strong product offerings that the Company has, near zero options and 6.7, 8.9 and 12-litre and all OBD compliant, we would have seen a significant uptick in—we would expect to see a significant uptick in volume growth anyway.

Rob Brown - Lake Street Capital Markets

Okay, good. Then on your automotive business, you mentioned some good growth in the European market, but how was your sort of core automotive business growth? Was it sort of similar to the market? Just some comments on how the automotive growth for your business is doing.

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

No, we are seeing strong growth in, particularly in the independent aftermarket and the OEM or the zero kilometre conversion parts, very strong in Europe, matter of fact. We've said in the past that we expect to see low to mid-single digit growth in this business. We have clearly outdone that, and our presence in the market is clearly playing its part in helping us grow there.

NANCY GOUGARTY speaking Chief Executive Officer, Westport Fuel Systems

Let me just add to that. I think what we're seeing is an independent aftermarket, just as Ashoka said, but what—I think that the other news is, Rob, is that we're starting to see content increase for some of our OEM customers as well, and we think that the combination of that is getting more content per vehicle, as well as the desire for them to have a portfolio that is more broad than just petrol and diesel is also helping us on the OEM side as well.

Rob Brown - Lake Street Capital Markets

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

Operator

Our next question comes from Jeff Osborne of Cowen & Company.

Jeff Osborne - Cowen & Company

Hey, good morning. A couple of questions on my end. Ashoka, the parts revenue on CWI was pretty high. Was that—is this a new run rate, or was there some one-time items affiliated with the OBD compliance.

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

I wouldn't say there was any one-time items. I mean, bear in mind the engine population increases as we sell more engines into the market, and as they come out of warranty, it is extremely favourable. So we expect to see continued growth in the parts revenue in this business.

Jeff Osborne - Cowen & Company

Got it. Then shifting gears to the 2.0 program, is there any sense of perspective you can offer in terms of which markets your partner's having the most success in, where the bulk of the infrastructure has come online and people can move forward with?

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

You want to take that, Nancy?

NANCY GOUGARTY speaking Chief Executive Officer, Westport Fuel Systems

Let me see if I can get it started. I think, at this point in time, it's still early days, and where I think that we are starting to see some good pickups is for sure in the U.K. and, what I would say, in areas where they have LNG as a really known fuel commodity. We're also seeing it in countries where there's relatively high incentives, which are Italy, as well as in the Nordic countries.

Jeff Osborne - Cowen & Company

Got it. Then the last question I had is just the feedback from the Act Show is there's certainly a lot of pent-up interest in the 12-litre near zero, but it sounded like some of the OEMs haven't qualified the engine. Can you just give us a sense of where we're at in terms of partners of Cummins that qualified that and how we should think about the revenue ramp for that? I think Eric had asked about that before, but safe to assume it's more of a back-end loaded year?

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

No, I wouldn't necessarily call it a back-end loaded year, Jeff. I think it will be—we are seeing a pickup already, as I mentioned, so we will see—more or less, shall we say, lineal growth is not unreasonable to expect.

Jeff Osborne - Cowen & Company

Great. Thank you.

Operator

Once again, if you'd like to ask a question, please press star, then one. Our next question comes from Colin Rusch of Oppenheimer.

Colin Rusch - Oppenheimer

Thanks so much, guys. Obviously, you're approaching this EBITDA breakeven very quickly. Can you talk a little bit about what's going to change in the financial statements to get you there? Is there incremental margin increase here, or are you just looking at a bit of revenue growth, or are there some meaningful savings, all of the above? But if you'd just get into the granular detail on that, that'd be great.

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

Absolutely, Colin. I mean, simplistically, I could say all of the above, but frankly, it is a three-pronged approach. I mean, as you've noticed, our Automotive, formal Automotive segment continues to perform strongly, particularly at the IAM and the OEM side. We are seeing strong growth there on the top line, stable to positive growth in the margins as well, as a result of all the integration and productivity measures we put in place since the merger in 2016. So that is clearly a strong contributor.

The second contributor is CWI. I mean, make no mistake, CWI is a very significant contributor to our bottom line, and you can see in our results that the strength of CWI goes a long way in helping us get to where we expect to get to in the second quarter.

The third prong, of course, is the reduction in R&D expenses. We have said in the past that with the launch of HPDI 2.0™, we expect the R&D program, and what we then called the Corporate and Technology segment, to come down by 50%. We are beginning to see that as well. So the net result of these three, as we expected, is getting us to where we think we need to be, which is starting off with consolidated Adjusted EBITDA positive in the next quarter.

Colin Rusch - Oppenheimer

Great. Then just in Europe, as you see the new trucks roll out, could you talk about what you're seeing in terms of preparedness and the service infrastructure, the kind of breadth and density of the service infrastructure, just from a country-by-country basis? How wide is it? Are we going to need to see some real investment in that to really see adoption on the trucks?

ASHOKA ACHUTHAN speaking Chief Financial Officer, Westport Fuel Systems

You want to take that, Nancy?

NANCY GOUGARTY speaking Chief Executive Officer, Westport Fuel Systems

Let me try to take—yes, I'll try to take that, and so I would tell you that at this point in time, that our launch has taken a significant, I'll say, effort a lot of people—their organization and instead of doing train the trainer and then moving in time to each of the service networks independently, they have decided to do it by bringing in multiple people from different

locations. So we are obviously set. That strategy will help get out the trained technicians in a much faster way and will be able to embed the technology and the capability as more trucks move actually out into, I'll say, truck fleets' hands.

Colin Rusch - Oppenheimer

Great. Thank you so much.

ASHOKA ACHUTHAN speaking
Chief Financial Officer, Westport Fuel Systems

Thank you, Colin.

Operator

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 speaking
Manager, Investor Relations and Communications, Westport Fuel Systems

Thank you, everyone, for joining us today. If you have any follow-up questions, feel free to reach out to the Westport Fuel Systems Investor Relations team. Thanks again and have a great day.

Operator

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