



Financial Report to Shareholders

For the years ended
December 31 2018,
2017 & 2016

Q4 and Year End 2018



BASIS OF PRESENTATION

This Management's Discussion and Analysis ("MD&A") for Westport Fuel Systems Inc. ("Westport Fuel Systems", the "Company", "we", "us", "our") is intended to assist readers in analyzing our financial results and should be read in conjunction with the audited consolidated financial statements, including the accompanying notes, for the fiscal year ended December 31, 2018. Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). The Company's reporting currency is the U.S. dollar. This MD&A is dated as of March 19, 2019.

Additional information relating to Westport Fuel Systems, including our Annual Information Form ("AIF") and Form 40-F, is available on SEDAR at www.sedar.com and on EDGAR at www.sec.gov. All financial information is reported in U.S. dollars unless otherwise noted.

FORWARD LOOKING STATEMENTS

This MD&A contains forward-looking statements that are based on the beliefs of management and reflects our current expectations as contemplated under the safe harbor provisions of Section 21E of the United States Securities Act of 1934, as amended. Such statements include but are not limited to statements regarding the orders or demand for our products, our investments, cash and capital requirements, the intentions of partners and potential customers, the performance of our products, our future market opportunities, availability of funding and funding requirements, our estimates and assumptions used in our accounting policies, our accruals, including warranty accruals, our financial condition, timing of when we will adopt or meet certain accounting and regulatory standards and the alignment of our business segments. These statements are neither promises nor guarantees but involve known and unknown risks and uncertainties that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed in or implied by these forward looking statements. These risks include risks related to revenue growth, operating results, liquidity, industry and products, general economy, conditions of the capital and debt markets, government or accounting policies and regulations, regulatory investigations, technology innovations, as well as other factors discussed below and elsewhere in this report, including the risk factors contained in the Company's most recent AIF filed on SEDAR at www.sedar.com. The forward-looking statements contained in this MD&A are based upon a number of material factors and assumptions which include, without limitation, market acceptance of our products, product development delays in contractual commitments, the ability to attract and retain business partners, competition from other technologies, price differential between natural gas and liquefied petroleum gas, unforeseen claims, exposure to factors beyond our control as well as the additional factors referenced in our AIF. Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date they were made. We disclaim any obligation to publicly update or revise such statements to reflect any change in our expectations or in events, conditions or circumstances on which any such statements may be based or that may affect the likelihood that actual results will differ from those set forth in the forward looking statements except as required by applicable legislation.



The forward looking statements contained in this document speak only as of the date of this MD&A. Except as required by applicable legislation, Westport Fuel Systems does not undertake any obligation to release publicly any revisions to these forward looking statements to reflect events or circumstances after this MD&A, including the occurrence of unanticipated events. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

BUSINESS OVERVIEW AND GENERAL DEVELOPMENTS

Westport Fuel Systems is a global company focused on engineering, manufacturing, and supply of alternative fuel systems and components for transportation applications. Our diverse product offering sold under a wide range of established brands enables the deployment of a range of alternative fuels offering environmental and economic advantages, including liquid petroleum gas ("LPG"), compressed natural gas ("CNG"), liquid natural gas ("LNG"), renewable natural gas ("RNG"), and hydrogen. We supply our products and services through a network of distributors and original equipment manufacturers ("OEMs") and we provide delayed OEM ("DOEM") services. In total, we have customers in more than 70 countries. Today, our products and services are available for passenger car, light-, medium- and heavy-duty truck, cryogenic, and hydrogen applications.

Westport Fuel Systems is well positioned to increase revenues and market share as new stringent environmental regulations mandating greenhouse gas emission reductions have been introduced in key markets around the world. We are leveraging our market-ready products and customer base to capitalize on these opportunities. In addition to our operational competency in well-established transportation markets, our development of new technologies provides us a technology leadership position which is expected to drive future growth. Westport Fuel Systems has a track record of innovation, specialized engineering capabilities, and a deep patent portfolio resulting in a strong intellectual property position.

The majority of our revenues in 2018 were generated through the following businesses:

- Independent aftermarket ("IAM"): we sell systems and components, primarily through a global network of distributors and across a wide range of brands, that are used to enable passenger cars to use LPG or CNG fuels in addition to gasoline.
- DOEM: we directly or indirectly convert new passenger cars for OEMs or importers, to address local market needs when a global LPG or CNG bi-fuel vehicle platform is not available.
- Light-duty OEM: we sell components to OEMs that are used to manufacture new, direct off the assembly line LPG or CNG-fueled vehicles.

During 2017, we reached a significant milestone with the shipment of the first commercial Westport High Pressure Direct Injection 2.0 ("Westport HPDI 2.0™" or "HPDI") components to our European OEM launch partner. Our fully integrated Westport HPDI 2.0™ system matches the power, torque, and fuel economy benefits found in traditional compression ignition engines using only diesel fuel but powered primarily by natural gas, resulting in reduced greenhouse gas emissions, and the capability to cost-effectively run on renewable fuels. In 2018, our European OEM launch partner commercially launched heavy duty trucks incorporating HPDI 2.0™ technology, and these truck models are available and on the road in Europe today.

During 2018, Westport entered into definitive development and supply agreements with Weichai Westport Inc. ("WWI") to develop, market, and commercialize a heavy-duty, natural gas engine featuring the Westport HPDI 2.0™ technology, based on one of Weichai Power Co., Ltd.'s ("Weichai Power") heavy-duty engine platforms. The new natural gas engine will be certified to meet China VI emissions standards and is expected to be launched in late 2019. WWI has committed to purchase Westport HPDI 2.0™ system components required for a minimum of 18,000 Westport HPDI 2.0™ engines between the launch date and the end of 2023 (see Operating Segments of this MD&A for additional details on WWI). The HPDI business is still at the early stages of commercial development, and, as a result, is currently generating losses. Meaningful increases in component sales, compared to 2018 levels, are expected to be required for the HPDI business to benefit from economies of scale and become profitable. We anticipate growth in volumes in 2019 and future years through sales to our initial launch partner, our supply arrangement with WWI, and the possibility of additional OEMs entering into supply agreements for our HPDI technology.

Revenues for the year ended December 31, 2018 increased by 18% to \$270.3 million from \$229.8 million in 2017, resulting from strength in our independent aftermarket and light-duty OEM businesses, the first full year of HPDI 2.0 component sales to a large European truck OEM, and the stronger Euro. Our HPDI revenues were relatively low during 2018, as expected during the first full year of commercial sales, however based on orders to date and forecasts from our launch partner, as well as the expected launch of sales to WWI in 2019, we expect a significant increase in 2019.

Westport Fuel Systems recorded a net loss from continuing operations of \$40.8 million for the year ended December 31, 2018 compared to a net loss from continuing operations of \$62.9 million for the year ended December 31, 2017. The decrease in the



loss from continuing operations is a result of higher gross margin, lower research and development expenses, stronger contribution from Cummins Westport Inc. ("CWI"), our 50:50 joint venture with Cummins, Inc. ("Cummins"), and lower interest expense, offset partially by higher legal costs and foreign exchange losses.

Westport Fuel Systems earned a positive \$9.7 million Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA" see Non-GAAP Measures section in this MD&A) during the year ended December 31, 2018 as compared to a loss of \$19.7 million for the year ended December 31, 2017. The factors noted above were key contributors to the improvement in Adjusted EBITDA.

We continue to co-operate with the SEC's investigation that commenced in June 2017 regarding our investment in Weichai Westport Inc. and compliance with the FCPA and securities law related to disclosures in SEC filings. Legal costs increased significantly during 2018 and has been a significant use of cash. See the Regulatory Compliance section for additional details.

LIQUIDITY AND GOING CONCERN

In connection with preparing financial statements for each annual and interim reporting period management of the Company is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the financial statements are issued. Substantial doubt exists when conditions and events, considered in the aggregate, indicate that it is probable that the Company will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. This evaluation initially does not take into consideration the potential mitigating effect of management's plans that have not been fully implemented as of the date that the financial statements are issued. When substantial doubt exists, management evaluates whether the mitigating effect of its plans sufficiently alleviates substantial doubt about the Company's ability to continue as a going concern. The mitigating effect of management's plans, however, is only considered if both (1) it is probable that the plans will be effectively implemented within one year after the date that the financial statements are issued, and (2) it is probable that the plans, when implemented, will mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. Generally, to be considered probable of being effectively implemented, the plans must have been approved before the date that the financial statements are issued.

At this time management's evaluation has concluded that there are no known or currently foreseeable conditions or events that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date the financial statements were issued. The Company's financial statements have therefore been prepared on the basis that the Company will continue as a going concern.

At December 31, 2018, the Company's net working capital was \$63.1 million including cash and cash equivalents of \$61.1 million, and its long-term debt, including the royalty payable, was \$76.2 million, of which \$16.4 million matures in 2019. The Company has incurred a loss from continuing operations of \$40.8 million and negative cash flows from continuing operating activities of \$27.4 million for the year ended December 31, 2018, and has accumulated a deficit of \$998.4 million since inception.

The Company continues to work towards its goals of increasing revenues and reducing expenditures, which has improved results from operations and operating cash flows in 2017 and 2018, and this improvement in operating results is expected to continue in 2019. In particular, the commercial launch of Westport HPDI 2.0™ in 2018 has allowed the Company to significantly reduce engineering and development spend and the associated capital expenditures on this product and this reduction has improved current and forecasted future cash flows. In addition, while the legal fees related to the SEC investigation that began in 2017 (see note 20 (b)) increased significantly in 2018, we anticipate these legal expenditures to decrease in 2019. However, since the possible outcomes of this proceeding remain uncertain at this time, it is also necessary to acknowledge that any final determination that the Company's operations or activities are not, or were not, in compliance with the FCPA and/or other U.S. securities laws could result in significant civil and criminal financial penalties and other sanctions, which could have a material adverse impact on our financial condition. Lastly, the Company continues to examine non-core assets to determine whether it is in the best interest of the Company to monetize assets or to continue to hold and invest in these assets. Connected with this activity of assessing its non-core assets, on July 25, 2018 the Company closed the sale of its CNG Compressor business announced in the second quarter of 2018, which resulted in gross proceeds of approximately \$14.7 million.

Based on currently known conditions and events, management believes that the cash on hand at December 31, 2018 and the improvements to the operations expected in 2019 will provide the cash flow necessary to fund operations over the next year to March 31, 2020. The ability of the Company to continue as a going concern beyond one year will be dependent on the Company's

ability to generate positive results from operations and cash flows. If, as a result of future events, the Company was to determine it was no longer able to continue as a going concern, significant adjustments would be required to the carrying value of its assets and liabilities in the accompanying financial statements and the adjustments could be material.

OPERATING SEGMENTS

Effective January 2018, commensurate with the commercial launch of Westport HPDI 2.0™, the Company restructured its business segments to allow for further integration of product offerings. Accordingly, from that date, the Westport HPDI 2.0™ product line and all other technology related activities previously reported under the Corporate & Technology segment have been combined with the Automotive business segment and renamed Transportation.

Under the new organization structure, the Company manages and reports the results of its business through three segments: Transportation, the CWI Joint Venture, and Corporate. This change reflects the manner in which operating decisions and the assessment of business performance is currently managed by the Chief Operating Decision Maker ("CODM"). All comparative figures presented have been revised to reflect this change.

The financial information for the Company's business segments evaluated by the CODM includes the results of CWI as if they were consolidated, which is consistent with the way the Company manages its business segments. As CWI is accounted for under the equity method of accounting, an adjustment is reflected in the tables below to reconcile the segment measures to the Company's consolidated measures.

Transportation Business Segment

Westport Fuel Systems' Transportation segment designs, manufactures, and sells alternative fuel systems and components for transportation applications. Our diverse product offerings are sold under established global brands and utilize a broad range of alternative fuels, which have numerous environmental and economic advantages including: LPG, CNG, LNG, RNG, and hydrogen. We supply our products and services through a global network of distributors and numerous OEMs and DOEMs in more than 70 countries. Today, our products and services are available for passenger cars, light-, medium- and heavy-duty trucks, cryogenics, and hydrogen applications.

The Transportation group includes the IAM, OEM and DOEM programs, the Westport HPDI 2.0™ product line, electronics, current and advanced research and development programs, supply chain, and product planning activities.

An agreement to sell the CNG Compressor business was announced during the second quarter of 2018 and closed in the third quarter of 2018, and as a result, the revenues and expenses related to this business have been recorded in discontinued operations for the current and prior years.

Cummins Westport Inc. ("CWI") Joint Venture

CWI serves the medium- and heavy-duty on-highway engine markets. CWI engines are offered by many OEMs for use in transit, school and shuttle buses, conventional trucks and tractors, and refuse collection trucks, as well as specialty vehicles such as short-haul port drayage trucks and street sweepers. CWI is the leading supplier of natural gas engines to the North American medium- and heavy-duty truck and transit bus industries.

All CWI natural gas engines are dedicated 100% natural gas engines. The fuel for CWI engines can be carried in tanks on the vehicle as CNG or LNG. All engines are also capable of operating on RNG.

CWI is a Delaware corporation owned 50% by Westport Power Inc., a wholly-owned subsidiary of Westport Fuel Systems, and 50% by Cummins. The board of directors of CWI is comprised of three representatives from each of Westport Fuel Systems and Cummins. On February 19, 2012, Westport Fuel Systems, Cummins and CWI entered into a Second Amended and Restated Joint Venture Agreement governing the operations of CWI which amended the focus of CWI's future product development investments to North American markets, including engines for on-road applications between the displacement range of 5.9 litres through 12 litres, and to have these engines manufactured in Cummins' North American plants.



The purpose of the joint venture is to engage in the business of developing, marketing and selling spark-ignited natural gas or propane engines for on-highway use. CWI utilizes Cummins' supply chain, back office systems and distribution and sales networks. The joint venture term is scheduled to end on December 31, 2021.

Corporate Business Segment

The Corporate business segment is responsible for public company activities, corporate oversight and general administrative duties, as well as R&D expenses relating to the protection of the Company's intellectual property; in particular, the costs associated with patenting our innovations and registering our trademarks, and maintaining our patent and trademark portfolios.

Weichai Westport Inc. ("WWI")

The Company, indirectly through its wholly-owned subsidiary, Westport Innovations (Hong Kong) Limited ("**Westport HK**"), is currently the registered holder of a 23.33% equity interest in Weichai Westport Inc. ("**WWI**"). Previously, the Company held a 35% indirect equity interest in WWI. However, in April 2016 the company sold to Pangaea Two Acquisition Holdings XIV, LLC and Pangaea Two Acquisition Holdings Parallel XIV, LLC (collectively, the "**Cartesian Entities**") a derivative economic interest granting the Cartesian Entities the right to receive an amount of future income received by Westport HK from WWI equivalent to having an 18.78% equity interest in WWI and concurrently granted Pangaea Two Management, LP (an additional entity related to the Cartesian Entities) an option to acquire all of the equity securities of Westport HK for a nominal amount. The Company retained the right to transfer any equity interest held by Westport HK in WWI that was in excess of an 18.78% interest in the event that such option was exercised. Then in August of 2016 the Company sold an aggregate 11.67% equity interest in the WWI joint venture for gross proceeds of 48.2 million RMB (approximately US\$7.2 million) to Weichai Holding Group Co., Ltd. (to which the Company sold a 6.42% equity interest) and Guanya (Shanghai) Private Equity Partnership (Limited Partnership) ("**Guanya**") (to which the Company sold a 5.25% equity interest). Public disclosures of this transaction made by the Company prior to our Q3 2018 MD&A filing, referred to Guanya as either "an additional undisclosed purchaser" or, inadvertently, as "Weichai Power Co., Ltd.", which was not a party to the transaction but instead was a limited partner of Guanya. The Company's 23.33% equity interest in WWI remains held by the Company's subsidiary, Westport HK. As a result of such transactions, the Company's residual 23.33% equity interest in WWI currently corresponds to an economic interest in WWI equivalent to just 4.55%.

The Company has not considered WWI a business segment since March 31, 2016 due to the Company's reduced interest pursuant to a sale to the Cartesian Entities as noted above.

As discussed in the Business Overview and General Developments section of this MD&A, Westport Fuel Systems entered into development and supply agreements with WWI on August 28, 2018.

SELECTED ANNUAL FINANCIAL INFORMATION

The following table sets forth a summary of our financial results for 2018, 2017 and 2016. The 2016 results include seven months results from Fuel Systems Solutions, Inc. ("Fuel Systems") as a result of the merger effective June 1, 2016.

Selected Consolidated Statements of Operations Data

	Years ended December 31,		
	2018	2017	2016
	(Note 1)	(Adjusted, note 1 and 2)	(Adjusted, note 1, 2 and 3)
<i>(expressed in millions of United States dollars, except for per share amounts and shares outstanding)</i>			
Revenue	\$ 270.3	\$ 229.8	\$ 167.2
Gross margin	64.2	60.3	34.1
GM %	23.8%	26.2%	20.4%
Net loss from continuing operations (note 3)	(40.8)	(62.9)	(100.7)
Net income from discontinued operations (note 1 and 2)	9.3	52.9	3.1
Net loss for the year	(31.5)	(10.0)	(97.6)
Net loss per share from continuing operations - basic and diluted	(0.31)	(0.52)	(1.10)
Net loss per share	(0.24)	(0.08)	(1.07)
Weighted average basic and diluted shares outstanding	132,371,396	119,558,566	91,028,504

- 2018:** with effect from the second quarter of 2018, the CNG Compressor business was reclassified retrospectively as discontinued operations and in the third quarter of 2018, it was sold and generated a net gain on sale of \$9.9 million, which was recorded in discontinued operations.
- 2017:** the year ended December 31, 2017 included a \$54.9 million gain on sale of substantially all of the former Industrial business unit, which was recorded in discontinued operations. See note 6 in the consolidated financial statements.
- 2016:** the comparative 2016 period data include revenue from Fuel Systems' business for the seven-month period following the June 1, 2016 acquisition, a bargain purchase gain of \$35.8 million, and a \$19.0 million restructuring provision recorded for severance and facility closures. These items were recorded in net loss from continuing operations.

The following table sets forth a summary of our financial position as at December 31, 2018 and December 31, 2017:

Selected Balance Sheet Data

	December 31, 2018	December 31, 2017
<i>(expressed in millions of United States dollars)</i>		
Cash and cash equivalents	\$ 61.1	\$ 71.8
Total assets	269.9	313.6
Debt, including current portion	55.3	54.4
Royalty payable, including current portion	20.9	19.0
Total liabilities	179.3	195.6
Shareholder's equity	90.7	118.0



Selected CWI Statements of Operations Data

We account for CWI using the equity method of accounting. However, due to its significance to our operating results, we disclose its assets, liabilities and income statement in notes 9(a) and 21 of our consolidated financial statements and discuss revenue and gross margins in this MD&A. The following table sets forth a summary of the financial results of CWI for 2018, 2017 and 2016.

	Years ended December 31,		
	2018	2017	2016
<i>(expressed in millions of United States dollars)</i>			
Total revenue	\$ 319.4	\$ 317.3	\$ 276.5
Gross margin	91.0	109.5	77.1
GM %	28.5%	34.5%	27.9%
Net income before income taxes	57.4	58.3	16.7
Net income attributable to the Company (1)	22.7	12.5	5.6

(1) As a result of the U.S. tax reform substantially enacted in the fourth quarter of 2017, CWI recorded a deferred tax expense of \$13.4 million in 2017. The net income attributable to the Company has increased in 2018 as a result of the lower tax rates in the U.S.

RESULTS FROM OPERATIONS

The following tables summarize results by segment for 2018, 2017 and 2016.

The 2017 and 2016 comparative periods have been revised to reflect the change in business segments previously discussed in the Operating Segments section and to reflect the reclassification of the CNG Compressor business to discontinued operations.

Revenue 2018/2017

Total consolidated revenues increased by \$40.5 million, or 18% from \$229.8 million for the year ended December 31, 2017 to \$270.3 million during the year ended December 31, 2018.

The following table summarizes revenues by segment for the year ended December 31, 2018 compared to the year ended December 31, 2017:

(expressed in millions of U.S. dollars)

	Years ended December 31,		Change	
	2018	2017	\$	%
Transportation (consolidated)	\$ 270.3	\$ 229.8	\$ 40.5	18%
CWI (non-consolidated)	319.4	317.3	2.1	1%

Transportation revenue for the year ended December 31, 2018 was \$270.3 million compared with \$229.8 million for the year ended December 31, 2017. The increase in revenue was primarily due to strong demand for our aftermarket products, strength in our light- and medium-duty OEM business and sales from our newly released Westport HPDI 2.0™ product. In addition, the Euro strengthened versus U.S. dollar approximately 5% during 2018 which resulted in an increase in U.S. dollar dominated revenues.

CWI revenue for the year ended December 31, 2018 was \$319.4 million compared with \$317.3 million for the year ended December 31, 2017. Unit sales for the year ended December 31, 2018 were 7,393 compared to 7,955 for the year ended December 31, 2017. The decrease in unit sales in the year ended December 31, 2018 is mainly due to certain pre-buy activities in the fourth quarter of 2017 in advance of the 2018 on-board diagnostic compliant engines.

Within total CWI revenue, parts revenue for the year ended December 31, 2018 was \$92.0 million compared to \$82.1 million for the year ended December 31, 2017. The increase in parts revenue is mainly due to the cumulative increase in the natural gas engine population in service, which offsets the decrease in units sold during the year ended December 31, 2018 compared to the prior year.

Gross Margin 2018/2017

Total consolidated gross margin increased by \$3.9 million, or 6% from \$60.3 million in 2017 to \$64.2 million in 2018.

The following table presents gross margin by segment for 2018 compared to 2017:

(expressed in millions of U.S. dollars)

	Year ended December 31, 2018		% of Revenue	Year ended December 31, 2017		% of Revenue	Change \$ %	
Transportation (consolidated)	\$	64.2	24%	\$	60.3	26%	\$ 3.9	6 %
CWI (non-consolidated)		91.0	28%		109.5	35%	(18.5)	(17)%

Transportation gross margin increased by \$3.9 million to \$64.2 million, for the year ended December 31, 2018, compared to \$60.3 million for the year ended December 31, 2017. The increase in gross margin is due to higher sales from our aftermarket and light- and medium-duty OEM, and DOEM businesses. Gross margin percentage decreased from 26% for the year ended December 31, 2017 to 24% for the year ended December 31, 2018 mainly because of low unit sales of the Westport HPDI 2.0™ business and lower service revenue.

CWI gross margin decreased by \$18.5 million to \$91.0 million, or 28% of revenue from \$109.5 million or 35% of revenue in the prior year. The decrease in gross margin and gross margin percentage in 2018 is due to product mix and higher warranty adjustments. There was a negative warranty adjustment of \$1.1 million for the year ended December 31, 2018 compared to a positive warranty adjustment of \$9.9 million for the year ended December 31, 2017. Excluding the warranty adjustments, the gross margin percentage in 2018 would have been consistent with 2017.

Research and Development Expenses 2018/2017

The following table presents details of research and development (“R&D”) expense by segment, excluding equity investees, for 2018 compared to 2017:

(expressed in millions of U.S. dollars)

	Years ended December 31, 2018		2017		Change \$ %	
Transportation	\$	29.6	\$	48.4	\$ (18.8)	(39)%
Corporate		1.0		1.7	(0.7)	(41)%
Total research and development	\$	30.6	\$	50.1	\$ (19.5)	(39)%

Transportation R&D expenses for the year ended December 31, 2018 were \$29.6 million compared with \$48.4 million for the year ended December 31, 2017. For the year ended December 31, 2017, the decrease of \$18.8 million during the year ended December 31, 2018 was due to the completion of various R&D programs as the Company launched its Westport HPDI 2.0™ product in the fourth quarter of 2017.

Corporate R&D expenses for the year ended December 31, 2018 were \$1.0 million compared with \$1.7 million for the year ended December 31, 2017. Corporate R&D expenses relate to costs associated with protecting the Company's intellectual property; in particular, the costs associated with patenting our innovations and registering our trademarks, and maintaining our patent and trademark portfolios.



Sales and Marketing, General and Administrative Expenses 2018/2017

The following table presents details of sales and marketing, general and administrative (“SG&A”) expense by segment, excluding equity investees, for 2018 compared to 2017:

(expressed in millions of U.S. dollars)

	Years ended December 31,		Change	
	2018	2017	\$	%
Transportation	\$ 36.8	\$ 43.4	\$ (6.6)	(15)%
Corporate	30.2	19.8	10.4	53 %
Total SG&A	<u>\$ 67.0</u>	<u>\$ 63.2</u>	<u>\$ 3.8</u>	<u>6 %</u>

Transportation SG&A expenses for the year ended December 31, 2018 were \$36.8 million compared to \$43.4 million for the year ended December 31, 2017. SG&A expenses decreased mainly due to restructuring activities that took place during 2017 that resulted in lower SG&A expenses in 2018.

Corporate SG&A expenses for the year ended December 31, 2018 were \$30.2 million compared to \$19.8 million for the year ended December 31, 2017. The increase is largely due to legal costs related to the ongoing SEC investigation of \$10.0 million incurred during the year ended December 31, 2018, net of expected insurance recoveries, compared to \$1.8 million for the year ended December 31, 2017.

Items Affecting Comparability of Results from 2016 to 2017

(1) The year ended December 31, 2016 includes only seven months of Fuel Systems' results from the June 1, 2016 acquisition and this is reported in the Transportation segment in the tables below.

(2) WWI results are only included in total segment revenue for the three months ended March 31, 2016, as WWI has no longer been considered an operating segment in subsequent periods as previously noted.

Revenues 2017/2016

Total segment revenues increased \$73.5 million, or 16% from \$473.6 million in 2016 to \$547.1 million in 2017.

The following table summarizes total revenue by segment for the year ended December 31, 2017 compared to the year ended December 31, 2016:

(expressed in millions of U.S. dollars)

	Years ended December 31,		Change	
	2017	2016	\$	%
Transportation	\$ 229.8	\$ 167.2	\$ 62.6	37 %
CWI	317.3	276.5	40.8	15 %
WWI	—	29.9	(29.9)	(100)%
Total segment revenues	\$ 547.1	\$ 473.6	\$ 73.5	16 %
Less: Equity investees' revenues	317.3	306.4	10.9	4 %
Total consolidated revenues	\$ 229.8	\$ 167.2	\$ 62.6	37 %

Transportation revenue for the year ended December 31, 2017 was \$229.8 million compared to \$167.2 million for 2016. The increase in revenue was primarily due to the consolidation of Fuel Systems for twelve months as opposed to seven months in 2016. Strong sales in the European aftermarket business and a 2% increase in the Euro also contributed to the year over year revenue increase.

CWI revenue for the year ended December 31, 2017 was \$317.3 million compared with \$276.5 million for the year ended December 31, 2016. Unit sales for the year ended December 31, 2017 were 7,955 compared to 7,232 for the year ended December 31, 2016. The increase in revenue was primarily due to the increase in units sold and an increase in parts revenue attributed to the increase in the natural gas engine population in service.

Gross Margin 2017/2016

Total consolidated gross margin increased by \$26.2 million or 77% from \$34.1 million in 2016 to \$60.3 million in 2017.

The following table presents gross margin by segment for 2017 compared to 2016:

(expressed in millions of U.S. dollars)

	Year Ended December 31, 2017		Year Ended December 31, 2016		Change	
		% of Revenue		% of Revenue	\$	%
Transportation	\$ 60.3	26%	\$ 34.1	20%	\$ 26.2	77 %
CWI	109.5	35%	77.1	28%	32.4	42 %
WWI	—	—%	3.0	10%	(3.0)	(100)%
Total segment gross margin	\$ 169.8	31%	\$ 114.2	24%	\$ 55.6	49 %
Less: equity investees' gross margin	109.5	35%	80.1	26%	29.4	37 %
Total consolidated gross margin	\$ 60.3	26%	\$ 34.1	20%	\$ 26.2	77 %

Transportation gross margin increased by \$26.2 million to \$60.3 million, or 26% of revenue, for the year ended December 31, 2017 compared to \$34.1 million or 20% of revenue for the year ended December 31, 2016. Gross margins increased due to higher revenues, lower obsolescence charges, an acquisition-related adjustment in the prior year and cost reductions resulting from the restructuring activities beginning in the third quarter of 2016.

CWI gross margin increased by \$32.4 million to \$109.5 million, or 35% of revenue from \$77.1 million or 28% of revenue in the prior year. The increase in gross margin and gross margin percentage is driven by higher revenues, a favorable parts revenue mix compared to the prior year. In addition, there was a positive warranty adjustment of \$9.9 million for the year ended December 31, 2017 compared to a negative warranty adjustment of \$0.6 million for the year ended December 31, 2016.

Research and Development Expenses 2017/2016

The following table presents details of research and development (“R&D”) expense by segment, excluding equity investees, for 2017 compared to 2016:

(expressed in millions of U.S. dollars)

	Years ended December 31,		Change	
	2017	2016	\$	%
Transportation	\$ 48.4	\$ 52.7	\$ (4.3)	(8)%
Corporate	1.7	2.7	(1.0)	(37)%
Total research and development	\$ 50.1	\$ 55.4	\$ (5.3)	(10)%

Transportation R&D expenses for the year ended December 31, 2017 decreased by \$4.3 million, compared to \$52.7 million for the year ended December 31, 2016. For the year ended December 31, 2016, total Transportation R&D expenses only includes Fuel Systems expenditures for the seven month period since the June 1, 2016 acquisition. Overall, R&D expenses decreased due to restructuring activities taken in 2016 with the closure of the Australian office and reduction of workforce in the US automotive business, offset by slightly higher charges due to the strength of the Euro compared to the US dollar.

Corporate R&D expenses year ended December 31, 2017 were \$1.7 million compared to \$2.7 million for the year ended December 31, 2016. R&D expenses decreased due to a reduction in headcount in Vancouver due to restructuring activities beginning in third quarter of 2016.

Sales and Marketing, General and Administrative Expenses 2017/2016

The following table presents details of Sales and Marketing, General and Administrative (“SG&A”) expense by segment, excluding equity investees, for 2017 compared to 2016:

(expressed in millions of U.S. dollars)

	Years ended December 31,		Change	
	2017	2016	\$	%
Transportation	\$ 43.4	\$ 34.0	\$ 9.4	28 %
Corporate	19.8	29.0	(9.2)	(32)%
Total SG&A	\$ 63.2	\$ 63.0	\$ 0.2	0.3 %

Transportation SG&A expenses for the year ended December 31, 2017 were \$43.4 million compared to \$34.0 million for the year ended December 31, 2016. For the year ended December 31, 2016, total Transportation SG&A expenses only includes expenditures associated with the Fuel Systems acquisition for the seven month period since June 1, 2016. SG&A expense also increased in the year ended December 31, 2017 due to the strong Euro as compared to the prior year and an increase to the bonus accrual.

Corporate SG&A expenses for the year ended December 31, 2017 were \$19.8 million compared with \$29.0 million for the year ended December 31, 2016. The decrease is due to merger related costs associated with the Fuel Systems acquisition in 2016 which did not occur in 2017 and lower salary expense due to restructuring activities that took place in 2016. The decrease was offset by an increase to the bonus accrual and a stronger Canadian dollar as compared to the prior year.

Other significant expense and income items for 2018, 2017 and 2016

Restructuring expenses recognized for the year ended December 31, 2018 were \$0.8 million compared to \$1.7 million for the year ended December 31, 2017. Restructuring costs incurred in 2018 related to charges from a reduction in workforce in Italy. For the year ended December 31, 2017, a recovery of \$4.1 million was recognized due to a change in estimate relating to the termination of a lease commitment in Vancouver, Canada. This recovery was fully offset by termination and other exit costs recorded for the year ended December 31, 2017 of \$5.8 million, due to reductions in workforce in Canada, Italy and Argentina.

Foreign exchange gains and losses reflect net realized gains and losses on foreign currency transactions and the net unrealized gains and losses on our net U.S. dollar denominated monetary assets and liabilities in our Canadian operations that were mainly composed of cash and cash equivalents, short-term investments, accounts receivable and accounts payable. In addition, the Company has foreign exchange exposure on Euro denominated monetary assets and liabilities where the functional currency of the subsidiary is not the Euro. For the year ended December 31, 2018, we recognized a net foreign exchange loss of \$9.0 million primarily due to fluctuations of the Euro and Canadian dollar relative to the U.S. dollar during the year.

For the year ended December 31, 2017, we recognized a net foreign exchange loss of \$0.6 million with the movement in the Canadian dollar and Euro relative to the U.S. dollar. This compares to a net foreign exchange loss of \$6.6 million for the year ended December 31, 2016.

Depreciation and amortization for the years ended December 31, 2018, December 31, 2017, and December 31, 2016 were \$16.5 million, \$14.7 million, and \$15.3 million, respectively. The amount included in cost of revenue for the same periods were \$7.7 million, \$4.9 million and \$4.2 million. The increase in 2018 over 2017 is due to the depreciation of fixed assets related to the Westport HPDI 2.0™ business, launched in the fourth quarter of 2017, and recognized for the full year in 2018. The decrease in the total depreciation and amortization expense for 2017 compared to 2016 was due to a decline in asset purchases, partially offset by an increase due to the acquisition of Fuel Systems.

Income from investments primarily relates to our 50% interest in CWI, accounted for by the equity method. The Company has not considered WWI a business segment since March 31, 2016 due to the Company's reduced interest pursuant to a sale to the Cartesian Entities. See note 8 of the consolidated financial statements for more details.

(expressed in millions of U.S. dollars)

	Years ended December 31,		
	2018	2017	2016
CWI - 50% interest	\$ 22.7	\$ 12.5	\$ 5.6
WWI	—	—	0.2
Income from investments accounted for by the equity method	\$ 22.7	\$ 12.5	\$ 5.8

As a result of the U.S. tax reform substantially enacted in the fourth quarter of 2017, CWI recorded a deferred tax expense of \$13.4 million in 2017 which reduced income from investments by \$6.7 million.

Interest on long-term debt and amortization of discount

(expressed in millions of U.S. dollars)

	Years ended December 31,		
	2018	2017	2016
Interest expense on long-term debt	\$ 4.2	\$ 6.1	\$ 6.7
Royalty payable accretion expense and finance charge from prepayment	4.9	8.4	4.1
Total interest on long-term debt and accretion on royalty payable	\$ 9.1	\$ 14.5	\$ 10.8

Interest on our long-term debt and accretion on our royalty payable for the year ended December 31, 2018 was \$9.1 million, a decrease of \$5.4 million compared to the year ended December 31, 2017. Interest on long-term debt decreased from \$6.1 million in 2017 to \$4.2 million in 2018 due to a net reduction of high interest debt during 2017. In addition, our average long-term debt balance was lower during 2018 than 2017. Accretion and finance charges associated with the royalty payable decreased from 2017, due to an additional finance charge of \$5.2 million in 2017 created by early extinguishment of a portion of the royalty payable on the completion of the sale of the Industrial business segment. This compared to an additional finance charge of \$0.8 million in 2018 created by early extinguishment of a portion of the royalty payable on the sale of the CNG Compressor business.

Income tax expense for the year ended December 31, 2018 was \$2.1 million and was primarily related to taxes payable in our Italian operations. This compared to an income tax recovery of \$4.4 million for the year ended December 31, 2017 and an income tax expense of \$3.9 million for year ended December 31, 2016.

The tax recovery for 2017 relates to the use of tax losses to offset the tax expense related to the gain on sale of Industrial assets. The tax expense for 2016 primarily relates to taxes on the disposition of a portion of our Weichai investment, a valuation allowance taken against deferred tax assets, and taxes in certain profitable jurisdictions (Canada/ The Netherlands).

Discontinued operations, as discussed in note 6 in the 2018 consolidated financial statements, the CNG Compressor business was sold during the year ended December 31, 2018, which resulted in a net gain on sale of \$9.9 million. The assets and liabilities of the CNG Compressor business were accounted as held for sale effective from the second quarter of 2018. During the year ended December 31, 2017, the Company recognized a net gain on sale of assets of \$58.3 million due to the sale of substantially all of the Industrial business segment. An additional gain of \$0.8 million was recorded on this sale in the second quarter of 2018.

CAPITAL REQUIREMENTS, RESOURCES AND LIQUIDITY

This “Capital Requirements, Resources and Liquidity” section contains certain forward-looking statements. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Readers are encouraged to read the “Forward Looking Statements” and “Basis of Presentation” sections of this MD&A, which discusses forward-looking statements and the “Business Risks and Uncertainties” section of this MD&A and of our AIF.

Our cash and cash position has decreased by \$10.7 million during 2018 to \$61.1 million from \$71.8 million at December 31, 2017. The decrease is primarily the result of operating losses (including increased legal expenses) and debt and royalty repayments, partially offset by cash proceeds from the sale of the CNG Compressor business and dividends from CWI. Cash and cash equivalents consist of guaranteed investment certificates, term deposits and bankers acceptances with maturities of 90 days or less when acquired, and restricted cash.

The Company continues to work towards its goals of increasing revenues and reducing expenditures, which has improved results from operations and operating cash flows in 2017 and 2018, and this improvement in operating results is expected to continue in 2019. In particular, the commercial launch of Westport HPDI 2.0™ in 2018 has allowed the Company to significantly reduce engineering and development spend and the associated capital expenditures on this product and this reduction has improved current and forecasted future cash flows. In addition, while the legal fees related to the SEC investigation that began in 2017 (see Regulatory Compliance section of the MD&A) increased significantly in 2018, we anticipate these legal expenditures to decrease in 2019. However, since the possible outcomes of this proceeding remain uncertain at this time, it is also necessary to acknowledge that any final determination that the Company’s operations or activities are not, or were not, in compliance with the FCPA and/or other U.S. securities laws could result in significant civil and criminal financial penalties and other sanctions, which could have a material adverse impact on our financial condition. Lastly, the Company continues to examine non-core assets to determine whether it is in the best interest of the Company to monetize assets or to continue to hold and invest in these assets. Connected with this activity of assessing its non-core assets, on July 25, 2018 the Company closed the sale of its CNG Compressor business announced in the second quarter of 2018, which resulted in gross proceeds of approximately \$14.7 million.

Based on currently known conditions and events, management believes that the cash on hand as of December 31, 2018 and the improvements to the operations expected in 2019 will provide the cash flow necessary to fund the operations over the next year to March 31, 2020. The ability of the Company to continue as a going concern beyond one year will be dependent on its ability to generate positive results from operations and cash flows. If, as a result of future events, the Company was to determine it was no longer able to continue as a going concern, significant adjustments would be required to the carrying value of its assets and liabilities in the accompanying financial statements and the adjustments could be material. See the "Business Overview and General Developments" section in the MD&A for further discussion on liquidity and going concern.

Cash Flow from Operating Activities

We prepare our statement of cash flows using the indirect method. Under this method, we reconcile net loss to cash flows from operating activities by adjusting net loss for those items that impact net loss but may not result in actual cash receipts or payments during the period. These reconciling items include but are not limited to depreciation and amortization, stock-based compensation expense, unrealized foreign exchange gain, income from investments accounted for by the equity method, provisions for inventory reserves and doubtful accounts, and changes in the consolidated balance sheet for working capital from the beginning to the end of the period.

For the year ended December 31, 2018, our net cash flow used in operating activities in continuing operations was \$27.4 million, a decrease of \$22.1 million from net cash flow used in operating activities in the year ended December 31, 2017. The improvement in cash flow from operating activities is primarily due to improved operations and working capital management, offset by higher legal expenses in 2018.

Cash Flow from Investing Activities

Our net cash from investing activities consisted primarily of cash acquired through dividends received from joint ventures and the sale of assets and investments, offset by purchases of property, plant and equipment (“PP&E”).

For the year ended December 31, 2018, our net cash flows received from investing activities of continuing operations was \$19.9 million compared to cash used of \$8.7 million for the year ended December 31, 2017. As a result of the launch of Westport HPDI

2.0 in late 2017, lower capital expenditures were required during 2018. In addition, dividends from CWI increased by \$6.6 million from \$16.6 million in 2017 to \$23.2 million in 2018.

Cash Flow from Financing Activities

For the year ended December 31, 2018, the Company's net cash used in financing activities was \$8.1 million, a decrease of \$6.2 million compared to the year ended December 31, 2017. During 2018, the Company repaid royalty payable of \$3.0 million and other debts of \$3.0 million. In 2017, the Company repaid subordinate debt of \$44.8 million and royalty payable of \$11.5 million. These 2017 repayments were offset by proceeds of \$26.0 million from the issuance of shares.

Cash Flow from Discontinued Operations

For the year ended December 31, 2018, our net cash flows from discontinued operations was \$12.6 million, which primarily reflects the proceeds received from the sale of the CNG Compressor business.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

	Carrying amount	Contractual cash flows	< 1 year	1 - 3 years	4-5 years	> 5 years
Accounts payable and accrued liabilities	\$ 82.9	\$ 82.9	\$ 82.9	\$ —	\$ —	\$ —
Long-term debt, principal (1)	55.3	55.3	10.3	39.2	5.8	—
Long-term debt, interest (1)	—	10.1	4.2	5.4	0.5	—
Long-term royalty payable (2)	20.9	32.3	6.1	13.2	6.2	6.8
Operating lease commitments	—	8.3	3.6	3.5	1.2	—
	<u>\$ 159.1</u>	<u>\$ 189.0</u>	<u>\$ 107.1</u>	<u>\$ 61.1</u>	<u>\$ 13.7</u>	<u>\$ 6.8</u>

(1) For details of our long-term debt, principal and interest, see note 14 of the consolidated financial statements. To the extent that our outstanding debt bears interest at floating rates, contractual cash flows for interest have been calculated based on interest rates at December 31, 2018.

(2) For details of our long-term royalty payable, see note 15 of the consolidated financial statements.

SHARES OUTSTANDING

For the year ended December 31, 2018, the weighted average number of shares used in calculating the loss per share was 132,371,396. During the year ended December 31, 2018, we granted 1,009,230 RSUs. The Common Shares, share options and Share Units outstanding and exercisable as at the following dates are shown below:

	December 31, 2018		March 18, 2019	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Common Shares outstanding	133,380,899		133,491,669	
Share Units				
Outstanding	2,667,403	N/A	2,553,633	N/A
Exercisable	2,076,684	N/A	2,111,176	N/A

(weighted average exercise prices are presented in Canadian dollars)

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are prepared in accordance with U.S. GAAP, which requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements. We have identified several policies as critical to our business operations and in understanding our results of operations. These policies, which require the use of judgment, estimates and assumptions in determining their reported amounts, include our warranty liability, revenue recognition, inventories, and property, equipment, furniture and leasehold improvements. The application of these and other accounting policies are described in Note 3 of our calendar year 2018 annual consolidated financial statements. Actual amounts may vary significantly from estimates used.

Warranty Liability

Estimated warranty costs are recognized at the time we sell our products and included in cost of revenue. We use historical failure rates and costs to repair product defects during the warranty period, together with information on known products to estimate the warranty liability. The ultimate amount payable and the timing will depend on actual failure rates and the actual cost to repair. We review our warranty provision quarterly and record adjustments to our assumptions based on the latest information available at that time. Since a number of our products are new in the market, historical data may not necessarily reflect actual costs to be incurred, and this exposes the Company to potentially significant fluctuations in liabilities and our statement of operations. New product launches require a greater use of judgment in developing estimates until claims experience becomes available. Product specific experience is typically available four or five quarters after product launch, with a clear experience trend not evident until eight to twelve quarters after launch. We generally record warranty expense for new products upon shipment using a factor based upon historical experience from previous engine generations in the first year, a blend of actual product and historical experience in the second year and product specific experience thereafter. Adjustments to and estimated future direct warranty costs are accrued and charged to cost of revenue in the period when the related revenues are recognized while indirect warranty overhead salaries and related costs are charged to cost of revenue in the period incurred.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Codification ("ASC") 606, *Revenue from Contracts with Customers*, a new accounting standard related to revenue recognition. ASC 606 supersedes nearly all U.S. GAAP on revenue recognition and eliminated industry-specific guidance. The underlying principle of ASC 606 is to recognize revenue when a customer obtains control of promised goods or services at an amount that reflects the consideration that is expected to be received in exchange for those goods or services. At the beginning of the first quarter of 2018, we adopted ASC 606 using the modified retrospective method. There was no material financial impact to our adoption of ASC 606.

The Company generates revenues primarily from product sales. Product revenues are derived primarily from standard product sales contracts and from long-term fixed price contracts. Under ASC 606, revenue is recognized when a customer obtains control of the goods or services. Determining the timing of the transfer of control, at a point in time or over time, requires judgment. On standard product sales contracts, revenues are recognized when customers obtain control of the product, that is when transfer of title and risks and rewards of ownership of goods have passed and when obligation to pay is considered certain. Invoices are generated and revenue is recognized at that point in time. Provisions for warranties are made at the time of sale.

Inventories

The Company's inventories consist of the Company's fuel system products (finished goods), work-in-progress, purchased parts and assembled parts. Inventories are recorded at the lower of cost and net realizable value. Cost is determined based on the lower of weighted average cost or first-in, first-out and net realizable value. The cost of fuel system product inventories, assembled parts and work-in-progress includes materials, labour and production overhead including depreciation. The Company provides inventory write-downs based on excess and obsolete inventories determined primarily by future demand forecasts. In addition, the Company records a liability for firm, noncancelable, and unconditional purchase commitments with manufacturers for quantities in excess of the Company's future demand forecast consistent with its valuation of excess and obsolete inventory

Property, Plant and Equipment and Intangible Assets

We consider whether or not there has been an impairment in our long-lived assets, such as equipment, furniture and leasehold improvements and intangible assets, whenever events or changes in circumstances indicate that the carrying value of the assets

may not be recoverable. If such assets are not recoverable, we are required to write down the assets to fair value. When quoted market values are not available, we use the expected future cash flows discounted at a rate commensurate with the risks associated with the recovery of the asset as an estimate of fair value to determine whether or not a write down is required.

Impairment of property, plant and equipment

During the year ended December 31, 2018, the Company recorded an impairment charge of \$0.7 million. The impairment resulted primarily from the write-down of tooling equipment and was recorded in the Transportation segment.

The Company has significant investments in property, plant and equipment related to its Westport HPDI 2.0™ business. The HPDI business is at the early stages of commercialization, and, as a result, is currently generating losses. Based on the Company's current projections, meaningful increases in component sales, compared to 2018 levels, are expected, allowing the HPDI business to benefit from economies of scale and become profitable. This growth in volumes in 2019 and future years is expected through sales with our initial launch partner, our supply arrangement with WWI, and the possibility of additional OEMs entering into supply agreements for our HPDI technology. If these assumptions are not realized, the Company may be required to record an impairment on these assets in future periods.

Intangible assets

Based on the revenue and operating results, the Company concluded that there were no impairment indicators as of November 30, 2018 for the intangible assets. Therefore, no impairment on intangible assets was recorded as at December 31, 2018.

NEW ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

(a) New accounting pronouncements adopted in 2018:

Revenue:

In May 2014, Financial Accounting Standards Board ("FASB") issued ASU 2014-09, *Revenue From Contracts With Customers* ("Topic 606"). The Company adopted the guidance using the modified retrospective method as at January 1, 2018 with no material impact to the financial statements. The adoption of this standard did not result in any impact on previously reported amounts. In accordance with the standard, additional disclosures have been provided.

Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments:

In August 2016, the FASB issued ASU 2016-15, which provides cash flow classification guidance on eight specific cash flow issues to reduce diversity in practice for which authoritative guidance did not previously exist. The Company adopted this standard on January 1, 2018 with no material impact to the Company's financial statements.

(b) New accounting pronouncements to be adopted in 2019:

Leases (Topic 842):

In February 2016, the FASB issued ASU 2016-02, which increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018, and interim periods with early adoption permitted. The Company's future minimum lease payments at December 31, 2018 under operating leases are disclosed in note 21 (a). The Company is finalizing its implementation of this new standard and will use the modified retrospective method as at January 1, 2019. The Company's significant leases relate to its leasing of operating premises.

REGULATORY COMPLIANCE

As disclosed in the Company's previous management discussion and analysis filings, on June 15, 2017, the Enforcement Division of the SEC issued a subpoena to Westport Fuel Systems for information concerning its investment in Weichai Westport Inc. and compliance with the FCPA and securities laws related to disclosure in SEC filings in connection with the Westport Fuel Systems operations in China. The SEC Enforcement Division issued follow up subpoenas on February 14, 2018, June 25, 2018, and August 2, 2018. The company has completed its response to those subpoenas. No new subpoenas have been received since August 2, 2018. Westport Fuel Systems is cooperating with these requests and cannot predict the duration, scope or outcome of the SEC's investigation. To date our management has devoted significant time and attention to these matters, and we may be required to devote even more time, attention and financial resources to these matters in the future. The SEC's investigation and our requirements in response thereto could have a material adverse impact on our results of operations, financial condition, liquidity and cash flows. While we cannot estimate our potential exposure, if any, in these matters at this time, we have already expended significant amounts investigating and responding to the subpoenas in respect of this investigation, including funding the expense of independent legal representation, and expect to continue to need to expend significant amounts to conclude the SEC investigation. During the year ended December 31, 2018, we recorded expenses related to the SEC investigation of \$10.0 million, net of expected insurance recoveries, and to date have recorded aggregate net expenses related to such investigation of \$11.8 million. Although we maintain insurance that may cover some of these expenses, and we have given notice to our insurers of the matter, there is a risk that a substantial portion of the overall expenses and costs relating to such SEC investigation will not be covered by such policies. In the event of future proceedings arising out of the SEC investigation, to the extent covered, our ultimate liability may possibly exceed the available insurance.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), are designed to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") (our principal executive officer and principal financial officer, respectively), as appropriate to allow timely decisions regarding required disclosures. As of the end of the period covered by this report, we evaluated, under the supervision and with the participation of management, including our CEO and CFO, the effectiveness of the design and operation of our disclosure controls and procedures.

Based on that evaluation, our CEO and CFO have concluded that as of December 31, 2018, our disclosure controls and procedures were effective at a reasonable assurance level.

Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act. Internal control over financial reporting is a process designed by, or under the supervision of, our CEO and CFO and effected by the Company's board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements for external reporting purposes in accordance with U.S. GAAP and the requirements of the SEC, as applicable. There are inherent limitations in the effectiveness of internal control over financial reporting, including the possibility that misstatements may not be prevented or detected.

Because of these inherent limitations internal control systems, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met, and no evaluation of controls can provide absolute assurance that all control issues have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under potential future conditions, regardless of how remote. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management, including the CEO and CFO, has evaluated the effectiveness of our internal control over financial reporting, based on the criteria in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the



Treadway Commission ("COSO"). Based on this evaluation, management has determined that our internal control over financial reporting was effective as of December 31, 2018.

During the year ended December 31, 2018, there were no changes to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

KPMG LLP ("KPMG"), our independent registered public accounting firm, has audited our consolidated financial statements and expressed an unqualified opinion thereon. KPMG has also expressed an unqualified opinion on the effective operation of our internal control over financial reporting as of December 31, 2018. KPMG's audit report on effectiveness of internal control over financial reporting is included in the consolidated financial statements of this filing.

SUMMARY OF QUARTERLY RESULTS AND DISCUSSION OF THE QUARTER ENDED DECEMBER 31, 2018

Our revenues and operating results can vary significantly from quarter to quarter depending on factors such as the timing of product deliveries, product mix, product launch dates, research and development project cycles, timing of related government funding, impairment charges, restructuring charges, stock-based compensation awards and foreign exchange impacts. Net loss has and can vary significantly from one quarter to another depending on operating results, gains and losses from investing activities, recognition of tax benefits and other similar events.

The Company has modified information from all prior quarters to exclude the financial results of the CNG Compressor business which has been recorded as discontinued operations with effect from the second quarter of 2018. The following table provides summary unaudited consolidated financial data for our last eight quarters:

Selected Consolidated Quarterly Operations Data

(expressed in millions of United States dollars except for per share amounts)

Three months ended	31-Mar-17	30-Jun-17	30-Sep-17	31-Dec-17	31-Mar-18	30-Jun-18	30-Sep-18	31-Dec-18
		(1)		(2)			(3)	
Total revenue	\$ 57.3	\$ 58.6	\$ 56.4	\$ 57.5	\$ 63.8	\$ 80.5	\$ 65.5	\$ 60.5
Cost of product and parts revenue	39.9	43.4	42.7	43.5	49.2	58.8	49.9	48.2
Gross margin	\$ 17.4	\$ 15.2	\$ 13.7	\$ 14.0	\$ 14.6	\$ 21.7	\$ 15.6	\$ 12.3
Gross margin percentage	30.4%	25.9%	24.3%	24.3%	22.9%	27.0%	23.8%	20.3%
Net loss from continuing operations	\$ (12.5)	\$ (13.4)	\$ (16.2)	\$ (20.8)	\$ (12.6)	\$ (5.7)	\$ (12.1)	\$ (10.4)
Net income (loss) for the period	\$ (12.5)	\$ 32.3	\$ (15.6)	\$ (14.2)	\$ (14.2)	\$ (4.9)	\$ (3.2)	\$ (9.2)
EBITDA (4)	\$ (6.3)	\$ (7.5)	\$ (11.1)	\$ (14.3)	\$ (5.4)	\$ 0.2	\$ (3.0)	\$ (5.3)
Adjusted EBITDA (5)	\$ (3.9)	\$ (5.3)	\$ (5.6)	\$ (4.9)	\$ (3.4)	\$ 8.6	\$ 4.3	\$ 0.2
Earnings (loss) per share								
Basic and diluted from continuing operations	\$ (0.11)	\$ (0.12)	\$ (0.15)	\$ (0.14)	\$ (0.10)	\$ (0.04)	\$ (0.09)	\$ (0.08)
Basic and diluted	\$ (0.11)	\$ 0.29	\$ (0.14)	\$ (0.14)	\$ (0.11)	\$ (0.04)	\$ (0.02)	\$ (0.07)
CWI net income attributable to the Company	\$ 1.8	\$ 5.3	\$ 5.8	\$ (0.4)	\$ 1.5	\$ 7.8	\$ 7.7	\$ 5.7

(1) During the second quarter of 2017, the Company completed the sale of non-core assets from its Industrial business unit and recognized a gain on sale of assets in discontinued operations of \$58.3 million.

(2) During the fourth quarter of 2017, the CWI recorded a tax charge of \$13.4 million due to the US tax reform. This reduced the Company's income from investments by \$6.7 million. Excluding this tax charge, the net loss from continuing operations would have been \$14.1 million and the net loss for the period would have been \$7.5 million.

(3) During the third quarter of 2018, the Company completed the sale of the CNG Compressor business and recognized a gain on sale of assets in discontinued operations of \$9.9 million.

(4) The term EBITDA (earnings before interest, taxes, depreciation and amortization) does not have a standardized meaning according to U.S. GAAP. See non-GAAP measures for more information.

(5) The term Adjusted EBITDA is not defined under U.S. GAAP and is not a measure of operating income, operating performance or liquidity presented in accordance with U.S. GAAP. Westport Fuel Systems defines Adjusted EBITDA as EBITDA adjusted for amortization of stock-based compensation, unrealized foreign exchange gain or loss, and non-cash and other adjustments that the Company deems to be non-recurring in nature. See non-GAAP measures for more information.

THREE MONTHS ENDED DECEMBER 31, 2018 AND 2017

Our total revenue for the three months ended December 31, 2018 was \$60.5 million, an increase of \$3.0 million, or 5.2%, from \$57.5 million for the three months ended December 31, 2017. The increase in revenue was primarily a result of higher sales of the Company's HPDI product.

Our consolidated net loss for the three months ended December 31, 2018 was \$9.2 million, or a loss of \$0.08 per share compared to a net loss of \$14.2 million, or a loss of \$0.14 per share, for the three months ended December 31, 2017. The decrease in net loss

primarily relates to higher gross margin, lower operating costs and an increase in investment income from our CWI joint venture, offset by unrealized foreign exchange losses and higher legal expenses in 2018.

Non-GAAP Measures:

We use certain non-GAAP measures to assist in assessing our financial performance. Non-GAAP measures do not have any standardized meaning prescribed in U.S. GAAP and are therefore unlikely to be comparable to similar measures presented by other companies.

EBITDA

The term EBITDA (earnings before interest, taxes, depreciation and amortization) is a non-GAAP financial measure. The Company defines EBITDA as net loss from continuing operations before income taxes adjusted for interest expense (net) and depreciation and amortization.

Management believes that EBITDA is an important indicator commonly reported and widely used by investors and analysts as an indicator of the Company's operating performance. The intent is to provide additional useful information to investors and analysts and such measures do not have any standardized meaning under U.S. GAAP. These measures should not be considered in isolation or as a substitute for measures of performance prepared in accordance with U.S. GAAP. Other issuers may define EBITDA differently.

Three months ended	31- Mar-17	30- Jun-17	30- Sep-17	31- Dec-17	31- Mar-18	30- Jun-18	30- Sep-18	31- Dec-18
Loss before income taxes from continuing operations	\$ (13.3)	\$ (17.3)	\$ (15.8)	\$ (20.7)	\$ (11.7)	\$ (5.6)	\$ (9.5)	\$ (11.9)
Interest expense, net (1)	3.4	6.3	0.9	2.5	2.1	1.7	2.3	2.6
Depreciation and amortization	3.6	3.5	3.8	3.9	4.2	4.1	4.2	4.0
EBITDA	<u>\$ (6.3)</u>	<u>\$ (7.5)</u>	<u>\$ (11.1)</u>	<u>\$ (14.3)</u>	<u>\$ (5.4)</u>	<u>\$ 0.2</u>	<u>\$ (3.0)</u>	<u>\$ (5.3)</u>

(1) Interest expense, net is calculated as interest and other income, net of bank charges and interest on long-term debt and other payables and amortization of discount.

EBITDA decreased by \$2.3 million from a loss of \$3.0 million for the three months ended September 30, 2018 to a loss of \$5.3 million in the three months ended December 31, 2018 primarily due to lower gross margin and lower CWI net income attributed to the Company.

Non-GAAP Measures (continued):

Adjusted EBITDA

The term Adjusted EBITDA is not defined under U.S. GAAP and is not a measure of operating income, operating performance or liquidity presented in accordance with U.S. GAAP.

Adjusted EBITDA is used by management to review operational progress of its business units and investment programs over successive periods and as a long-term indicator of operational performance since it ties closely to the unit's ability to generate sustained cash flows.

Westport Fuel Systems defines Adjusted EBITDA as EBITDA from continuing operations adjusted for stock-based compensation, unrealized foreign exchange gains or losses, and non-cash and other adjustments. Adjusted EBITDA has limitations as an analytical tool, and when assessing the Company's operating performance, investors should not consider Adjusted EBITDA in isolation, or as a substitute for net loss or other consolidated statement of operations data prepared in accordance with U.S. GAAP. Among other things, Adjusted EBITDA does not reflect the Company's actual cash expenditures. Other companies may calculate similar measures differently than Westport Fuel Systems, limiting their usefulness as comparative tools. Westport Fuel Systems compensates for these limitations by relying primarily on its U.S. GAAP results.

Three months ended	31- Mar-17	30- Jun-17	30- Sep-17	31- Dec-17	31- Mar-18	30- Jun-18	30- Sep-18	31- Dec-18
EBITDA	\$ (6.3)	\$ (7.5)	\$ (11.1)	\$ (14.3)	(5.4)	0.2	(3.0)	(5.3)
Stock based compensation	1.1	3.1	2.1	0.7	0.3	1.4	0.6	0.7
Unrealized foreign exchange (gain) loss	(1.6)	1.0	2.5	(1.3)	—	5.2	2.2	1.6
Asset impairment	—	—	—	0.6	—	—	—	0.6
Restructuring, termination and other exit costs	1.6	(1.6)	(0.1)	1.8	0.6	0.2	—	—
CWI US tax adjustment	—	—	—	6.7	—	—	—	—
Legal costs associated with SEC investigation	—	—	0.9	0.9	0.9	2.5	3.5	3.1
Other	1.3	(0.3)	0.1	—	0.2	(0.9)	1.0	(0.5)
Adjusted EBITDA	<u>\$ (3.9)</u>	<u>\$ (5.3)</u>	<u>\$ (5.6)</u>	<u>\$ (4.9)</u>	<u>(3.4)</u>	<u>8.6</u>	<u>4.3</u>	<u>0.2</u>

Adjusted EBITDA decreased by \$4.1 million from \$4.3 million for the three months ended September 30, 2018 to \$0.2 million in the three months ended December 31, 2018 primarily due to lower gross margin and lower CWI net income attributed to the Company.

BUSINESS RISKS AND UNCERTAINTIES

An investment in our business involves risk and readers should carefully consider the risks described in our AIF and other filings on www.sedar.com and www.sec.gov. Our ability to generate revenue and profit from our technologies is dependent on a number of factors, and the risks discussed in our AIF, if they were to occur, could have a material impact on our business, financial condition, liquidity, results of operation or prospects. While we have attempted to identify the primary known risks that are material to our business, the risks and uncertainties discussed in our AIF may not be the only ones we face. Additional risks and uncertainties, including those that we do not know about now or that we currently believe are immaterial may also adversely affect our business, financial condition, liquidity, results of operation or prospects. A full discussion of the risks impacting our business is contained in the AIF for the year ended December 31, 2018 under the heading "Risk Factors" and is available on SEDAR at www.sedar.com.

Consolidated Financial Statements
(Expressed in thousands of United States dollars)

WESTPORT FUEL SYSTEMS INC.

For the years ended December 31, 2018, 2017 and 2016



KPMG LLP
PO Box 10426 777 Dunsmuir Street
Vancouver, BC V7Y 1K3
Canada

Telephone: (604) 691-3000
Fax: (604) 691-3031
Internet: www.kpmg.ca

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of Westport Fuel Systems Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Westport Fuel Systems Inc. (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations and comprehensive income (loss), shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and its financial performance and its cash flows for each of the years in the three-year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 19, 2019, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Change in Accounting Principle

As discussed in note 4 (a) to the consolidated financial statements, the Company has changed its accounting policies for revenue as of January 1, 2018 due to the adoption of ASC 606 - Revenue from Contracts with Customers.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ **KPMG LLP**

Chartered Professional Accountants

We have served as the Company's auditor since 2015.

Vancouver, Canada
March 19, 2019

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of Westport Fuel Systems Inc.:

Opinion on Internal Control Over Financial Reporting

We have audited Westport Fuel Systems Inc.'s (the Company) internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2018 and 2017, the related consolidated statements of operations and comprehensive income (loss), shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements), and our report dated March 19, 2019 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management's Annual Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ **KPMG LLP**

Chartered Professional Accountants
Vancouver, Canada
March 19, 2019

WESTPORT FUEL SYSTEMS INC.

Consolidated Balance Sheets

(Expressed in thousands of United States dollars, except share amounts)

December 31, 2018 and 2017

	December 31, 2018	December 31, 2017 (Adjusted, note 6)
Assets		
Current assets:		
Cash and cash equivalents (including \$5,095 restricted cash, note 3(c) and 14(a))	\$ 61,119	\$ 71,842
Accounts receivable (note 7)	55,442	61,900
Inventories (note 8)	46,011	45,737
Prepaid expenses	4,835	4,726
Current assets held for sale (note 6)	1,676	16,992
Total current assets	169,083	201,197
Long-term investments (note 9)	8,818	9,302
Property, plant and equipment (note 10)	63,431	69,804
Intangible assets (note 11)	16,829	20,943
Deferred income tax assets (note 18(b))	1,664	1,848
Goodwill (note 12)	3,170	3,324
Other long-term assets	6,933	7,204
Total assets	\$ 269,928	\$ 313,622
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities (note 13)	\$ 82,851	\$ 86,225
Current portion of long-term debt (note 14)	10,327	8,993
Current portion of long-term royalty payable (note 15)	6,091	2,390
Warranty liability (note 16)	2,800	3,529
Current liabilities held for sale (note 6)	3,870	19,141
Total current liabilities	105,939	120,278
Long-term debt (note 14)	44,983	45,429
Long-term royalty payable (note 15)	14,844	16,641
Warranty liability (note 16)	2,141	2,772
Deferred income tax liabilities (note 18(b))	4,229	4,616
Other long-term liabilities	7,116	5,854
Total long-term liabilities	179,252	195,590
Shareholders' equity:		
Share capital (Unlimited common and preferred shares, no par value)(note 17):		
133,380,899 (2017 - 131,279,709) common shares issued	1,087,068	1,078,280
Other equity instruments	12,948	16,247
Additional paid in capital	10,079	10,079
Accumulated deficit	(998,361)	(966,869)
Accumulated other comprehensive loss	(21,058)	(19,705)
Total shareholders' equity	90,676	118,032
Total liabilities and shareholders' equity	\$ 269,928	\$ 313,622

Commitments and contingencies (note 20)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board

Brenda J. Eprile Director

Colin Johnston Director

WESTPORT FUEL SYSTEMS INC.

Consolidated Statements of Operations and Comprehensive Income (Loss)

(Expressed in thousands of United States dollars, except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

	Years ended December 31,		
	2018	2017	2016
		(Adjusted, note 6)	(Adjusted, note 6)
Revenue	\$ 270,283	\$ 229,833	\$ 167,181
Cost of revenue and expenses:			
Cost of revenue	206,059	169,552	133,055
Research and development	30,619	50,133	55,452
General and administrative	51,075	47,399	44,777
Sales and marketing	15,923	15,817	18,184
Restructuring costs	808	1,682	19,000
Foreign exchange loss	8,957	562	6,565
Depreciation and amortization (notes 10 and 11)	8,824	9,826	11,244
Impairments on long lived assets, net (note 10)	736	1,550	4,843
	<u>323,001</u>	<u>296,521</u>	<u>293,120</u>
Loss from continuing operations	(52,718)	(66,688)	(125,939)
Income from investments accounted for by the equity method	22,728	12,514	5,838
Interest on long-term debt and accretion on royalty payable	(9,133)	(14,487)	(10,773)
Bargain purchase gain from acquisition (note 5)	—	—	35,808
Interest and other income (expense), net of bank charges	465	1,377	(1,656)
Loss from continuing operations before income taxes	<u>(38,658)</u>	<u>(67,284)</u>	<u>(96,722)</u>
Income tax expense (recovery) (note 18):			
Current	3,950	(2,780)	1,610
Deferred	<u>(1,838)</u>	<u>(1,644)</u>	<u>2,340</u>
	2,112	(4,424)	3,950
Net loss from continuing operations	(40,770)	(62,860)	(100,672)
Net income from discontinued operations (note 6)	9,278	52,881	3,099
Net loss for the year	<u>(31,492)</u>	<u>(9,979)</u>	<u>(97,573)</u>
Other comprehensive income (loss):			
Cumulative translation adjustment	(1,353)	11,382	1,295
Comprehensive gain (loss)	<u>\$ (32,845)</u>	<u>\$ 1,403</u>	<u>\$ (96,278)</u>
Income (loss) per share:			
From continuing operations - basic and diluted	\$ (0.31)	\$ (0.52)	\$ (1.10)
From discontinued operations - basic and diluted	\$ 0.07	\$ 0.44	\$ 0.03
Net loss per share	<u>\$ (0.24)</u>	<u>\$ (0.08)</u>	<u>\$ (1.07)</u>
Weighted average common shares outstanding:			
Basic and diluted	<u>132,371,396</u>	<u>119,558,566</u>	<u>91,028,504</u>

See accompanying notes to consolidated financial statements.

WESTPORT FUEL SYSTEMS INC.

Consolidated Statements of Shareholders' Equity

(Expressed in thousands of United States dollars, except share amounts)

December 31, 2018, 2017 and 2016

	Common shares outstanding	Share capital	Other equity instruments	Additional paid in capital	Accumulated deficit	Accumulated other comprehensive income (loss)	Total shareholders' equity
January 1, 2016	64,380,819	\$ 937,029	\$ 16,460	\$ 9,837	\$ (859,317)	\$ (32,382)	\$ 71,627
Issuance of common shares on exercise of share units	845,491	6,639	(6,639)	—	—	—	—
Issuance of common shares in connection with acquisition	44,882,782	98,742	655	—	—	—	99,397
Beneficial conversion feature on convertible debt	—	—	—	242	—	—	242
Stock-based compensation	—	—	10,450	—	—	—	10,450
Net loss for the year	—	—	—	—	(97,573)	—	(97,573)
Other comprehensive income	—	—	—	—	—	1,295	1,295
December 31, 2016	110,109,092	1,042,410	20,926	10,079	(956,890)	(31,087)	85,438
Issuance of common shares on exercise of share units	2,045,617	9,917	(9,917)	—	—	—	—
Issuance of common shares on public offering, net of costs incurred	19,125,000	25,953	—	—	—	—	25,953
Stock-based compensation	—	—	5,238	—	—	—	5,238
Net loss for the year	—	—	—	—	(9,979)	—	(9,979)
Other comprehensive income	—	—	—	—	—	11,382	11,382
December 31, 2017	131,279,709	1,078,280	16,247	10,079	(966,869)	(19,705)	118,032
Issuance of common shares on exercise of share units	2,101,190	8,788	(8,788)	—	—	—	—
Stock-based compensation	—	—	5,489	—	—	—	5,489
Net loss for the year	—	—	—	—	(31,492)	—	(31,492)
Other comprehensive loss	—	—	—	—	—	(1,353)	(1,353)
December 31, 2018	133,380,899	\$ 1,087,068	\$ 12,948	\$ 10,079	\$ (998,361)	\$ (21,058)	\$ 90,676

See accompanying notes to consolidated financial statements.

WESTPORT FUEL SYSTEMS INC.

Consolidated Statements of Cash Flows

(Expressed in thousands of United States dollars)

Years ended December 31, 2018, 2017 and 2016

	Years ended December 31,		
	2018	2017	2016
		(Adjusted, note 6)	(Adjusted, note 6)
Cash flows from (used in) operating activities:			
Net loss for the year from continuing operations	\$ (40,770)	\$ (62,860)	\$ (100,672)
Items not involving cash:			
Depreciation and amortization	16,510	14,741	15,322
Stock-based compensation expense	3,040	6,961	10,450
Unrealized foreign exchange loss	8,957	562	6,565
Deferred income tax (recovery) expense	(1,838)	(1,644)	2,340
Income from investments accounted for by the equity method	(22,728)	(12,514)	(5,838)
Accretion of long-term debt and long-term royalty payable	9,133	10,071	4,945
Impairments on long lived assets, net	736	1,550	4,843
Inventory write-downs to net realizable value	162	1,111	6,591
Bargain purchase gain from acquisition	—	—	(35,808)
Change in fair value of derivative liability and bad debt expense	(433)	1,397	1,670
Restructuring obligations	—	(14,187)	14,123
Changes in non-cash operating working capital:			
Accounts receivable	3,512	2,605	(4,930)
Inventories	(78)	4,565	31,352
Prepaid expenses	(170)	(93)	952
Accounts payable and accrued liabilities	(1,367)	6,755	(22,836)
Deferred revenue	(851)	(2,143)	(4,974)
Warranty liability	(1,252)	(6,330)	(5,855)
Net cash used in operating activities of continuing operations	(27,437)	(49,453)	(81,760)
Net cash from (used in) operating activities of discontinued operations	(1,435)	7,920	2,439
Cash flows from (used in) investing activities:			
Purchase of property, plant and equipment	(10,273)	(25,288)	(8,654)
Acquisitions, net of acquired cash (note 5)	—	—	45,344
Proceeds on sale of assets and investments	—	(85)	26,334
Dividends received from joint ventures	23,191	16,633	13,398
Proceeds received from holdbacks	6,968	—	—
Net cash from (used in) investing activities of continuing operations	19,886	(8,740)	76,422
Net cash from investing activities of discontinued operations	14,050	77,148	—
Cash flows from (used in) financing activities:			
Drawings on operating lines of credit and long-term facilities	12,612	42,641	9,184
Repayment of operating lines of credit and long-term facilities	(15,616)	(71,387)	(12,789)
Proceeds from share issuance, net	—	25,953	—
Repayment of royalty payable	(3,009)	(11,467)	—
Issuance of convertible debt and royalty payable	—	—	35,000
Long-term asset securing debt	(2,129)	—	—
Net cash from (used in) financing activities of continuing operations	(8,142)	(14,260)	31,395
Effect of foreign exchange on cash and cash equivalents	(7,645)	4,246	4,570
Increase (decrease) in cash and cash equivalents	(10,723)	16,861	33,066
Cash and cash equivalents, beginning of year	71,842	60,905	27,839
Cash and cash equivalents, end of year	61,119	77,766	60,905
Less: cash and cash equivalents from discontinued operations, end of year	—	5,924	—
Cash and cash equivalents from continuing operations, end of year	\$ 61,119	\$ 71,842	\$ 60,905

See accompanying notes to consolidated financial statements.

WESTPORT FUEL SYSTEMS INC.

Consolidated Statements of Cash Flows (continued)

(Expressed in thousands of United States dollars)

December 31, 2018, 2017 and 2016

	Years ended December 31,		
	2018	2017	2016
Supplementary information:			
Interest paid	\$ 4,039	\$ 4,416	\$ 4,339
Taxes paid, net of refunds	540	722	2,479
Non-cash transactions:			
Shares issued for acquisitions	—	—	98,742

See accompanying notes to consolidated financial statements.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

1. Company organization and operations:

Westport Fuel Systems Inc. (the "Company") was incorporated under the Business Corporations Act (Alberta) on March 20, 1995. The Company engineers, manufactures and supplies alternative fuel systems and components for use in transportation applications on a global basis. The Company's components and systems control the pressure and flow of gaseous alternative fuels, such as propane and natural gas used in internal combustion engines.

2. Liquidity and going concern:

In connection with preparing the consolidated financial statements for each annual and interim reporting period management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the consolidated financial statements are issued. Substantial doubt exists when conditions and events, considered in the aggregate, indicate that it is probable that the Company will be unable to meet its obligations as they become due within one year after the date that the consolidated financial statements are issued. This evaluation initially does not take into consideration the potential mitigating effect of management's plans that have not been fully implemented as of the date that the consolidated financial statements are issued. When substantial doubt exists, management evaluates whether the mitigating effect of its plans sufficiently alleviates substantial doubt about the Company's ability to continue as a going concern. The mitigating effect of management's plans, however, is only considered if both (1) it is probable that the plans will be effectively implemented within one year after the date that the consolidated financial statements are issued, and (2) it is probable that the plans, when implemented, will mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the consolidated financial statements are issued. Generally, to be considered probable of being effectively implemented, the plans must have been approved before the date that the consolidated financial statements are issued.

At this time Management's evaluation has concluded that there are no known or currently foreseeable conditions or events that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date these consolidated financial statements were issued. These consolidated financial statements have therefore been prepared on the basis that the Company will continue as a going concern.

At December 31, 2018, the Company's net working capital was \$63,144 (2017 - \$80,919) including cash and cash equivalents of \$61,119 (2017 - \$71,842), and its long-term debt, including the royalty payable, was \$76,245, of which \$16,418 matures in 2019. The Company has incurred a loss from continuing operations of \$40,770 (2017 - \$62,860) and negative cash flows from continuing operating activities of \$27,437 (2017 - \$49,453) for the year ended December 31, 2018, and has accumulated a deficit of \$998,361 since inception.

The Company continues to work towards its goals of increasing revenues and reducing expenditures, which has improved results from operations and operating cash flows in 2017 and 2018, and this improvement in operating results is expected to continue in 2019. In particular, the commercial launch of Westport HPDI 2.0™ in 2018 has allowed the Company to significantly reduce engineering and development spend and the associated capital expenditures on this product and this reduction has improved current and forecasted future cash flows. In addition, while the legal fees related to the Securities and Exchange Commission ("SEC") investigation that began in 2017 (see note 20(b)) increased significantly in 2018, we anticipate these legal expenditures to decrease in 2019. However, since the possible outcomes of this proceeding remain uncertain at this time, it is also necessary to acknowledge that any final determination that the Company's operations or activities are not, or were not, in compliance with the Foreign Corrupt Practices Act ("FCPA") and/or other U.S. securities laws could result in significant civil and criminal financial penalties and other sanctions, which could have a material adverse impact on our financial condition. Lastly, the Company continues to examine non-core assets to determine whether it is in the best interest of the Company to monetize assets or to continue to hold and invest in these assets. Connected with this activity of assessing its non-core assets, on July 25, 2018 the Company closed the sale of its CNG Compressor business announced in the second quarter of 2018, which resulted in gross proceeds of approximately \$14,729.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

2. Liquidity and going concern (continued):

Based on currently known conditions and events, management believes that the cash on hand at December 31, 2018 and the improvements to the operations expected for 2019 will provide the cash flow necessary to fund operations over the period from March 2019 to March 31, 2020. The ability of the Company to continue as a going concern beyond one year will be dependent on the Company's ability to generate positive results from operations and cash flows. If, as a result of future events, the Company was to determine it was no longer able to continue as a going concern, significant adjustments would be required to the carrying value of its assets and liabilities in the consolidated financial statements and the adjustments could be material.

3. Significant accounting policies:

(a) Basis of presentation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated on consolidation.

These consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Cartesian Capital Group is a global private equity firm based in New York that has investments in the Company. Various Cartesian entities are associated with these investments including Pangaea Two Management, LP; Pangaea Two Acquisition Holdings XIV, LLC; Pangaea Two Acquisition Holdings Parallel XIV, LLC. Collectively, these entities will be referred to as "Cartesian". In addition, Peter Yu, the founder and managing partner of Cartesian, was elected as a Director of the Company in January 2016. See notes 9(b), 14(c) and 15 for additional details of Cartesian's investments in the Company.

(b) Foreign currency translation:

The Company's functional currency is in the Canadian dollar and its reporting currency for its consolidated financial statement presentation is the United States dollar. The functional currencies for the Company's subsidiaries include the following: United States, Canadian ("CDN") and Australian dollars, Euro, Argentina Peso, Chinese Renminbi ("RMB"), Swedish Krona, and Indian Rupee. The Company translates assets and liabilities of non-U.S. dollar functional currency operations using the period end exchange rates, shareholders' equity balances using historical exchange rates, and revenues and expenses using the monthly average rate for the period with the resulting exchange differences recognized in other comprehensive income.

Transactions that are denominated in currencies other than the functional currency of the Company's operations or its subsidiaries are translated at the rate in effect on the date of the transaction. Foreign currency denominated monetary assets and liabilities are translated to the applicable functional currency at the exchange rate in effect on the balance sheet date. Non-monetary assets and liabilities are translated at the historical exchange rate. All foreign exchange gains and losses are recognized in the statement of operations, except for the translation gains and losses arising from available-for-sale instruments, which are recorded through other comprehensive income until realized through disposal or impairment.

As at June 30, 2018, the Company concluded that Argentina's economy is highly inflationary. As a result, the Company remeasured the financial statements of the Argentinian subsidiary in the Company's reporting currency beginning July 1, 2018.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

3. Significant accounting policies (continued):

Except as otherwise noted, all amounts in these financial statements are presented in U.S. dollars. For the periods presented, the Company used the following exchange rates:

	Year end exchange rate as at:		Average for the year ended:		
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017	December 31, 2016
Canadian dollar	0.73	0.80	0.77	0.77	0.76
Australian dollar	0.70	0.78	0.75	0.77	0.74
Euro	1.14	1.20	1.18	1.13	1.11
Argentina Peso	0.03	0.06	0.04	0.06	0.07
RMB	0.15	0.15	0.15	0.15	0.15
Swedish Krona	0.11	0.12	0.12	0.12	0.12
Indian Rupee	0.0143	0.0157	0.0156	0.0154	0.0150

(c) Cash and cash equivalents:

Cash and cash equivalents includes cash, term deposits, bankers acceptances and guaranteed investment certificates with maturities of ninety days or less when acquired. Cash equivalents are considered as held for trading and recorded at fair value with changes in fair value recognized in the consolidated statements of operations. The \$5,095 of restricted cash forms part of the security for the Export Development Canada ("EDC") loan (note 14(a)).

(d) Accounts receivable, net:

Accounts receivable are measured at amortized cost. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Past due balances over 90 days are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the allowance and a credit to accounts receivable.

(e) Inventories:

The Company's inventories consist of the Company's fuel system products (finished goods), work-in-progress, purchased parts and assembled parts. Inventories are recorded at the lower of cost and net realizable value. Cost is determined based on the lower of weighted average cost or first-in, first-out. The cost of fuel system product inventories, assembled parts and work-in-progress includes materials, labour and production overhead, including depreciation. The Company records inventory write-downs based on an analysis of excess and obsolete inventories determined primarily by future demand forecasts. In addition, the Company records a liability for firm, noncancelable, and unconditional purchase commitments with manufacturers for quantities in excess of the Company's future demand forecast consistent with its valuation of excess and obsolete inventory.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

3. Significant accounting policies (continued):

(f) Property, plant and equipment:

Property, plant and equipment are stated at cost. Depreciation is provided for as follows:

Assets	Basis	Rate
Buildings	Straight-line	15 years
Computer equipment and software	Straight-line	3 years
Furniture and fixtures	Straight-line	5 years
Machinery and equipment	Straight-line	8 – 10 years
Leasehold improvements	Straight-line	Lease term

Depreciation expense on equipment used in the production and manufacturing process is included in cost of sales. All other depreciation is included in the depreciation and amortization expense line on the statement of operations.

(g) Long-term investments:

The Company accounts for investments in which it has significant influence, including variable interest entities ("VIEs") for which the Company is not the primary beneficiary, using the equity method of accounting. Under the equity method, the Company recognizes its share of income from equity accounted investees in the statement of operations with a corresponding increase in long-term investments. Any dividends paid or payable are credited against long-term investments.

(h) Financial liabilities:

Accounts payable and accrued liabilities, short-term debt and long-term debt are measured at amortized cost. Transaction costs relating to long-term debt are netted against long-term debt and are amortized using the effective interest rate method.

(i) Research and development costs:

Research and development costs are expensed as incurred and are recorded net of government funding received or receivable.

(j) Intangible assets:

Intangible assets consist primarily of the estimated value of intellectual property, trademarks, technology, customer contracts and non-compete agreements acquired through acquisitions. Intangible assets are amortized over their estimated useful lives, which range from 5 to 20 years.

(k) Impairment of long-lived assets:

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If such conditions exist, assets are considered impaired if the sum of the undiscounted expected future cash flows expected to result from the use and eventual disposition of an asset is less than its carrying amount. An impairment loss is measured at the amount by which the carrying amount of the asset exceeds its fair value. When quoted market prices are not available, the Company uses the expected future cash flows discounted at a rate commensurate with the risks associated with the recovery of the asset as an estimate of fair value.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

3. Significant accounting policies (continued):

(l) Goodwill:

Goodwill is recorded at the time of purchase for the excess of the amount of the purchase price over the fair values of the identifiable assets acquired and liabilities assumed. Goodwill is not amortized and instead is tested at least annually for impairment, or more frequently when events or changes in circumstances indicate that goodwill might be impaired. This impairment test is performed annually at November 30. Future adverse changes in market conditions or poor operating results of underlying assets could result in an inability to recover the carrying value of the goodwill, thereby possibly requiring an impairment charge.

(m) Warranty liability:

Estimated warranty costs are recognized at the time the Company sells its products and are included in cost of revenue. The Company provides warranty coverage on products sold from the date the products are put into service by customers. Warranty liability represents the Company's best estimate of warranty costs expected to be incurred during the warranty period. Furthermore, the current portion of warranty liability represents the Company's best estimate of the costs to be incurred in the next twelve-month period. The Company uses historical failure rates and costs to repair defective products to estimate the warranty liability. New product launches require a greater use of judgment in developing estimates until claims experience becomes available. Product specific experience is typically available four or five quarters after product launch, with a clear experience trend not evident until eight to twelve quarters after launch. The Company records warranty expense for new products using historical experience from previous engine generations in the first year, a blend of actual product and historical experience in the second year and product specific experience thereafter. The amount payable by the Company and the timing will depend on actual failure rates and cost to repair failures of its products.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

3. Significant accounting policies (continued):

(n) Revenue recognition:

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Codification ("ASC") 606, *Revenue from Contracts with Customers*, a new accounting standard related to revenue recognition. ASC 606 supersedes nearly all U.S. GAAP on revenue recognition and eliminated industry-specific guidance. The underlying principle of ASC 606 is to recognize revenue when a customer obtains control of promised goods or services at an amount that reflects the consideration that is expected to be received in exchange for those goods or services. At the beginning of the first quarter of 2018, the Company adopted ASC 606 using the modified retrospective method. There was no material financial impact to our adoption of ASC 606.

The Company generates revenues primarily from product sales. Product revenues are derived from standard product sales contracts and from long-term fixed price contracts. Under ASC 606, revenue is recognized when a customer obtains control of the goods or services. Determining the timing of the transfer of control, at a point in time or over time, requires judgment. On standard product sales contracts, revenues are recognized when customers obtain control of the product, that is when transfer of title and risks and rewards of ownership of goods have passed and when obligation to pay is considered certain. Invoices are generated and revenue is recognized at that point in time. Provisions for warranties are made at the time of sale.

(o) Income taxes:

The Company accounts for income taxes using the asset and liability method. Under this method, deferred income tax assets and liabilities are determined based on the temporary differences between the accounting basis and tax basis of the assets and liabilities and for loss carry-forwards, tax credits and other tax attributes, using the enacted tax rates in effect for the years in which the differences are expected to reverse. The effect of a change in tax rates on the deferred income tax assets and liabilities is recognized in income in the period that includes the enactment date.

The Company recognizes deferred income tax assets to the extent the assets are more-likely-than-not to be realized. In making such a determination the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If it is determined that, based on all available evidence, it is more-likely-than-not that some or all of the deferred income tax assets will not be realized, a valuation allowance is provided to reduce the deferred income tax assets.

The Company uses a two-step process to recognize and measure the income tax benefit of uncertain tax positions taken or expected to be taken in a tax return. The tax benefit from an uncertain tax position is recognized if it is more-likely-than-not that the position will be sustained upon examination by a tax authority based solely on the technical merits of the position. A tax benefit that meets the more-likely-than-not recognition threshold is measured as the largest amount that is greater than 50% likely to be realized upon settlement with the tax authority. To the extent a full benefit is not expected to be realized, an income tax liability is established. Any change in judgment related to the expected resolution of an uncertain tax position is recognized in the year of such a change.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

4. Accounting changes:

(a) New accounting pronouncements adopted in 2018:

Revenue:

In May 2014, FASB issued Accounting Standards Updates ("ASU") 2014-09, *Revenue From Contracts With Customers* ("Topic 606"). The Company adopted this standard on January 1, 2018, using the modified retrospective method. The adoption of this standard did not result in any impact on previously reported amounts. In accordance with the standard, additional disclosures have been provided in note 3(n).

Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments:

In August 2016, the FASB issued ASU 2016-15, which provides cash flow classification guidance on eight specific cash flow issues to reduce diversity in practice for which authoritative guidance did not previously exist. The Company adopted this standard on January 1, 2018 with no material impact to the Company's financial statements.

(b) New accounting pronouncement to be adopted in 2019:

Leases (Topic 842):

In February 2016, the FASB issued ASU 2016-02, which increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018, and interim periods with early adoption permitted. The Company's future minimum lease payments at December 31, 2018 under operating leases are disclosed in note 21 (a). The Company is finalizing its implementation of this new standard and will use the modified retrospective method as at January 1, 2019. The Company's significant leases relate to its leasing of operating premises.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

5. Business combinations:

Merger with Fuel Systems:

On June 1, 2016 ("the acquisition date"), the Company completed a merger with Fuel Systems Solutions, Inc. ("Fuel Systems"). Fuel Systems shareholders received 2.4755 Westport common shares for each share of Fuel Systems common stock owned. The Company issued 44,882,782 common shares to former Fuel Systems shareholders and 653,532 restricted stock units. The Company determined the purchase price using the Nasdaq closing share price on the acquisition date at \$2.20 per share, which resulted in total purchase consideration of \$99,397. The Company incurred total acquisition related costs of \$9,890 in 2015 and 2016, which were expensed as incurred.

This business combination resulted in a bargain purchase transaction, as the fair value of assets acquired and liabilities assumed exceeded the total of the transaction date fair value of equity issued by \$35,808. The Company believes it was able to acquire the assets of Fuel Systems for less than their fair value due to the weakness in the alternative fuel sector.

6. Sale of assets:

The Company completed the sale of its CNG Compressor business on July 25, 2018 for gross proceeds of \$14,729 and recorded a net gain of \$9,910. The assets and liabilities of the CNG Compressor business were accounted for as held for sale effective from the second quarter of 2018. The comparative balances of the CNG Compressor business were also reclassified as at December 31, 2017, with an impact to the following balance sheet accounts: accounts receivable, inventories, property, plant and equipment, accounts payable and accrued liabilities, warranty liability and other long-term liabilities. The notes for these account balances have been adjusted for these reclassifications in these financial statements.

During the second quarter of 2017, substantially all of the former Industrial business segment was sold resulting in a gain of \$58,310.

As discussed in note 15, 15% of the net consideration received on these asset sales was paid or will be payable against the royalty payable due to Cartesian.

The carrying amount of the major classes of assets and liabilities for the held-for-sale for both the CNG Compressor business and Industrial business segment at December 31, 2018 and December 31, 2017 are shown below:

	December 31, 2018	December 31, 2017
Cash	\$ —	\$ 5,924
Accounts receivable	1,676	5,267
Inventories	—	5,006
Property, plant, and equipment	—	795
Total assets classified as held for sale	<u>\$ 1,676</u>	<u>\$ 16,992</u>
Accounts payable and accrued liabilities	\$ 57	\$ 12,597
Restructuring obligations	467	—
Income taxes payable	2,054	3,448
Other current liabilities	—	1,462
Deferred income tax liabilities and other liabilities	1,292	1,634
Total liabilities classified as held for sale	<u>\$ 3,870</u>	<u>\$ 19,141</u>

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

6. Sale of assets (continued):

The following table presents the combined financial results of the CNG Compressor business and Industrial business segments which are included in net income from discontinued operations for the years ended December 31, 2018, 2017 and 2016:

	December 31, 2018	December 31, 2017	December 31, 2016
Revenue	\$ 8,837	\$ 46,268	\$ 57,715
Cost of revenue	7,548	34,647	43,495
Research and development	603	2,972	3,960
General and administrative	1,083	5,027	3,429
Sales and marketing	575	2,713	2,765
	9,809	45,359	53,649
Operating income (loss) from discontinued operations	(972)	909	4,066
Restructuring costs	1,268	—	—
Net gain on sale of assets	(10,710)	(58,310)	—
Other expenses (recovery)	—	220	(93)
Income from discontinued operations before income tax	8,470	58,999	4,159
Income tax expense (recovery)	(808)	6,118	1,060
Net income from discontinued operations	\$ 9,278	\$ 52,881	\$ 3,099

On January 1, 2018, the Company exited the portion of the facility related to the discontinued Industrial business segment and recorded a \$1,268 lease-exit restructuring obligation. The lease terminates in August of 2019. During the second quarter of 2018, the Company adjusted a provision related to the Industrial business segment and recorded an additional gain of \$800.

7. Accounts receivable:

	December 31, 2018	December 31, 2017
Customer trade receivables	\$ 50,867	\$ 51,719
Holdback receivables	—	6,750
Other receivables	6,775	4,337
Income tax receivable	717	1,232
Due from related parties (note 19)	122	156
Allowance for doubtful accounts	(3,039)	(2,294)
	\$ 55,442	\$ 61,900

8. Inventories:

	December 31, 2018	December 31, 2017
Purchased parts and materials	\$ 31,735	\$ 32,352
Work-in-process	2,297	2,187
Finished goods	11,367	10,505
Inventory on consignment	612	693
	\$ 46,011	\$ 45,737

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

8. Inventories (continued):

During the year ended December 31, 2018, the Company recorded write-downs to net realizable value of approximately \$162 (year ended December 31, 2017 - \$1,111; year ended December 31, 2016 - \$6,591).

9. Long-term investments:

	December 31, 2018	December 31, 2017
Cummins Westport Inc. (a)	\$ 6,309	\$ 6,799
Weichai Westport Inc. (b)	1,824	1,824
Other equity accounted investees	685	679
	<u>\$ 8,818</u>	<u>\$ 9,302</u>

(a) Cummins Westport Inc.:

The Company entered into a joint venture with Cummins Inc. ("Cummins") on March 7, 2001. The joint venture term is scheduled to end on December 31, 2021 and can be terminated under certain circumstances before the end of the term, including in the event of a material breach of the agreement by, or in the event of a change of control of, one of the parties.

On February 20, 2012, the joint venture agreement ("JVA") was amended and restated to provide for, among other things, clarification concerning the scope of products within CWI. In addition, the parties revised certain economic terms of the JVA. Prior to February 20, 2012, the Company and Cummins shared equally in the profits and losses of CWI. Under the amended JVA, profits and losses are shared equally up to an established revenue baseline, then any excess profit will be allocated 75% to the Company and 25% to Cummins.

The Company has determined that CWI is a VIE. Cummins and Westport each own 50% of the common shares of CWI and have equal representation on the Board of Directors. No one shareholder has the unilateral power to govern CWI. The Board of Directors has power over the operating decisions and to direct other activities of CWI that most significantly impact CWI's economic performance as set forth in the governing documents. As decision-making at the Board of Directors' level requires unanimous approval, this power is shared. Accordingly neither party is the primary beneficiary.

The Company recognized its share of CWI's income and received dividends as follows:

	Years ended December 31,		
	2018	2017	2016
Investment income under the equity method	\$ 22,701	\$ 12,482	\$ 5,606
Dividends received	23,191	16,633	10,198

The Company has not historically provided and does not intend to provide financial or other support to CWI that the Company is not contractually required to provide. As at December 31, 2018, the Company has a related party accounts receivable balance of \$122 (2017 - \$150) due from CWI. During the year ended December 31, 2018, total sales to CWI were \$1,855 (2017 - \$2,721; 2016 - \$2,744).

The carrying amount and maximum exposure to losses relating to CWI were as follows:

	Balance at December 31, 2018		Balance at December 31, 2017	
	Carrying amount	Maximum exposure to loss	Carrying amount	Maximum exposure to loss
Equity method investment in CWI	\$ 6,309	\$ 6,309	\$ 6,799	\$ 6,799
Accounts receivable due from CWI	122	122	150	150

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

9. Long-term investments (continued):

(a) Cummins Westport Inc. (continued):

Assets, liabilities, revenue and expenses of CWI, are as follows:

	December 31, 2018	December 31, 2017
Current assets:		
Cash and short-term investments	\$ 85,812	\$ 91,720
Accounts receivable	2,336	10,925
Other current assets	120	—
Long-term assets:		
Property, plant and equipment	934	1,245
Deferred income tax assets	22,851	28,096
Total assets	<u>\$ 112,053</u>	<u>\$ 131,986</u>
Current liabilities:		
Current portion of warranty liability	\$ 19,829	\$ 25,866
Current portion of deferred revenue	21,299	22,157
Accounts payable and accrued liabilities	4,348	12,603
	<u>45,476</u>	<u>60,626</u>
Long-term liabilities:		
Warranty liability	22,995	16,253
Deferred revenue	27,009	38,321
Other long-term liabilities	3,943	3,175
	<u>53,947</u>	<u>57,749</u>
Total liabilities	<u>\$ 99,423</u>	<u>\$ 118,375</u>

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

9. Long-term investments (continued):

	Years ended December 31,		
	2018	2017	2016
Product revenue	\$ 227,408	\$ 235,220	\$ 205,235
Parts revenue	91,997	82,077	71,230
	<u>319,405</u>	<u>317,297</u>	<u>276,465</u>
Cost of revenue and expenses:			
Cost of product and parts revenue	228,452	207,840	199,317
Research and development	18,000	30,733	36,066
General and administrative	1,474	1,113	1,136
Sales and marketing	15,350	19,675	23,047
Foreign exchange loss	12	51	8
Bank charges, interest and other	706	609	695
	<u>263,994</u>	<u>260,021</u>	<u>260,269</u>
Income from operations	55,411	57,276	16,196
Interest and investment income	1,939	982	552
Income before income taxes	57,350	58,258	16,748
Income tax expense:			
Current	8,397	16,068	4,680
Deferred (1)	3,552	17,226	856
	<u>11,949</u>	<u>33,294</u>	<u>5,536</u>
Income for the year	<u>\$ 45,401</u>	<u>\$ 24,964</u>	<u>\$ 11,212</u>

(1) As a result of the U.S. tax reform substantially enacted in the fourth quarter of 2017, CWI recorded a deferred tax expense of \$13,423 in 2017 arising from related adjustments to deferred income tax assets.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

9. Long-term investments (continued):

(b) Weichai Westport Inc.:

The Company, indirectly through its wholly-owned subsidiary, Westport Innovations (Hong Kong) Limited (“Westport HK”), is currently the registered holder of a 23.33% equity interest in Weichai Westport Inc. (“WWI”). Previously, the Company held a 35% indirect equity interest in WWI. However, in April 2016, the Company sold to Cartesian entities a derivative economic interest granting it the right to receive an amount of future income received by Westport HK from WWI equivalent to having an 18.78% equity interest in WWI and concurrently granted a Cartesian entity an option to acquire all of the equity securities of Westport HK for a nominal amount. The Company retained the right to transfer any equity interest held by Westport HK in WWI that was in excess of an 18.78% interest in the event that such option was exercised. Then in August 2016, the Company sold an aggregate 11.67% equity interest in the WWI joint venture for gross proceeds of \$7,372 (RMB 48,185) to Weichai Holding Group Co., Ltd. (to which the Company sold a 6.42% equity interest) and Guanya (Shanghai) Private Equity Partnership (Limited Partnership) (“Guanya”) (to which the Company sold a 5.25% equity interest). Public disclosures of this transaction made by the Company prior to the third quarter of 2018 filing of our financial statements referred to Guanya as either “an additional undisclosed purchaser” or, inadvertently, as “Weichai Power Co., Ltd.”, which was not a party to the transaction but instead was a limited partner of Guanya. The Company’s 23.33% equity interest in WWI remains held by the Company’s subsidiary, Westport HK. As a result of such transactions, the Company’s residual 23.33% equity interest in WWI currently corresponds to an economic interest in WWI equivalent to just 4.55%.

On August 28, 2018, the Company entered into definitive development and supply agreements with WWI to develop, market, and commercialize a heavy-duty, natural gas engine featuring the Westport HPDI 2.0™ technology, based on one of Weichai Power Co. Ltd.’s (“Weichai Power”) heavy-duty engine platforms. Under the new development program, the Company will support the adaptation of the Westport HPDI 2.0™ technology onto one of Weichai Power’s heavy-duty engine platforms.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

10. Property, plant and equipment:

December 31, 2018	Cost	Accumulated depreciation	Net book value
Land and buildings	\$ 4,765	\$ 1,474	\$ 3,291
Computer equipment and software	7,079	6,043	1,036
Furniture and fixtures	3,553	2,975	578
Machinery and equipment	87,151	33,476	53,675
Leasehold improvements	11,578	6,727	4,851
	<u>\$ 114,126</u>	<u>\$ 50,695</u>	<u>\$ 63,431</u>
December 31, 2017	Cost	Accumulated depreciation	Net book value
Land and buildings	\$ 4,947	\$ 1,412	\$ 3,535
Computer equipment and software	7,742	7,438	304
Furniture and fixtures	5,322	3,585	1,737
Machinery and equipment	90,570	33,007	57,563
Leasehold improvements	14,261	7,596	6,665
	<u>\$ 122,842</u>	<u>\$ 53,038</u>	<u>\$ 69,804</u>

During the year ended December 31, 2018, the Company recorded an impairment charge of \$736 (year ended December 31, 2017 - \$1,550; year ended December 31, 2016 - \$2,708). The impairment resulted primarily from the write-down of tooling equipment and was recorded in the Transportation segment.

The Company has significant investments in property, plant and equipment related to its Westport HPDI 2.0™ business. The HPDI business is at the early stages of commercialization, and, as a result, is currently generating losses. Based on the Company's current projections, meaningful increases in component sales, compared to 2018 levels, are expected, allowing the HPDI business to benefit from economies of scale and become profitable. If these assumptions are not realized, the Company may be required to record an impairment on these assets in future periods.

Total depreciation expense for the year ended December 31, 2018 was \$13,090 (year ended December 31, 2017 - \$11,289; year ended December 31, 2016 - \$12,305). The amount of depreciation expense included in cost of sales for the year ended December 31, 2018 was \$7,685 (year ended December 31, 2017 - \$4,915; year ended December 31, 2016 - \$4,266).

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

11. Intangible assets:

December 31, 2018	Cost	Accumulated amortization	Net book value
Patents and trademarks	\$ 21,142	\$ 7,978	\$ 13,164
Technology	5,150	4,369	781
Customer contracts	12,355	9,476	2,879
Other intangibles	334	329	5
Total	\$ 38,981	\$ 22,152	\$ 16,829

December 31, 2017	Cost	Accumulated amortization	Net book value
Patents and trademarks	\$ 22,031	\$ 6,995	\$ 15,036
Technology	5,400	4,059	1,341
Customer contracts	12,964	8,404	4,560
Other intangibles	351	345	6
Total	\$ 40,746	\$ 19,803	\$ 20,943

Based on revenues and operating results, the Company concluded that there were no impairment indicators as of November 30, 2018 related to the intangible assets. Therefore, no impairment on intangible assets was recorded as at December 31, 2018.

During the year ended December 31, 2018, amortization of \$3,420 (year ended December 31, 2017 - \$3,452; year ended December 31, 2016 - \$3,059) was recognized in the statement of operations.

12. Goodwill:

A continuity of goodwill is as follows:

	December 31, 2018	December 31, 2017
Balance, beginning of year	\$ 3,324	\$ 2,923
Impact of foreign exchange changes	(154)	401
Balance, end of year	\$ 3,170	\$ 3,324

The Company completed its annual assessment at November 30, 2018 and concluded that the remaining goodwill of \$3,170 related to the Netherlands reporting unit under the Transportation business segment was not impaired.

13. Accounts payable and accrued liabilities:

	December 31, 2018	December 31, 2017
Trade accounts payable	\$ 59,970	\$ 56,309
Accrued payroll	13,723	16,292
Accrued interest	1,568	1,567
Taxes payable	2,244	511
Deferred revenue	996	1,398
Restructuring obligation	—	2,969
Other payables	4,350	7,179
	\$ 82,851	\$ 86,225

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

14. Long-term debt:

	December 31, 2018	December 31, 2017
Term loan facilities, net of debt issuance costs (a)	24,023	18,987
Senior financing (b)	8,645	10,901
Convertible debt (c)	17,382	17,335
Other bank financing (d)	3,744	6,562
Capital lease obligations (e)	1,516	637
Balance, end of period	\$ 55,310	\$ 54,422
Current portion	(10,327)	(8,993)
Long-term portion	\$ 44,983	\$ 45,429

(a) On December 20, 2017, the Company entered into a loan agreement with EDC for a \$20,000 non-revolving term facility. The loan bears interest at 9% plus monitoring fees, payable quarterly, as well as quarterly principal repayments. The Company incurred debt issuance costs of \$1,013 related to the this loan, which reduced the carrying value to \$18,987 at December 31, 2017. These costs are amortized over the term of this loan using the effective interest rate method. As at December 31, 2018, the amount outstanding for this loan was \$16,860, net of issuance costs.

The loan is secured by share pledges over Westport Power, Inc., Fuel Systems Solutions, Inc., and MTM S.r.L. and 85% of the proceeds received from the holdback related to the sale of a portion of the Industrial business segment (as discussed in note 6). As at December 31, 2018, this holdback security of \$5,095 is held as restricted cash. On March 1, 2019, as a result of achieving certain milestones, the restricted cash was released and the interest rate on the loan was reduced to 6%.

On October 9, 2018, the Company entered into a Euro denominated loan agreement with UniCredit S.p.A. ("UniCredit"). The loan bears interest at the 3-month Euribor plus 2.3% and interest is paid quarterly. As at December 31, 2018, the amount outstanding for this loan was \$7,163 and was secured by a pledge of \$2,129, with these restricted funds being recorded in other long-term assets.

(b) The senior financing facility was renewed on March 24, 2017. The loan bears interest at the 6-month Euribor plus 3.3% and can increase or decrease by 30 basis points based on an annual leverage ratio calculation. Interest is paid semi-annually. The Company has pledged its interest in EMER S.p.A. as a general guarantee for its senior revolving financing.

(c) In January 2016, the Company entered into a financing agreement ("Tranche 2 Financing") with Cartesian. As part of the agreement, on June 1, 2016, convertible debt was issued in exchange for 9.0% convertible unsecured notes due June 1, 2021, which are convertible into common shares of the Company in whole or in part, at Cartesian's option, at any time following the twelve month anniversary of the closing at a conversion price of \$2.17 per share. Interest is payable annually in arrears on December 31 of each year during the term. The convertible debt is held by a related party as Peter Yu, founder and managing partner of Cartesian, became a member of the Board of Directors of the Company in January 2016. Cartesian is secured by an interest in the Company's HPDI 2.0 intellectual property and a priority interest in the Company's CWI joint venture interest.

(d) Other bank financing consists of various secured and unsecured bank financing arrangements that carry rates of interest ranging from 0.75% to 3.8% and have various maturities out to 2022. Security includes a building owned by the Company in the Netherlands and certain accounts receivable in one of our Italian subsidiaries.

(e) The Company has capital lease obligations that have terms of three to four years at interest rates ranging from 1.3% to 12.0% (2017 - 3.1% to 12.0%).

Throughout the entire term of these financing arrangements, the Company is required to meet certain financial and non-financial covenants. As of December 31, 2018, the Company is in compliance with all covenants under the financing arrangements.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

14. Long-term debt (continued):

The principal repayment schedule of the long-term debt is as follows for the years ending December 31:

	Term loan facilities	Senior financing	Convertible debt	Other bank financing	Capital lease obligations	Total
2019	\$ 5,234	\$ 1,880	\$ —	\$ 2,714	\$ 499	\$ 10,327
2020	7,166	2,009	—	344	475	9,994
2021	8,785	2,254	17,382	343	418	29,182
2022	1,419	2,502	—	343	124	4,388
2023 and thereafter	1,419	—	—	—	—	1,419
	<u>\$ 24,023</u>	<u>\$ 8,645</u>	<u>\$ 17,382</u>	<u>\$ 3,744</u>	<u>\$ 1,516</u>	<u>\$ 55,310</u>

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

15. Long-term royalty payable:

In January 2016, the Company entered into a financing agreement with Cartesian to support the Company's global growth initiatives. The financing agreement immediately provided \$17,500 in cash (the "Tranche 1 Financing"). In consideration for the funds provided to the Company, Cartesian is entitled to royalty payments based on the greater of (i) a percentage of amounts received by the Company on select HPDI systems and CWI joint venture income through 2025 and (ii) stated fixed amounts per annum (subject to adjustment for asset sales). The carrying value is being accreted to the expected redemption value using the effective interest method, which is approximately 23% per annum. Cartesian's debt is secured by an interest in the Company's HPDI intellectual property and a priority interest in the Company's CWI joint venture interest.

In January 2017, the Company and Cartesian signed a Consent Agreement which allows the Company to sell certain assets in exchange for prepayment of the Cartesian royalty: Cartesian will be paid 15% of the net proceeds from these asset sales to a maximum of \$15,000, with this payment being allocated on a non-discounted basis to future years' minimum payments.

The Company's divestiture of the Industrial business segment during 2017 and the CNG Compressor business in 2018 resulted in royalty prepayments of \$9,435 in 2017 and \$1,045 in 2018. Due to the early extinguishment of a portion of the royalty payable, the Company recorded an additional finance charge of \$5,236 in 2017 and \$778 in 2018.

As of December 31, 2018, the total royalty prepayments paid or payable to Cartesian as a result of the Consent Agreement, including the prepayment arising from the sale of the CNG Compressor business to be made in 2019, was \$12,204.

A continuity schedule of the long-term royalty payable is as follows:

	December 31, 2018	December 31, 2017
Balance, beginning of year	\$ 19,031	\$ 21,562
Accretion expense	4,135	3,168
Repayment	(3,009)	(10,935)
Additional finance charge from prepayment	778	5,236
Balance, end of year	20,935	19,031
Current portion	(6,091)	(2,390)
Long-term portion	<u>\$ 14,844</u>	<u>\$ 16,641</u>

The minimum repayments including interest are as follows, for the years ending December 31:

2019	\$ 6,091
2020	5,926
2021	7,258
2022	5,065
2023	1,162
2024 and thereafter	6,758
	<u>\$ 32,260</u>

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

16. Warranty liability:

A continuity of the warranty liability is as follows:

	Years ended December 31,		
	2018	2017	2016
Balance, beginning of year	\$ 6,301	\$ 11,612	\$ 13,991
Warranty assumed on acquisition	—	—	2,454
Warranty claims	(2,787)	(2,627)	(7,684)
Warranty accruals	2,112	1,232	1,493
Change in estimate	(1,443)	(2,949)	—
Impact of foreign exchange changes	758	(967)	1,358
Balance, end of year	4,941	6,301	11,612
Less: Current portion	(2,800)	(3,529)	(5,499)
Long-term portion	\$ 2,141	\$ 2,772	\$ 6,113

17. Share capital, stock options and other stock-based plans:

During the year ended December 31, 2018, the Company issued 2,101,190 common shares upon exercises of share units (year ended December 31, 2017 – 2,045,617 common shares). The Company issues shares from treasury to satisfy share unit exercises.

During the year ended December 31, 2017, the Company issued 19,125,000 common shares at \$1.50 per share, for gross proceeds of \$28,688. Transaction costs of \$2,735 were incurred for net proceeds of \$25,953.

(a) Share Units ("Units"):

The value assigned to issued Units and the amounts accrued are recorded as other equity instruments. As Units are exercised or vested and the underlying shares are issued from treasury of the Company, the value is reclassified to share capital.

During the year ended December 31, 2018, the Company recognized \$3,040 (year ended December 31, 2017 - \$6,961; year ended December 31, 2016 – \$10,450) of stock-based compensation associated with the Westport Omnibus Plan and the former Amended and Restated Unit Plan.

A continuity of the Units issued under the Westport Omnibus Plan and the former Amended and Restated Unit Plan as of December 31, 2018, December 31, 2017 and December 31, 2016 are as follows:

	December 31, 2018		December 31, 2017		December 31, 2016	
	Number of units	Weighted average grant date fair value (CDN \$)	Number of units	Weighted average grant date fair value (CDN \$)	Number of units	Weighted average grant date fair value (CDN \$)
Outstanding, beginning of year	4,509,990	\$ 6.00	6,664,591	\$ 6.75	9,657,921	\$ 7.62
Granted	1,009,230	3.50	993,659	2.18	684,402	2.90
Exercised/vested	(2,101,190)	5.44	(2,045,617)	6.31	(845,491)	10.26
Forfeited/expired	(750,627)	3.61	(1,102,643)	6.51	(2,832,241)	6.60
Outstanding, end of year	2,667,403	\$ 4.41	4,509,990	\$ 6.00	6,664,591	\$ 6.75
Units outstanding and exercisable, end of year	2,076,684	\$ 4.66	636,073	\$ 5.38	1,891,008	\$ 7.77

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

17. Share capital, stock options and other stock-based plans (continued):

During 2018, 1,009,230 (2017 - 993,659) restricted share units ("RSUs") were granted to directors, executives and employees. Values of RSU awards are generally determined based on the fair market value of the underlying common share on the date of grant. RSUs typically vest over a three year period so the actual value received by the individual depends on the share price on the day such RSUs are settled for common shares, not the date of grant.

As at December 31, 2018, \$2,074 of compensation expense related to Units has yet to be recognized in results from operations and will be recognized over a weighted average period of approximately 1 and a half years.

(b) Aggregate intrinsic values:

The aggregate intrinsic value of the Company's share units at December 31, 2018 and 2017 are as follows:

	December 31, 2018 CDN\$	December 31, 2017 CDN\$
Share units:		
Outstanding	\$ 4,828	\$ 21,332
Exercisable	3,759	3,009

(c) Stock-based compensation:

Stock-based compensation associated with the Unit plans is included in operating expenses as follows:

	2018	2017	2016
Research and development	\$ 778	\$ 1,182	\$ 6,010
General and administrative	1,952	5,450	2,334
Sales and marketing	310	329	2,106
	<u>\$ 3,040</u>	<u>\$ 6,961</u>	<u>\$ 10,450</u>

During the first quarter of 2018, the Performance Stock Units ("PSUs") that had been conditionally approved were finalized and granted. As a result, the stock-based compensation of \$2,449 related to 730,000 PSUs was reclassified from a liability to shareholders' equity.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

18. Income taxes:

(a) The Company's income tax provision differs from that calculated by applying the combined enacted Canadian federal and provincial statutory income tax rate of 27% for the year ended December 31, 2018 (year ended December 31, 2017 – 26%; year ended December 31, 2016 – 26%) as follows:

	2018	2017	2016
		(Adjusted, Note 6)	(Adjusted, Note 6)
Loss before income taxes	\$ (38,658)	\$ (67,284)	\$ (96,722)
Expected income tax recovery	(10,438)	(17,494)	(25,148)
Increase (reduction) in income taxes resulting from:			
Non-deductible stock-based compensation	433	786	2,176
Other permanent differences	3,762	3,624	5,875
Withholding taxes	657	444	1,109
Change in enacted tax rates	135	22,960	—
Foreign tax rate differences, foreign exchange and other adjustments	1,585	138	(4,560)
Non-taxable income from equity investment	(6,834)	(3,245)	925
Change in valuation allowance	12,812	(11,637)	32,583
Change in uncertain tax position	—	—	301
Bargain purchase gain	—	—	(9,311)
Income tax expense (recovery)	<u>\$ 2,112</u>	<u>\$ (4,424)</u>	<u>\$ 3,950</u>

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

18. Income taxes (continued):

(b) The significant components of the deferred income tax assets and liabilities are as follows:

	December 31, 2018	December 31, 2017
Deferred income tax assets:		
Net loss carry forwards	\$ 197,585	\$ 189,627
Intangible assets	5,655	6,502
Property, plant and equipment	12,799	13,046
Warranty liability	3,251	3,290
Foreign tax credits	620	5,241
Inventory	4,223	4,668
Research and development	5,961	5,795
Other	11,135	13,190
Total gross deferred income tax assets	241,229	241,359
Valuation allowance	(239,565)	(239,511)
Total deferred income tax assets	1,664	1,848
Deferred income tax liabilities:		
Intangible assets	(2,456)	(4,062)
Property, plant and equipment	(106)	(231)
Other	(1,667)	(323)
Total deferred income tax liabilities	(4,229)	(4,616)
Total net deferred income tax liabilities	\$ (2,565)	\$ (2,768)
Allocated as follows:		
Deferred income tax assets	\$ 1,664	\$ 1,848
Deferred income tax liabilities	(4,229)	(4,616)
Total net deferred income tax liabilities	\$ (2,565)	\$ (2,768)

The valuation allowance is reviewed on a quarterly basis to determine if, based on all available evidence, it is more-likely-than-not that some or all of the deferred income tax assets will not be realized. The ultimate realization of deferred income tax assets is dependent on the generation of sufficient taxable income during the future periods in which those temporary differences are expected to reverse. If the evidence does not exist that the deferred income tax assets will be fully realized, a valuation allowance has been provided.

The deferred income tax assets have been reduced by the uncertain tax position presented in note 18(f).

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

18. Income taxes (continued):

(c) The components of the Company's income tax expense (recovery) are as follows:

		Income tax expense (recovery)		
	Net income (loss) before income taxes	Current	Deferred	Total
Year ended December 31, 2018				
Canada	\$ (61,933)	214	—	\$ 214
United States	17,161	803	—	803
Italy	7,445	1,741	(1,188)	553
Other	(1,331)	1,192	(650)	542
	<u>\$ (38,658)</u>	<u>\$ 3,950</u>	<u>\$ (1,838)</u>	<u>\$ 2,112</u>
Year ended December 31, 2017				
Canada	\$ (61,458)	\$ (3,737)	\$ (17)	\$ (3,754)
United States	3,023	17	—	17
Italy	679	493	(1,470)	(977)
Other	(9,528)	447	(157)	290
	<u>\$ (67,284)</u>	<u>\$ (2,780)</u>	<u>\$ (1,644)</u>	<u>\$ (4,424)</u>
Year ended December 31, 2016				
Canada	\$ (104,060)	\$ 56	\$ 120	\$ 176
United States	14,926	7	—	7
Italy	(5,601)	192	1,440	1,632
Other	(1,987)	1,355	780	2,135
	<u>\$ (96,722)</u>	<u>\$ 1,610</u>	<u>\$ 2,340</u>	<u>\$ 3,950</u>

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

18. Income taxes (continued):

(d) The Company has loss carry-forwards in the various tax jurisdictions available to offset future taxable income as follows:

	2019	2020	2021	2022 and later	Total
Canada	\$ —	\$ —	\$ —	\$ 518,969	\$ 518,969
Italy	—	—	—	2,976	2,976
United States	—	—	—	103,673	103,673
Sweden	—	—	—	19,155	19,155
Other	4,668	4,039	4,131	14,009	26,847
Total	<u>\$ 4,668</u>	<u>\$ 4,039</u>	<u>\$ 4,131</u>	<u>\$ 658,782</u>	<u>\$ 671,620</u>

Certain tax attributes are subject to an annual limitation as a result of the acquisition of Fuel Systems which constitutes a change of ownership as defined under Internal Revenue Code Section 382.

(e) The Company has not recognized a deferred income tax liability for certain undistributed earnings of foreign subsidiaries which are essentially investments in those foreign subsidiaries and are permanent in duration.

(f) The Company records uncertain tax positions in accordance with ASC No. 740, Income Taxes. As at December 31, 2018, the total amount of the Company's uncertain tax benefits was \$4,704 (year ended December 31, 2017 - \$4,345). If recognized in future periods, the uncertain tax benefits would affect our effective tax rate. The Company files income tax returns in Canada, the U.S., Italy, and various other foreign jurisdictions. All taxation years remain open to examination by the Canada Revenue Agency, the 2015 to 2018 taxation years remain open to examination by the Internal Revenue Service and the 2013 to 2018 taxation years remain open to examination by the Italian Revenue Agency, and various years remain open in the other foreign jurisdictions.

19. Related party transactions:

The Company's related parties are CWI, Cartesian, directors, officers and shareholders which own greater than 10% of the Company's shares.

(a) Pursuant to the amended and restated Joint Venture Agreement, Westport engages in transactions with CWI (see note 9 (a)). Amounts receivable relate to costs incurred by the Company on behalf of CWI. The amounts are generally reimbursed by CWI to the Company in the month following the month in which the payable is incurred.

(b) Other transactions with related parties:

Peter Yu, founder and managing partner of Cartesian, was elected as a Director of the Company in January 2016 in connection with the convertible debt (note 14(c)) and royalty payable (note 15), which are related party balances. The Company made an interest payment on the convertible debt of \$1,575 in 2018 (2017 - \$919) to Cartesian. In addition, the Company made a payment of \$3,009 (2017 - \$10,935) to Cartesian relating to the royalty payable during the year ended December 31, 2018 and has continued to accrue interest in accordance with the terms of the agreements. In addition, fees of \$250 (2017 - \$250) were paid to Cartesian during the year ended December 31, 2018.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

20. Commitments and contingencies:

(a) Contractual commitments

The Company has obligations under operating lease arrangements that require the following minimum annual payments during the respective fiscal years:

2019	\$	3,594
2020		2,545
2021		903
2022		762
2023		452
Thereafter		—
	\$	<u>8,256</u>

For the year ended December 31, 2018, the Company incurred operating lease expense of \$3,269 (year ended December 31, 2017 - \$4,782; year ended December 31, 2016 - \$5,675).

The Company is a party to a variety of agreements in the ordinary course of business under which it is obligated to indemnify a third party with respect to certain matters. Typically, these obligations arise as a result of contracts for sale of the Company's product to customers where the Company provides indemnification against losses arising from matters such as product liabilities. The potential impact on the Company's financial results is not subject to reasonable estimation because considerable uncertainty exists as to whether claims will be made and the final outcome of potential claims. To date, the Company has not incurred significant costs related to these types of indemnifications.

(b) Contingencies

As disclosed in the Company's previously filed interim financial statements and management's discussion and analysis, on June 15, 2017, the Enforcement Division of the SEC issued a subpoena to the Company for information concerning its investment in WWI and compliance with the FCPA and securities laws related to disclosure in SEC filings in connection with the Company's operations in China. The SEC Enforcement Division issued follow up subpoenas on February 14, 2018, June 25, 2018, and August 2, 2018. The Company has completed its response to those subpoenas. No new subpoenas have been received since August 2, 2018. Westport Fuel Systems is cooperating with these requests and cannot predict the duration, scope or outcome of the SEC's investigation. To date our management has devoted significant time and attention to these matters, and we may be required to devote even more time, attention and financial resources to these matters in the future. The SEC's investigation and our requirements in response thereto could have a material adverse impact on our results of operations, financial condition, liquidity and cash flows. While we cannot estimate our potential exposure, if any, in these matters at this time, we have already expended significant amounts investigating and responding to the subpoenas in respect of this investigation, including funding the expense of independent legal representation, and expect to continue to need to expend significant amounts to conclude the SEC investigation. During the year ended December 31, 2018, the Company recorded expenses related to the SEC investigation of \$9,977, net of insurance recoveries, and to date has recorded aggregate net expenses related to such investigation of \$11,794. Although the Company maintains insurance that may cover some of these expenses, and has given notice to the insurers of the matter, there is a risk that a substantial portion of the overall expenses and costs relating to such SEC investigation will not be covered by such policies. In the event of future proceedings arising out of the SEC investigation, to the extent covered, our ultimate liability may possibly exceed the available insurance.

The Company is also engaged in certain legal actions and tax audits in the ordinary course of business and believes that, based on the information currently available, the ultimate outcome of these actions will not have a material adverse effect on our operating results, liquidity or financial position.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

21. Segment information:

Effective January 2018, commensurate with the commercial launch of Westport HPDI 2.0™, the Company restructured its business segments to allow for further integration of product offerings. Accordingly, from that date, the Westport HPDI 2.0™ product line and all other technology related activities previously reported under the Corporate & Technology segment have been combined with the previously reported Automotive business segment and renamed Transportation.

Under the organization structure in effect from January 2018, the Company manages and reports the results of its business through three segments: Transportation, the CWI Joint Venture, and Corporate. This reflects the manner in which operating decisions and the assessment of business performance is currently managed by the Chief Operating Decision Maker ("CODM"). All comparative figures presented have been revised to reflect this change.

The financial information for the Company's business segments evaluated by the CODM includes the results of CWI as if they were consolidated, which is consistent with the way the Company manages its business segments. As CWI is accounted for under the equity method of accounting, an adjustment is reflected in the tables below to reconcile the segment measures to the Company's consolidated measures.

Transportation Business Segment

Westport Fuel Systems' Transportation group designs, manufactures, and sells alternative fuel systems and components for transportation applications. The Company's diverse product offerings are sold under established global brands and include a broad range of alternative fuels which have environmental and economic advantages including: liquefied petroleum gas ("LPG"), compressed natural gas ("CNG"), liquefied natural gas ("LNG"), renewable natural gas ("RNG"), and hydrogen. The Company supplies its products and services through a global network of distributors and original equipment manufacturers ("OEMs") and delayed OEMs ("DOEMs") in more than 70 countries. Today, our products and services are available for passenger cars, light-, medium- and heavy-duty trucks, high horsepower, cryogenics, and hydrogen applications.

The Transportation segment includes the independent aftermarket ("IAM"), OEMs and DOEMs, the Westport HPDI 2.0™ product line, electronics, current and advanced research and development programs, supply chain, and product planning activities.

An agreement to sell the CNG Compressor business was announced during the second quarter of 2018 and closed in the third quarter of 2018, and as a result, the revenues and expenses related to this business were reclassified to discontinued operations with effect from the second quarter of 2018 and all comparative figures presented have been revised to reflect this reclassification.

Cummins Westport Inc. ("CWI") Joint Venture

CWI serves the medium- and heavy-duty on-highway engine markets. CWI engines are offered by many OEMs for use in transit, school and shuttle buses, conventional trucks and tractors, and refuse collection trucks, as well as specialty vehicles such as short-haul port drayage trucks and street sweepers. CWI is the leading supplier of natural gas engines to the North American medium- and heavy-duty truck and transit bus industries.

All CWI natural gas engines are dedicated 100% natural gas engines. The fuel for CWI engines can be carried in tanks on the vehicle as CNG or LNG. All engines are also capable of operating on RNG.

CWI is a Delaware corporation owned 50% by Westport Power Inc., a wholly-owned subsidiary of Westport Fuel Systems, and 50% by Cummins. The board of directors of CWI is comprised of three representatives from each of Westport Fuel Systems and Cummins. On February 19, 2012, Westport Fuel Systems, Cummins and CWI entered into a Second Amended and Restated Joint Venture Agreement governing the operations of CWI which amended the focus of CWI's future product development investments to North American markets, including engines for on-road applications between the displacement range of 5.9 litres through 12 litres, and to have these engines manufactured in Cummins' North American plants.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

21. Segment information (continued):

The purpose of the joint venture is to engage in the business of developing, marketing and selling spark-ignited natural gas or propane engines for on-highway use. CWI utilizes Cummins' supply chain, back office systems and distribution and sales networks. The joint venture term is scheduled to end on December 31, 2021.

Corporate Business Segment

The Corporate business segment is responsible for public company activities, corporate oversight and general administrative duties, as well as research and development expenses relating to the protection of the Company's intellectual property; in particular, the costs associated with patenting our innovations and registering our trademarks, and maintaining our patent and trademark portfolios.

Weichai Westport Inc. ("WWI")

The Company has not considered WWI a business segment since March 31, 2016 due to the Company's reduced interest pursuant to a sale to the Cartesian Entities as discussed in note 9(b).

Financial information by business segment as follows:

	Years ended December 31,		
	2018	2017	2016
Revenue:			
Transportation	\$ 270,283	\$ 229,833	\$ 167,181
CWI	319,405	317,297	276,465
WWI	—	—	29,931
Total segment revenues	\$ 589,688	\$ 547,130	\$ 473,577
Less: equity investees' revenue	(319,405)	(317,297)	(306,396)
Consolidated revenue from continuing operations	\$ 270,283	\$ 229,833	\$ 167,181
Consolidated revenue from discontinuing operations	\$ 8,837	\$ 46,268	\$ 57,715

	Years ended December 31,		
	2018	2017	2016
Operating income (loss):			
Transportation	\$ (10,706)	\$ (40,638)	\$ (63,608)
CWI	55,411	57,276	29,782
Corporate	(31,511)	(22,256)	(31,923)
Restructuring costs	(808)	(1,682)	(19,000)
Foreign exchange loss	(8,957)	(562)	(6,565)
Impairments on long lived assets, net (note 10)	(736)	(1,550)	(4,843)
WWI	—	—	718
Total segment operating income (loss)	2,693	(9,412)	(95,439)
Less: equity investees' operating income	(55,411)	(57,276)	(30,500)
Consolidated loss from continuing operations	\$ (52,718)	\$ (66,688)	\$ (125,939)
Consolidated income (loss) from discontinued operations	\$ (972)	\$ 909	\$ 4,066

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

21. Segment information (continued):

	Years ended December 31,		
	2018	2017	2016
Total additions to long-lived assets, excluding business combinations:			
Transportation	\$ 10,062	\$ 25,177	\$ 8,181
Corporate	211	111	473
	<u>\$ 10,273</u>	<u>\$ 25,288</u>	<u>\$ 8,654</u>

It is impracticable for the Company to provide geographical revenue information by individual countries; however, it is practicable to provide it by geographical regions. Product and service and other revenues are attributable to geographical regions based on location of the Company's customers and presented as a percentage of the Company's product and service revenues are as follows:

	% of total product revenue and service and other revenue		
	Years ended December 31,		
	2018	2017	2016
Europe	62%	60%	63%
Americas	18%	20%	23%
Asia	10%	12%	12%
Others	10%	8%	2%

As at December 31, 2018, total goodwill of \$3,170 (December 31, 2017 - \$3,324) was allocated to the Automotive segment.

As at December 31, 2018, total long-term investments of \$8,269 (December 31, 2017 - \$8,756) were allocated to the Corporate segment and \$549 (December 31, 2017 - \$546) to the Transportation segment.

Total assets are allocated as follows:

	Total assets by operating segment	
	Years ended December 31	
	2018	2017
Transportation	\$ 236,340	\$ 254,037
Corporate	31,912	42,593
CWI	112,053	131,986
	<u>\$ 380,305</u>	<u>\$ 428,616</u>
Add: assets held for sale	1,676	16,992
Less: equity investee's total assets	(112,053)	(131,986)
Total consolidated assets	<u>\$ 269,928</u>	<u>\$ 313,622</u>

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

21. Segment information (continued):

The Company's long-lived assets consist of property, plant and equipment (fixed assets), intangible assets and goodwill.

Long-lived assets information by geographic area:

December 31, 2018	Property, plant and equipment	Intangible assets and goodwill	Total
Italy	\$ 23,470	\$ 16,067	\$ 39,537
Canada	35,089	237	35,326
United States	1,210	—	1,210
Rest of Europe	2,870	3,695	6,565
Asia Pacific	1,726	—	1,726
	64,365	19,999	84,364
Less: equity investee's long lived assets	(934)	—	(934)
Total consolidated long-lived assets	\$ 63,431	\$ 19,999	\$ 83,430

December 31, 2017 (Adjusted, note 6)	Property, plant and equipment	Intangible assets and goodwill	Total
Italy	\$ 24,660	\$ 19,476	\$ 44,136
Canada	39,732	317	40,049
United States	1,587	—	1,587
Rest of Europe	2,859	4,474	7,333
Asia Pacific	2,211	—	2,211
	71,049	24,267	95,316
Less: equity investee's long lived assets	(1,245)	—	(1,245)
Total consolidated long-lived assets	\$ 69,804	\$ 24,267	\$ 94,071

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

22. Financial Instruments:

(a) Financial risk management:

The Company has exposure to liquidity risk, credit risk, foreign currency risk and interest rate risk.

(b) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company has sustained losses and negative cash flows from operations since inception. At December 31, 2018, the Company has \$61,119 of cash, cash equivalents and short-term investments, including of \$5,095 restricted cash (see note 3(c)).

The following are the contractual maturities of financial obligations as at December 31, 2018:

	Carrying amount	Contractual cash flows	< 1 year	1-3 years	4-5 years	>5 years
Accounts payable and accrued liabilities	\$ 82,851	\$ 82,851	\$ 82,851	\$ —	\$ —	\$ —
Term loan facilities (note 14 (a))	24,023	28,794	7,561	18,340	2,893	—
Senior revolving financing (note 14 (b))	8,645	10,027	2,161	4,918	2,948	—
Convertible debt (note 14 (c))	17,382	21,302	1,575	19,727	—	—
Other bank financing (note 14 (d))	3,744	3,751	2,714	694	343	—
Capital lease obligations (note 14 (e))	1,516	1,566	495	917	154	—
Long-term royalty payable (note 15)	20,935	32,260	6,091	13,184	6,227	6,758
Operating lease commitments (note 20(a))	—	8,256	3,594	3,448	1,214	—
	<u>\$ 159,096</u>	<u>\$ 188,807</u>	<u>\$ 107,042</u>	<u>\$ 61,228</u>	<u>\$ 13,779</u>	<u>\$ 6,758</u>

(c) Credit risk:

Credit risk arises from the potential that a counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash and cash equivalents, short-term investments and accounts receivable. The Company manages credit risk associated with cash and cash equivalents by regularly consulting with its current bank and investment advisors and investing primarily in liquid short-term paper issued by Schedule 1 Canadian banks, R1 rated companies and governments. The Company monitors its portfolio and its policy is to diversify its investments to manage this potential risk.

The Company is also exposed to credit risk with respect to uncertainties as to timing and amount of collectability of accounts receivable and other receivables. As at December 31, 2018, 87% (December 31, 2017 - 80%) of accounts receivable relates to customer receivables, and 13% (December 31, 2017 - 20%) relates to amounts due from related parties and income tax authorities for value added taxes and other tax related refunds. In order to minimize the risk of loss for customer receivables, the Company's extension of credit to customers involves review and approval by senior management as well as progress payments as contracts are executed. Most sales are invoiced with payment terms in the range of 30 days to 90 days. The Company reviews its customer receivable accounts and regularly recognizes an allowance for doubtful receivables as soon as the account is determined not to be fully collectible. Estimates for allowance for doubtful debts are determined on a customer-by-customer evaluation of collectability at each balance sheet reporting date, taking into consideration past due amounts and any available relevant information on the customers' liquidity and financial position.

(d) Foreign currency risk:

Foreign currency risk is the risk that the fair value of future cash flows of financial instruments will fluctuate because of changes in foreign currency exchange rates. The Company conducts a significant portion of its business activities in foreign currencies, primarily the United States dollar and the Euro. Cash and cash equivalents, short-term investments, accounts receivable, accounts payable, and long-term debt that are denominated in foreign currencies will be affected by changes in the exchange rate between the Canadian dollar and these foreign currencies.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

22. Financial Instruments (continued):

The Company's functional currency is the Canadian dollar. The U.S. dollar amount of financial instruments subject to exposure to foreign currency risk reflected in the consolidated balance sheet at December 31, 2018 is as follows:

	US Dollars
Cash and cash equivalents	\$ 8,973
Accounts receivable	1,229
Accounts payable	5,519
Long-term debt, including current portion	34,243
Long-term royalty payable, including current portion	20,935

(e) Interest rate risk:

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company is subject to interest rate risk on certain long-term debt with variable rates of interest. The Company limits its exposure to interest rate risk by continually monitoring and adjusting portfolio duration to align to forecasted cash requirements and anticipated changes in interest rates.

If interest rates for the year ended December 31, 2018 had increased or decreased by 50 basis points, with all other variables held constant, net loss for the year ended December 31, 2018 would have increased or decreased by \$92.

WESTPORT FUEL SYSTEMS INC.

Notes to Consolidated Financial Statements

(Expressed in thousands of United States dollars except share and per share amounts)

Years ended December 31, 2018, 2017 and 2016

22. Financial Instruments (continued):

(f) Fair value of financial instruments:

The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to the short-term period to maturity of these instruments.

The long-term investments represent our interest in CWI, WWI and other investments. CWI is accounted for using the equity method. WWI and other investments are accounted for at fair value.

The carrying value of the EDC loan included in the long-term debt (note 14(a)) approximates its fair value as the loan was executed shortly before the 2017 year end. The UniCredit term loan facility was executed in October 2018 and the interest rates on debt is floating, therefore, the carrying amount as at December 31, 2018 of this loan approximates its fair value. The carrying value reported in the balance sheet for the senior financing (note 14(b)) approximates its fair value as at December 31, 2018, as the interest rates on the debt is floating and therefore approximate the market rates of interest.

The Company categorizes its fair value measurements for items measured at fair value on a recurring basis into three categories as follows:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

When available, the Company uses quoted market prices to determine fair value and classify such items in Level 1. When necessary, Level 2 valuations are performed based on quoted market prices for similar instruments in active markets and/or model-derived valuations with inputs that are observable in active markets. Level 3 valuations are undertaken in the absence of reliable Level 1 or Level 2 information.

As at December 31, 2018, cash and cash equivalents and short-term investments are measured at fair value on a recurring basis and are included in Level 1.