

Conference Call Transcript

Fourth Quarter and Full Year Fiscal 2021 Results: March 15th, 2022

Operator

Welcome to the Westport Fuel Systems Fourth Quarter and Full Year Fiscal 2021 Results Conference Call.

As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions.

I would now like to turn the conference over to Christian Tweedy, Westport's Investor Relations Representative. Please go ahead.

Christian Tweedy

Investor Relations Representative

Good morning, everyone. Welcome to Westport Fuel Systems Fourth Quarter and Yearend 2021 Conference Call, which is being held following the press release yesterday of Westport Fuel Systems' financial results.

On today's call, speaking on behalf of Westport Fuel Systems, is Chief Executive Officer David Johnson and Chief Financial Officer Richard Oraziatti.

This call is open to the public and the media, but questions will be restricted to the investment community.

You are reminded that certain statements made in this conference call and our responses to various questions may constitute forward-looking statements within the meaning of the U.S. and applicable Canadian securities laws. As such, forward-looking statements are made based on our current expectations and involve certain risks and uncertainties.

With that, David, I'll turn the call over to you.

David Johnson

Chief Executive Officer

Thanks, Christian. Good morning, everyone. Thanks for joining us to review Westport Fuel Systems' results for the fourth quarter and Full Year 2021.

Twenty-twenty-one was a good year for Westport Fuel Systems. Despite lingering COVID restrictions, supply chain challenges, and rising commodity prices, we continued our recovery from COVID-19. We set a new annual revenue record of \$312 million, driven by the strength of our OEM business, which was up 31% year-over-year due to record HPDI system sales, combined with strong light-duty OEM sales, especially in India. Our profitability improved year-over-year and we look forward to further improvement as our production increases and economies of scale and operating leverage are realized.

In addition to the positive financial results that demonstrate our resiliency in the face of global challenges, during 2021 we also made significant progress developing and positioning our Company for future success. For example, our purchase of Stako. Completed in May of last year, Stako, based in Slupsk Poland, is a world leader in LPG fuel storage systems. Their comprehensive product portfolio adds to and complements our existing product lines and manufacturing capabilities. Stako's products serve the OEM and independent aftermarket as well as other markets like recreational vehicles and material handling applications. And, we recognized a \$5.9M gain on the purchase. In 2022, Stako will contribute a full year of operating results to our P&L.

Another 2021 accomplishment was the strengthening of our balance sheet by way of an equity raise and by restructuring our debt to lower costs and to align repayment terms with our business plan. With the successfully negotiated exit from Cummins Westport, we've further strengthened our cash position. Also in 2021, we had our initial demonstration of hydrogen HPI. This technical success has led to new hydrogen HPDI projects with Scania, AVL, and 2P, and as announced in February, now also with Cummins.

In our view, the demonstrated capability of HPDI is a hugely important development for Westport Fuel Systems, which dramatically improves the potential for our near term and long-term success with HPDI. Internally in 2021, we brought the Company together into a single, global organization so that we're poised to bring all our capabilities to all our customers in

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markets around the world with efficiency and effectiveness, enabled by unlocking synergies throughout our global team.

Despite the various challenges we've faced over the last two years and despite the challenges we face today and the new challenges that will come tomorrow, fundamental market drivers continue to support a positive outlook for Westport Fuel Systems. The climate crisis is still a priority. Clean air is still a priority. Affordable transportation is still a priority. COVID, supply chain problems, inflation even war... none of these diminish the challenge we face to keep the world moving without fouling the air and endangering our lives, our climate and our planet. We owe this to society and to our children.

Global transportation is responsible for roughly a quarter of greenhouse gas emissions, so we must continue to use all available options to clean the air and reduce CO2 emissions from transportation. We must do so quickly and effectively. To move quickly, we need clean technology NOW. To be effective, we need scale. To achieve scale, we need practical, affordable solutions.

Westport Fuel Systems products are Affordable, Effective, Practical and Available Now.

Our strategy stands on three pillars that enable progress towards our financial goals of \$1 billion in revenue, 20% gross margin, and 10% operating margin. First among them, principled growth. Growth that's realized through a diverse portfolio of technologies, products, and services, delivered by a team that's focused on doing the right thing in the right way and making a difference in our world. We're focused on satisfying the demand for clean, low emissions transportation in Europe, India, North America, and China. As we've done in the past, we'll continue to complement our organic growth by adding products and scale through relevant M&A activities.

Second, quality and reliability are fundamental to our performance as a leading tier one supplier of clean, affordable fuel systems. We must reliably deliver high quality products with high production efficiency to enable low cost and to achieve the scale necessary to make a difference in our world and for our stakeholders.

Third, through innovation and technology we deliver transportation solutions that power a cleaner future. Advances in our HPDI fuel system technology, including HPDI 3.0 and hydrogen HPDI will lead to growth and prosperity, including the ability to reuse our customer's capital

investments in manufacturing supply chain infrastructure, while achieving their goal to satisfy their customers' needs and government regulations, while reducing carbon emissions.

Ultimately, the foundation for our strategic pillars is the continued strength of our organizational capability and a focus on operational excellence. Our people are at the heart of what we do. We are one company, working together to deliver valuable, impactful products and services to customers around the world, enabling an affordable transition to a decarbonized transportation sector.

In the marketplace around the world, we continue to see evidence that clean, affordable, gaseous fuels are a growing part of the transportation marketplace, even in or rather especially in challenging economic times. LPG, CNG, LNG, bio methane and soon, if not already hydrogen, will add resiliency to our global transportation system and do so cleanly and affordably. Global initiatives regulations demand clean vehicles. Customers demand practical, affordable vehicles. Let me share a few examples.

Markets are responding right now by adding more refueling infrastructure, like in Europe where the number of LNG stations doubled in just the last two years. Today there are 521 LNG stations according to MGBA Europe and the fuel in those refueling stations is getting greener, as biogas continues to grow. More than a quarter of the gas used in road transportation in Europe today is from renewable sources.

Likewise in India, we also see compelling growth for natural gas vehicles. Infrastructure there has recently doubled to more than 3,200 stations and the government continues to champion their plan to reach 10,000 stations within this decade. OEMs in India are dropping diesel engines and moving to natural gas at a rapid pace. Westport Fuel Systems is well placed with the right products to support the growing demand.

Another example, government support. The European Union has just recently added natural gas as part of its taxonomy, a significant endorsement that can help make the EU more efficient in the use of energy and more resilient to energy price spikes, while providing affordable and clean energy to end users. Another form of government support, incentives. We observed in Italy late last year that the Italian Transport Ministry announced a decision to confirm, increase, and expand incentives for the purchase of LNG trucks. The decree for highly sustainable

investments makes €50 million available to transport companies through 2026, paid exclusively for the purchase of new, ecological, alternative fuel vehicles, including LNG powered trucks.

Another one, renewables. We have seen encouraging biogas developments in the past few months. In Germany, the share of bio methane supplied at stations has already reached 80%, moving towards 100% in 2022. Swedish Biogas, a leading provider of biofuel in Scandinavia, saw increased sales to the haulage sector of 145% in 2021 compared to 2020, citing a 30% to 35% price differential for heavy-duty trucks, a significant cost reduction and a solution available here and now for long distance heavy transport that wants to switch to fossil fleet transportation.

Finally, ultimately, market share growth. Earlier this month the European Automobile Manufacturers Association, that is ACEA, published vehicle registration statistics for 2021. Alternative fuels, which include natural gas, LPG, biofuels, and ethanol accounted for the vast majority of the alternatively powered trucks sold across the EU in 2021, with a total market share of 3.6%, up 40% from 3% in the prior year. While at the same time, the registration of hybrid electric trucks is down 55% versus the prior year. We're seeing a growing number of stories and advancements like this in our space, creating a very encouraging outlook for our product portfolio. OEMs without LPG, CNG, or LNG options today are at a disadvantage that our clean, affordable product can help them overcome.

As you know, HPDI has been and will be a critical part of our path to growth and to profitability. Let me point out some of the key developments. First, production and sales of HPDI 2.0 continue to increase as evidenced by our top line growth and increasing weight of our OEM businesses, which reached 62% of our revenue in 2021.

Second, we're developing HPDI 3.0 for our customers. This next step for HPDI enables the use of HPDI with next generation engines that use higher working pressures to achieve even higher efficiency and higher performance.

Third, we're developing HPDI with hydrogen. This combination of our technology with green hydrogen offers more power, more torque, and more efficiency than an IC engine fueled with either natural gas or diesel. We have demonstrated and documented its performance, including the economic advantage that hydrogen HPDI offers as compared to fuel cell technologies in heavy-duty long-haul applications. Hydrogen HPDI lengthens and broadens the appeal of our proprietary HPDI technology, reaching all the way to zero carbon green hydrogen future that so

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many are pursuing today with massive financial commitments from both government and private sources.

We're pleased with the developments we've already concluded and those we have underway and look forward to sharing more data with you later this year. In the meantime, I point you to the white paper analysis we recently posted on our website showing our expectations to achieve 52.5% break thermal efficiency, using hydrogen HPDI on a state of the art 13-litre truck engine. This 52.5% BTE figure corresponds to a 5% reduction in energy consumption relative to the same engine platform operating with diesel fuel. This is a big deal. This will make IC engines with HPDI the best way to use green hydrogen for long-haul heavy-duty transportation applications.

I'd also like to provide an update on China where HPDI's powered vehicle models have been certified and field trials are ongoing. We're continuing to work with our partner to launch our HPDI 2.0 product successfully with their OEM customers. Multiple OEMs are working to integrate HPDI equipped engines into their trucks and bring those trucks to market. We're confident that HPDI equipped trucks will enable substantial market growth in China, increasing the share of natural gas in Chinese trucking market beyond today's already significant 10% market share. Westport Fuel Systems looks forward to being part of that growth.

We are in parallel, continuing our discussions with other potential partners in China as the interest in HPDI, particularly hydrogen HPDI is growing in China, too. Just recently, China National Petroleum Corp. launched a roadmap for the country's energy sector to meet goals of carbon peaking by 2030 and carbon neutrality by 2060. They forecast a transportation energy mix, including hydrogen at 23.7% and natural gas at 10.7%, a strong endorsement for these two fuels.

Before Richard takes us through the financials, let me address the proverbial elephant in the room. I'm talking about Russia, Ukraine, and fuel prices. You may have noticed in our press release that Russia market is relevant for us, representing 10% to 15% of our light-duty business through both our after market and OEM channels. We expect this to be directly effected by the conflict and have already seen the beginning of those effects, including the reports of shortages affecting production and delayed processing of transaction through the financial system.

In addition, the conflict in Ukraine seems likely to further exacerbate the supply chain issues we

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face as well as put pressure on fuel availability and pricing. I want to call out three factors that don't all point in the same direction making the near term future rather unclear:

First, higher fuel prices. Commodity fuel prices are up dramatically including Crude Oil and LNG. Higher fuel prices tend to be positive for our business as it intensifies the search for products and technologies that can reduce fuel expenses. Gaseous Fuels have often been the remedy for high diesel and petrol prices.

Second, fuel price differentials. When gaseous fuel prices are lower than petrol and diesel, then our markets strengthen. When gaseous fuel prices are higher than diesel and petrol then this is a headwind for us. We are seeing both effects right now, as in some markets, for some fuels, we have an advantage, while in others, we are at a disadvantage. Of course, what matters is what drivers see at the pump which has some relationship to commodity prices.

Third, Volatility... as prices change, market participants can pause their decision-making waiting to see what the new normal will be. This is categorically unhelpful to all of us.

While it is hard to predict the future, especially these days, we remain confident that our products will continue to deliver and expand our market share in response to the persistent need for clean, affordable transportation. We saw this through COVID and we expect to keep seeing it through the current challenges. We are keeping our focus on this long term outlook while we work to mitigate the near term challenges as we have successfully done before.

With that, let me hand it over to Richard.

Richard Oraziotti
Chief Financial Officer

Thanks, David.

In the fourth quarter, we generated revenues of \$82.7 million, which decreased YoY by 1.4%. The decrease was mainly attributable to slightly lower HD OEM sales volumes and a contractual

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price reduction to our initial OEM launch partner. Lower HD OEM revenue was partially offset by the addition of fuel storage revenues from the acquisition of Stako in the second quarter this year.

The fourth quarter was challenging for gross margin as we generated \$9.3m, which was a decrease YoY of 28.5%. Besides the impact of lower HD OEM sales volumes and the price reduction, gross margin was pressured by lower sales volumes affected by elevated and volatile fuel prices, lower margin sales mix to emerging markets in both LD OEM and IAM and higher material cost resulting from global supply chain disruptions and inflation.

Net income was \$5.4m for the quarter, an improvement of \$1.3m YoY. The CWI joint-venture had a stronger than expected fourth quarter generating \$15m to our account, which primarily drove the increase net income, and was partially offset by the lower gross margin.

Revenues for the full year 2021 increased 24% to \$312m due to the continued recovery of sales volumes in our OEM and IAM businesses and the addition of \$13.8 million in revenue from our fuel storage business. In 2021, we generated 21% higher sales volumes to our initial OEM launch partner in HD OEM; saw rapid growth of LD OEM volumes in India & experienced a recovery in sales volumes in IAM notwithstanding the headwinds from the pandemic, supply chain disruption, and fuel price volatility. Further, we are seeing growth in our newer businesses in Electronics and Hydrogen.

Gross margin increased significantly YoY by 22% to \$48.2m mainly due to higher sales volumes across all our businesses and the addition of the fuel storage business. This was partially offset by the HPDI price reduction, a lower margin sales mix in IAM, and higher material costs caused by the supply chain shortages, which we were not able to pass on effectively to our customers. FY 2020 also included large COVID-19 related wage subsidies offset by a \$2.4m field campaign charge

We reported net income of \$13.7 million for the full year 2021 compared to a net loss of \$7.4 million for the prior year. The improvement in net income was driven by several factors, primarily by the increase in gross margin of \$8.7 million, \$9.7m in higher income from CWI, an income tax recovery of \$8.9 million related to an Italian Government COVID-19 tax relief program, and a bargain purchase gain of \$5.9 million on the acquisition of Stako. This was partially offset by \$5m less in government subsidies received compared to 2020.

Adjusting for non-recurring items per our definition of Adjusted EBITDA, we generated \$17.5 million in Adjusted EBITDA in 2021 compared to \$14.7 million in the prior year.

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Revenue for fourth quarter of \$57.4m was marginally lower than \$58.8 million in 2020. Revenue decreased by \$1.4 million in the fourth quarter due to lower HPDI sales volumes to our initial OEM launch partner and the negative impact of the price reduction given at the beginning of the year. Delayed OEM revenues were also worse YoY due to lower sales volumes caused by supply chain shortages of vehicles to convert from our OEM partners. This was partially offset by additional revenue of \$6.7 million from our fuel storage business.

For the full year, OEM revenue of \$195.5m increased by \$45.9 million or 31% over the prior year. The increase was mainly due to the aforementioned higher sales volumes in our heavy-duty and lightduty OEM businesses, \$13.8m in fuel storage, and increased sales growth in our electronics business. The impact of COVID-19 was significant in the prior year period, which was impacted by plant shutdowns combined with lower light-duty OEM sales to German and Russian OEMs. Although HD OEM revenue was higher YoY from better sales volumes, the positive momentum on customer demand was impacted by manufacturing delays caused by the shortage of semiconductors on our initial OEM launch partner. Although the long term outlook for HPDI sales volumes is positive, there is also near term pressure on sales volumes caused by the rapid increase and volatility in LNG prices.

For the fourth quarter 2021, gross margin decreased YoY by \$1.5 million to \$5.1 million, or 9% of revenue compared to \$6.6 million, or 11% of revenue, for the same prior year period. The decrease in gross margin and gross margin percentage was mainly due to an increase in material costs stemming from the global supply chain disruption across all business segments, increasing sales mix of light-duty OEM sales to India and the aforementioned HPDI price reduction. This was partially offset by additional gross margin from the fuel storage business. As India will play an important role in our LD OEM growth strategy, we are evaluating opportunities to localize production and other value creation initiatives to improve our margins.

Revenue for the fourth quarter and full-year 2021 were \$25.3 million and \$116.9 million, respectively, compared with \$25.1 million and \$102.9 million for the same prior year periods. Revenue growth in 2021 was primarily due to higher sales to African and South American markets, offset by softness in demand from the Russian and Turkish markets due to the rapid increase in LPG prices. We expect to see continued improvement in revenues from the IAM business segment for the full year of 2022, but temper expectations in the near term due to volatile LPG prices in our key markets and disruption from the Russia-Ukraine conflict.

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Gross margin decreased significantly year-over-year by \$2.2 million to \$4.2 million, or 17% of revenue, this past fourth quarter compared to \$6.4 million, or 25% of revenue, for the same prior year period. The decrease in gross margin and gross margin percentage was due to the evolving change in sales mix toward lower margin African and other emerging markets, slower than expected recovery of sales volumes in Western Europe and higher material costs due to the global supply chain disruption. The prior year also benefited from government subsidies, which resulted in a higher gross margin percentage. To counter this margin pressure we are actively pursuing cost rationalization, manufacturing productivity enhancements and sales volume growth.

As we have discussed over the quarters, we made great strides to strengthen our balance sheet and liquidity to fund the growth in our HD OEM and other business plans through raising equity and refinancing our debt to better match the expected organic cash flow profile to the debt repayment. As at year-end, our cash position was \$124.9 million, and our debt was \$79 million.

During the fourth quarter, we closed the refinancing of our loans with our banking partner Export Development Canada into one \$20m term loan repayable over five years. We are very appreciative of the support and relationship EDC has and continues to provide WFS.

Another significant boost to our near-term liquidity was derived from the termination of the CWI joint-venture. On February 7, 2022, we agreed to sell 100% of our shares in CWI to Cummins Inc. for proceeds of approximately \$22.2 million, along with our interest in the joint venture's intellectual property for an additional \$20.0 million. We received proceeds of \$31.4 million, net of a \$10.8 million holdback, after the closing date.

Moving away from financing activities, net cash used in operating activities was \$43.8m in 2021. The use of cash is driven by operating losses of HD OEM business due to lack of scale, and a large increase in working capital, specifically inventory caused by a build up of HD OEM inventory for customer growth, supply chain disruption and inflation.

We are proactively managing our working capital to monetize the inventory and optimizing purchasing levels in the evolving supply chain landscape. Risks from the Russia-Ukraine conflict and volatile fuel prices will also cause near-term pressure on revenues and margins. Although the headwinds in 2022 are very challenging, we believe the long term fundamentals of our products to deliver affordable, clean transportation solutions will prevail.

With that, I would like to turn it back to David.

David Johnson

Chief Executive Officer

Thank you, Richard. To recap, I'm proud of our team. We made important progress in our strategic positioning for the long-term and we recovered from the pandemic and supply chain challenges in the last two years. Despite the new challenges facing us in 2022, we see the need for our product and the need to decarbonize transportation will persist.

In the coming months, you'll find us participating at various investment conferences, including but not limited to the Cormark Inflection conference, Oppenheimer's Annual Emerging Growth conference, and the RBC Capital Markets Automotive conference. We'll be participating at the ACT Expo in Long Beach, California in May, which is North America's largest clean transportation, technology, and clean fleet event where we'll be providing an update on our latest development with hydrogen and HPDI.

With that, I'd like to turn it back to the Operator for your questions.

Operator

Thank you. We will now begin the question-and-answer session.

Our first question comes from Eric Stine of Craig-Hallum. Please go ahead.

Eric Stine

Hi David. Hi Richard.

David Johnson

Chief Executive Officer

Good morning.

Eric Stine

Good morning. Maybe just to start with HPDI 3.0 if you could give a few more details there. I know you mentioned performance benefits. Curious if those are HPDI related or because it's on the, as you said, the next gen engine platforms out there. Then just wondering what your activity level is with this technology to date, whether you've got current development programs going on right now.

David Johnson

Chief Executive Officer

Yes, excuse me, great question. Glad to talk about HPDI 3.0. I think the context, just to paint the picture of that needs to be real clear. In the market, in the media today, many people think the internal combustion engine is going away. But yet, we see with our partners around the world that people are continuing to invest in advancing the internal combustion engine. The development of internal combustion engines is far from complete. There's always more improvement that can be made. Fundamentally, in this day and age that means lower emissions from the base engine and more performance, more efficiency from the base engine.

For us as a fuel systems supplier, that means that we need to upgrade our fuel systems to match the engine improvements that are being made. Very specifically, basically, to make cleaner, more efficient engines, you—the diesel engines—you up the working pressure in the combustion chamber. As the working pressures go up, the pressures for our fuel systems need to go up to match and keep pace. That's what we're doing. That work to basically increase the capability of our systems to match and complement the upgrades to the base engine. We see this across the industry in the work we're doing with various customers for applying our technology, whether it's with hydrogen or natural gas.

Eric Stine

Okay, that's helpful. Maybe just turning to hydrogen a little bit here. I know HPDI, along with the rest of your business near term, it's a little tough to call given a lot of cross currents. But if you think about hydrogen in the HPDI version, just curious how that might be helping the LNG HPDI version, or discussions with OEMs given that maybe they don't hesitate to go HPDI with LNG if they have the potential to migrate to something down the road. Obviously, everyone's got to be looking at hydrogen.

David Johnson

Chief Executive Officer

Yes, the process our customers and OEMs around the world are going through, evaluating different technologies, and trying to choose the path forward. If they could put all eggs in one basket it's because they were sure what the future lay ahead. This is an ongoing, evolving process as they learn about different technologies. When I talk different technologies, I'm including the full list of electrification and fuel cell and even autonomy, all the things that you read about and hear about in the industry today.

With respect to our hydrogen development, we see this as helping our customers to understand the potential for a green hydrogen future in long-haul trucking and what that economic and technical equation looks like. As per the paper that we published last year, in combination or partnership with AVL, we see our HPDI with hydrogen as a very economic and really an easy path forward to use green hydrogen very effectively because we have this significant efficiency improvement versus diesel and natural gas on an internal combustion engine, using hydrogen and HPDI. But also, offers more performance, more power, and more torque.

Better efficiency, more power, and more torque gives it an advantage that even extends its lead over other technologies from a technical standpoint and also a commercial standpoint where it's very affordable to adopt HPDI onto an internal combustion engine, as compared to the alternative of creating a fuel cell vehicle. This really is an education process that as we generate more data and demonstrate to customers, like the partnership and project that we're doing with Scania. This then factors into their work and their decision making on where to place their bets and what priorities to make internally for future technology.

I'll say seeing that HPDI can take an OEM all the way to zero carbon hydrogen with more power, more torque, and more efficiency than they have today on their engine is a really compelling vision that allows them then to think about, okay, let's consider HPDI even sooner and we can use it today with fossil natural gas and biogas. This trend I mentioned a few moments ago about the biogas increasing, it's a share of the fuel supply to the marketplace is really important for everybody's mission to try and commit transportation. Reusing natural gas or methane that would otherwise go into the environment is a truly beautiful environmental reuse scenario that HPDI enables.

Eric Stine

Okay, great. Thanks, on that. Maybe last one for me, just some thoughts on plans in North America. I know it's only been, what a month and a half since or a couple months here since the end of CWI. But just maybe, what your current thought process is on North America.

David Johnson

Chief Executive Officer

Yes, the North American business case for natural gas is also improving right now. I mentioned in my comments that these fuel price differentials are really the driver of our business, and we see a widening gap for basically in North America, diesel prices are going up more than natural gas prices. The advantage for natural gas is growing in this moment. That's a positive sign.

Additionally, as mentioned in my comments, we'll be going to the ACT Expo this year. We really look forward to joining that, let's say on our own as Westport Fuel Systems this year and showing the trucking industry what we have to offer with HPDI for natural gas, HPDI for biogas, and HPDI with hydrogen. These are really great combinations of fuels and our technology that can be an important part of what trucking does in North America. We're eager and excited.

We recognize at the same time there are steps that need to be taken. Some of our customers around the world, of course, are already present in North America, so we're hopeful that that could accelerate the path towards commercialization in the near future.

Eric Stine

Okay, thanks David.

David Johnson

Chief Executive Officer

Thank you, Eric.

Operator

Our next question comes from Rod Brown of Lake Street Capital Markets. Please go ahead.

Robert Brown

Hi, good morning. Thanks for taking my call. Really around the—the questions around the EU market and what are you seeing in terms of visibility now in the HPDI heavy-duty market in terms of demand with pricing. Is it, how much are you seeing it decline? Has it happened yet or are you just getting cautious on it? Just some colour about how that market is trending now with the pricing environment?

David Johnson

Chief Executive Officer

Yes, good morning, Rob. Thanks for your question. In the EU market right now, we are facing higher LNG prices than we have historically and that is for sure, some headwind for our business. Additionally, the Russia-Ukraine conflict and the shut off of or the not realization of Nord Stream 2, all these things weigh on the marketplace relative to our product.

We have seen some moderation of demand, let's say but we're hopeful that that's a temporary thing. In the end, I can remember two years ago when COVID was being unleashed, we saw a moderating of demand then as we worked through what's the new normal going to be, what's required in the future.

My expectation is that this is temporary. In the end, I'm very comfortable with the fact that we need to move goods and we need to do it cleanly, and our systems enable that in an economic way on an ongoing basis. We'll have to see where it all shakes out but for the near term, some moderation and hopefully recovery in the coming quarters.

Robert Brown

Good, and then I think Richard said that you expect the independent after market to grow in '22, despite these headwinds. I just wanted to clarify that what's your view on growth in the independent after market in the current environment?

David Johnson

Chief Executive Officer

Yes, I would tell you that the independent after market is already a sizable business around the world for us, on the order of a third of our revenues. We're not expecting super strong, a doubling, or tripling type growth but nonetheless, we do see opportunities in various markets around the world that really are opening up and becoming new markets for us. We had mentioned in prior discussions Egypt, Algeria, India.

We had currently in last period seen some softening in places like Turkey and Poland but now with the outbreak of the conflict, I think LPG becomes increasingly something that local governments have and can make available. We have some of the largest price differentials today between petrol and LPG in various markets in Europe and we do expect that to persist and to drive our growth in those markets.

We're hopeful and our outlook is positive in respect to the after-market business continuing to be an important part and a growing part of our business.

Robert Brown

Okay, great. Thank you. I'll turn it over.

David Johnson

Chief Executive Officer

Thank you, Rob.

Operator

Our next question comes from Amit Dayal of H.C. Wainwright. Please go ahead.

Amit Dayal

Thank you. Good morning, everyone. David, just with respect to the macro developments in Russia, EU, etc. Are there any accounts receivables or funds tied to those markets that may be at risk?

David Johnson

Chief Executive Officer

We're monitoring this very carefully and you could imagine with respect to our business in Russia that with all the sanctions being put in place there's a high degree of anxiety and let's say, additional friction in the system, so that I mentioned in my comments some slower payments. I think that's just the banks being careful to make sure that they follow all the sanctions precisely.

We're not doing business today with any government entities in Russia and but yet we have customers in Russia who are seeking clean transportation, affordable transportation. We aim to

continue to help those customers access those. But it sure is getting more and more challenging as the days of this conflict roll on and so our outlook on that business is quite guarded. But we could see it actually come all the way to a zero in the future, depending on what happens. But frankly, we don't know.

Nonetheless, we are being very let's say cautious about what we do and changing our terms to our customers so that we get paid in advance and things like this. We don't see any significant risk from that perspective, just something to be managed.

Amit Dayal

Understood. The gaps from that market towards revenues and margins, etc. are there other avenues for you to maybe make up some of those or do you just have to get through this, and that situation has to normalize before you can make some recoveries from those markets?

David Johnson

Chief Executive Officer

It's truly hard to say. What I think in general is that we should expect that our sales in Russia will decline and so that's a pressure on us. Nonetheless, one of the advantages we have as a company is that we are present in 70 markets around the world. Russia and the Ukraine are just two of those markets. We have lots of opportunities in other places. As mentioned earlier, this price differential between petrol and LPG, for example, in a number of markets is widening as opposed to shrinking. We do see some bright spots in the business around the world and we're hopeful those will offset or more than offset any decline that we have in Russia. That will be a challenge for us but certainly our goal.

Amit Dayal

Understood. That's all I have for now, David. I'll take any other questions offline. Thank you.

David Johnson
Chief Executive Officer

Thanks Amit.

Operator

Our next question comes from Colin Rusch of Oppenheimer. Please go ahead.

Colin Rusch

Thanks so much, guys. Can you talk a little bit about the Cummins testing process and the duration, how long you think it's going to take before you're able to get some sort of result you can speak about?

David Johnson
Chief Executive Officer

This for us is (multiple speakers 0:40:16).

Colin Rusch

Sorry, yes, just specifically on hydrogen. Sorry to clarify that.

David Johnson

Chief Executive Officer

Yes, no problem. Yes, the work we're doing with Cummins is as announced on hydrogen. We are getting that started now and I expect that to be completed within the year. The actual pace isn't something we control because we do it with our partner and so there's, as you saw with our work with Scania last year, there could be some big delays. We don't expect the big delay that we had with Scania to be the case with Cummins but it's to be demonstrated, as opposed to known in advance. But I think I can say confidently we'll have some progress within this year.

The secondary factor that will matter to you, Colin, and the marketplace is okay, when we finish that work, what does Cummins say allow us to say in the marketplace. Our customers have that important right to decide what we say as a supplier, and so we have that as the highest priority in our to do list, if you will.

Colin Rusch

Sounds good. Then just around the supply chain, obviously you guys saw some of this stuff come in early around back in 2020 around COVID and pulling things in to have inventory on hand. With some of the things that we're seeing right now in China and potential for some other disruptions, given the conflict in Europe, what can you talk about formable (phonetic 0:41:47) points in your supply chain now and how you're managing that.

David Johnson

Chief Executive Officer

Yes, I would tell you that we haven't had any severe problems at this point in time but we're absolutely on top of it with respect to trying to manage the supply chain and these sanctions that come into place are something that cannot be ignored and have to be abided by, so that's what we do. At the same time, we're not sourcing any materials from Russia, and we don't have really a big exposure to Ukraine.

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I'd say the one commodity that is challenging for us is steel for our plans at Stako. This is kind of one example. Nonetheless, there are other sources and so far, we haven't been able to—we haven't had any trouble that we haven't been able to mitigate. But I would tell you it's yes, there's some anxiety associated with it because we don't know what tomorrow holds and we're working very hard to do that without having to increase our inventories the way we did through the COVID period. Hopefully, we're in a good place and we'll manage it day by day.

Colin Rusch

Great, thank you so much.

David Johnson Chief Executive Officer

Thanks, Colin.

Operator

Our next question comes from Bill Peterson of JP Morgan. Please go ahead.

Bill Peterson

Yes, hi. Good morning and thanks for taking my questions. I know you refrain or wanted to refrain from providing forward guidance but the Russia-Ukraine started towards the end of February. Can you comment just on the demand trends with the OEM and are you at least heading into that, at least if not quantitatively, at least qualitatively?

David Johnson

Chief Executive Officer

Yes, sure, Bill. It's good to hear you this morning. As a general premise, we had a good fourth quarter and we've seen a little bit of softness in the first quarter so far. But generally, we have demand and order books that yes, are not as exciting as we'd like to see but they're okay so far. We have not seen a tail off in demand. In fact, we've seen some uptick in demand in certain markets around the world as people recognize these big price differentials and customers are interested in our products.

On one hand and so super ambiguous answer, I apologize because what we've seen basically is we're seeing this kind of continuation of recovery trend coming out of COVID that we saw in '21, coming into '22 at the same time that we're seeing this anxiety driven and volatility—fuel price volatility driven anxiety that kind of tempers the market. Hence, no guidance for today because it's really challenging to see how this will all play out near term and through the later parts of this year. How long will the conflict last for example and what will all the actions be taken around the world.

Nonetheless, my overriding principle here and thought is that in tough times, people go looking for less expensive ways to move and access to lower cost fuels. I think that price differential is really the key driver in markets around the world for us. It has been always, and I expect it always will be going forward.

Bill Peterson

That's helpful. Thanks for that. I guess maybe just speaking on the cost side and also some of your cash outlays and so forth. Again, I understand you may not want to provide quantitative, but how should we think about your OpEx trajectory, as well as CapEx given, I guess some of the positives or near-term dynamics? How should we think about that trending through the year for 2022?

Richard Oraziotti

Chief Financial Officer

I want to take that one, Bill. Like in terms of CapEx, we're within the range of \$15 million to \$20 million, depending on our programs. I mean, we're obviously trying to rationalize our CapEx to be a little bit prudent during this period of time. The HPDI itself, as David mentioned earlier at the outset of the call, like the HPDI 3.0 there's sort of longer-term programs that it would be foolish for us not to continue. We're on a timeline with our launch partner, so those things will have to continue but \$15 million or so would be a good number, in terms of CapEx.

In terms of OpEx trends, material costs and inflation are showing up and we sort of provided that guidance in there. Having said that, obviously we're taking actions to offset those through our other productivity initiatives that we had ongoing there. For the time being, I would say they're relatively stable in terms of percentages. We're spending more on R&D. You'll see that sort of show up in our P&L. The G&A should be more or less the same as you see there.

Margins are the ones that are coming a little bit more under pressure and unfortunately, it's a little bit hard to model that, just given how many markets we're in. The fourth quarter was particularly bad, we'll say, compared to where our expectations are. We obviously, we're working to improve those margins to get, we'll call it more of our targeted rates there.

Bill Peterson

No, that's good colour. Maybe just a big picture question. Again, recognize that it's hard to call how some of these geopolitical things turn out but if we were reconvening a year from now, what are the key milestones we should be looking out for? What would you have accomplished during this year that we would look back on and call it a success?

David Johnson

Chief Executive Officer

Yes, so let me just look back on 2021. I think really important in 2021 were the developments that we started with customers. One of the key markers that I think about is when we're installing our HPDI fuel system on a new engine, almost doesn't matter what fuel we're going to use. That's a really important step towards starting a program that will lead to production for me. We can't get to the finish line unless we get to the start line and get started.

The work we're doing with Scania, the work that we announced with Cummins, the project we have with AVL and 2P. I expect all of these will have really important milestones through this year and some of those milestones will be announced, hopefully and will show progress towards further commercialization of HPDI.

We're still pursuing our business interests in India and in China and see really great opportunities there. I look forward to having more to talk about through this year for both of those markets also. Yes, I think there will be some really important business progress that we can share with the market through this year, and you should definitely look for that.

Bill Peterson

Thank you.

Operator

Our next question comes from Mac Whale of Cormark Securities. Please go ahead.

MacMurray Whale

Hi, good morning. I was just wondering, just a little bit of detail on the effect that a narrowing in the spread between gaseous fuels and diesel and gas may have had in terms of how long

does it take for that to recover or to kick in when you see that swing from one direction to another?

David Johnson
Chief Executive Officer

Yes, it's a really good question. It doesn't have a closed form answer because frankly, it depends on the products and the markets and the channels.

MacMurray Whale

Okay.

David Johnson
Chief Executive Officer

We sell, right. We sell products for three wheelers in India that are super inexpensive. We sell high end HPDI systems in the European market for big trucks and everything in between. Every market is a little different and so we sell directly to OEMs as we've got this channel through the OEMs where they also have dealers in inventory. I would tell you there's all these lags in the system that really make it hard to categorize as we see it within three weeks, or we see it within three months.

MacMurray Whale

Okay.

David Johnson

Chief Executive Officer

But in general, the other thing I would point to is that most of the markets around the world have some kind of what they consider normal, right. That's a 30% discount on a gaseous fuel versus petrol or a 35% discount to diesel between LNG. When that moves, if it moves a couple percentage points this is normal. We're always used to this at the pump that the pricings move. But when you start to notice it, like hey, wait, those prices are close to the same and they used to be different, that does effect the consumer behaviour and the fleet behaviour, and this comes back through the system to us. But the time constants are tough to call and tough to categorize, it's just one.

MacMurray Whale

Okay, and does that—would you say that that's basically a lost sale? Is that a situation where say a fleet manager is looking at replacing a vehicle and it's like, okay we're replacing that one this quarter or this period of time. You're not going to see that until that's replaced on the next cycle or is it a delay and then a pent-up demand?

David Johnson

Chief Executive Officer

Yes, I think it's more the latter. I think it's more a delay, especially with respect to volatility. When fuel prices are volatile then it's like, well, I was planning on buying 20 trucks every quarter or 10 trucks every month, or whatever the sequence is that normal fleets are going through, depending on their fleet size and their buying behaviours and patterns. They say well, let's wait and see before I place that order.

I tend to believe in most cases it's more delay than it is dropping of that order. It does come back, (multiple speakers 0:51:55) assuming the conditions come back, right.

MacMurray Whale

Yes. Yes, that makes sense. I guess whether you're going to downsize or upsize your fleet is more about the fleet outlook on their business, as opposed to how.

David Johnson

Chief Executive Officer

Yes, that's right.

MacMurray Whale

Yes.

David Johnson

Chief Executive Officer

Yes, that's right. Basically, fleets are buying some mix of natural gas vehicles, different technologies and so forth and it's really that decision on the mix and what they're going to buy. Then when economic times are challenging, they sometimes delay. Instead of buying 10, they'll only buy five or change their order timing. All those things are the behaviours of fleets that are pretty consistent around the world in terms of how they behave. It's based on macroeconomics and fuel prices.

MacMurray Whale

Yes, okay. Then Richard, I think you already answered a question on the R&D. I'm thinking about the OpEx. What percentage of that spend of the OpEx in general or maybe you wanted to talk about R&D is would you say is stuff you're going to spend regardless of your revenues

and margin. Is it like how do you budget? I'm trying to fish for the question. What level of OpEx spending is not negotiable because you're looking at certain programs that just aren't going to be impacted by quarters of revenue or margin. You just say we're doing this this year and so we're going to spend X millions on this. I'm wondering what, how big that is.

Richard Orazietti
Chief Financial Officer

I would say on the R&D, probably I would say 90%.

MacMurray Whale

Okay, yes.

Richard Orazietti
Chief Financial Officer

To 100%. We're pushing that. We raised the money specifically because the Company itself was starving itself over a period of time there. Let's say between the period of 2016 to even up to 2020, obviously going into COVID. Now, we're trying to accelerate, especially on the heavy-duty side. There were certain things that needed to and now need to get done. That's why more towards the 100% on R&D. We're trying to always optimize the spend of where we do work.

Where you would actually see, we'll call it, austerity measures, as we're going to go through this year, obviously the Russian crisis causes us problems. There is just a bunch of headwinds, unfortunately that have all shown up at the same time. That obviously G&A and OpEx are the ones where we'll look at the discretionary spend there.

MacMurray Whale

Right. Then is that, when you look at the trends, obviously you had more cash on the balance sheet. It went up in '21 by single digit millions, \$4 million or \$5 million or so. Do you then—does that incrementally go higher from there again or is it more a flat line?

Richard Oraziotti

Chief Financial Officer

More flat line.

MacMurray Whale

Yes, okay. Okay. Okay, that's all my questions. Thanks, guys.

David Johnson

Chief Executive Officer

Thank you.

Operator

Our next question comes from Jeff Osborne of Cowen and Company. Please go ahead.

Jeff Osborne

Good morning. I just wanted to revisit the after-market business and the 10 points of gross margin differential sequentially. How much of that was the regional mix? On your slide you

have three points with—I'm trying to get is the majority of it the over emphasis of India in Q4? Then as a related question, if we think about Russia being weaker in 2022, does that segment have some of the same pressures that will linger, assuming that Russia was a more profitable market relative to others?

Richard Orazietti

Chief Financial Officer

Jeff, so the answer is yes. For sure there was a lot more India. It was one of the markets that we didn't speak about specifically that has been growing very quickly. We're looking to try to optimize, obviously how we do business in that country and that could come through localization. But that was a big, a significant portion of it.

We did see inflation as well that is showing up that we're trying to pass those costs on. You don't see that in the margin percentage because we're just literally passing the cost on, not necessarily with a markup. We're cognizant of trying to protect market share. It's case by case.

The question with Russia is roughly about half, in terms of the exposure we quoted about half of the business is an independent after market. Call it about \$12.5 million or so and so that will effect our after-market business.

Jeff Osborne

Is Stako, their sales out of Poland, where do those go geographically, \$6 million, \$7 million a quarter from that?

Richard Orazietti

Chief Financial Officer

Those ones are all going mainly towards Renault in Western Europe. They're less, not impacted by the conflict from a revenue perspective.

Jeff Osborne

Then my last question was just on the localization in India. Could you walk through what the CapEx burden of something like that would be and is that in the, I think \$15 million to \$20 million guidance that you provided or commentary you provided for 2022?

Richard Oraziotti

Chief Financial Officer

It's not in the \$15 million. It would be, we'll call it more of a something that would happen over the next few years. But David, maybe over to you. I'm thinking \$5 million is roughly what that would be, but I'll let the expert answer that better than I.

David Johnson

Chief Executive Officer

Yes, so as we look at the Indian market, we are responding right now with respect to adding capacity. Basically, we've been able to do that without CapEx, just through operating pattern. Some of those goods that we make are made in our JV in India already and then some of those are made in Italy and also in North America, so we have a distributed supply base.

As we look at localization, I don't expect we're talking about big CapEx for that, and Richard is surely right that it's going to be over a period of time. I will tell you more the localization is just buying the subcomponents locally than it is having to invest heavily ourselves. It could be a few million, but it will be spread out over time.

Jeff Osborne

Got it. That's all I had, David. Thank you. Appreciate it.

David Johnson

Chief Executive Officer

Thanks, Jeff.

Operator

This concludes the question-and-answer session. I would like to turn the conference back over to Mr. Johnson for any closing remarks.

David Johnson

Chief Executive Officer

Yes, thanks, everybody, for your time this morning and for your questions and the discussion. I enjoyed it very much. The year past was in general a good one for us. I feel good about what we accomplished. We set the groundwork for our future. Real happy about our hydrogen work and excited for what we can bring back to the marketplace with news through this year. There's a fair bit of challenge ahead but we feel quite strongly that we're well positioned to manage that. As we've managed through the COVID period, we'll manage through this one too and continue on our path to deliver clean transportation in an affordable way for markets around the world.

Thanks for your time and look forward to seeing you at the various conferences in the near future.

Operator

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