

Westport Fuel Systems(Q2)
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Corporate Speakers

- Ashley Nuell; Westport Fuel Systems; Vice President, Investor Relations
- Dan Sceli; Westport Fuel Systems; Chief Executive Officer and Director
- Bill Larkin; Westport Fuel Systems; Chief Financial Officer

Participants

- Eric Stine; Craig-Hallum; Analyst
- Chris Dendrinis; RBC Capital Markets; Analyst
- Colin Rusch; Oppenheimer & Company; Analyst
- Rob Brown; Lake Street Capital Markets; Analyst
- Jeff Osborne; TD Cowen; Analyst

PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to the Westport Fuel Systems Q2 2024 Conference Call. (Operator Instructions)

Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Ashley Nuell VP, Investor Relations.

Ashley Nuell^ Thank you. Good morning, everyone. Welcome to Westport Fuel Systems' second quarter conference call for 2024.

This call is being held to coincide with the press release containing Westport's financial results that was issued yesterday.

On today's call speaking on behalf of Westport is Chief Executive Officer and Director, Dan Sceli; and Chief Financial Officer, Bill Larkin.

Attendance on this call is open to the public, but questions will be restricted to the investment community.

You are reminded that certain statements made on this conference call and our responses to certain questions may constitute forward-looking statements within the meaning of the U.S. and applicable Canadian securities laws.

And as such, forward-looking statements are made based on our current expectations and involve certain risks and uncertainties.

With that, I will turn the call over to you, Dan.

Dan Sceli^ Thanks, Ashley. And good day, everyone.

Today I'll be recapping our progress and results in the second fiscal quarter of 2024, providing updates on our 2024 strategic priorities including an update on the JV with Volvo introducing our new reporting segments and touching on the success of our July four event before turning the call over to Bill to walk us through our Q2 results and new segment reporting structure in more detail. Q2 was a solid quarter, demonstrated by improvements in our margins.

Impacting results was the launch of the JV with the Volvo Group.

During the quarter, we were excited to close this HPDI JV transaction, which resulted in us recognizing two months of revenue from the Heavy-Duty business and our results.

Beginning in June, the HPDI JV was accounted for under the equity method of accounting for investments. The improvement in our margins and adjusted EBITDA we saw in the quarter reflects the initiatives we have undertaken to reduce costs and streamline our business along with initial results from our more recent growth initiatives such as our LPG fuel system sales to our OEM customer.

Our revolving business strategy has long recognized the value of strategic partnerships and our collaboration within the HPDI joint venture exemplifies this approach.

By aligning with the right partners, we amplify our strengths and leverage shared expertise to drive innovation more efficiently and effectively.

As we continue to adapt and refine our focus, we have restructured our business into five key segments: The HPDI JV, Light-Duty, High-Pressure Controls and Systems, Heavy-Duty OEM, and Corporate.

This reorganization strengthens the alignment between our competitive strategy and our internal operations, positioning us to deliver sustainable profitable growth over time.

Our new structure empowers our team to be more agile, accountable, and sharply focused on achieving our long-term goals, while also providing added transparency and visibility into our operations in our external reporting.

We are excited to close our transformational joint venture in early June with Volvo Group acquiring a 45% interest in the JV for approximately \$28 million, plus up to an additional \$45 million via an earnout, subject to the performance of the joint venture.

We know our partnership with Volvo is just beginning, and we are excited to continue working together.

Also in June, we shared our 2023 ESG report, which highlighted our commitment to environmental stewardship, social responsibility, and strong governance.

We're dedicated to sustainable operations because we see the value it brings to our customers. Guided by our core values of integrity, respect and perseverance, we're especially focused on reducing carbon emissions in the transportation -- in transportation to help clean the air and build a more sustainable future.

We continue to make advancements against our three main priorities for 2024 and beyond.

As a reminder, those priorities include: One, driving success via our HPDI joint venture with Volvo; two, improving operational excellence; and three, reimagining a hydrogen-powered future. Regarding our first priority, as I mentioned, we closed our HPDI joint venture in June of 2024.

Although closing the JV with Volvo was a significant milestone, the hard work is still ahead of us.

We have a lot to accomplish together to ensure that the JV results in the acceleration of the commercialization and global adoption of the HPDI fuel system technology for long-haul and off-road applications. Thankfully, the work has already begun.

As we progress, we actively promote and develop markets for our technologies and sectors that are challenging to decarbonize, thereby expanding the joint venture's reach into the future.

As I have said before, our pursuit of profitability and cost cutting is not merely a priority. It is essential. In Q2, we closed the amended Westport-Minda JV with the broader restructuring in India. It is expected to transition this initiative to generating positive cash flow.

We have done a number of things to rightsize the business and cut costs where we can. Many of these changes won't be visible in the financials immediately.

However, in Q2 2024, we began to see some of our initiatives materialize.

Our margins grew from 17% of revenue in Q2 of 2023 to 21% of revenue this quarter, which was achieved by implementing tighter cost controls and beginning to see the benefits of our newer growth projects supported by stronger margins.

One of the significant changes in our recast financial segments is the additional transparency we now provide for our growing High-Pressure Controls and Systems business. Here, we are at the forefront of the clean energy revolution, designing, developing, and producing high-demand components for transportation and industrial

applications. This includes fuel containment and fuel pressure management components for fuel storage and fuel delivery systems.

We partner with the world's leading fuel cell and hydrogen engine manufacturers and companies committed to decarbonizing transport, offering versatile solutions that serve a variety of fuel types.

While hydrogen is the key to the future decarbonization of transport, our components and solutions are already powering emission-reducing innovation today across a range of gaseous fuels including both CNG and hydrogen. With decades of experience, market-leading brands, and unmatched engineering expertise, we are leading the market.

While we're still small, our strategic position and innovative capabilities put us on the cusp of significant growth, ensuring we're the go-to choice for those shaping the future of clean energy today and tomorrow.

In the supplementary information we provided this quarter, outlining our historical results recast under the new segments, we show this business generating revenue of \$12 million in 2023.

Today, this segment has a pipeline of future business representing approximately \$70 million in additional revenue to be generated in the latter part of the decade.

Westport is excited to play a part in an innovative industry in which alternative fuels are seeing increased support and investments.

We are poised to deliver now providing alternative fuel solutions to support transport and industrial applications, and are prepared to capture the growth as hydrogen develops into the fuel source of the future in the mobility sector.

On July 4, Volvo and Westport marked a defining moment in the journey of our newly-formed joint venture. The two companies celebrated the official launch of our partnership with an exclusive event at the University of British Columbia, the birthplace of Westport's HPDI fuel system technology.

Leaders from both companies joined in, in the celebration of this milestone, emphasizing the significance of the partnership and driving forward HPDI's breakthrough technology and tackling the urgent challenges of climate change.

By combining Volvo's extensive expertise in commercial vehicle and power system manufacturing with Westport's innovative fuel system technology, we are creating a powerful force for change that can make a meaningful contribution to reduce carbon emissions immediately and affordably. With that, I'll hand the call over to Bill, who will speak -- who will walk you through our financial results.

Bill Larkin^ Good morning. And thank you, Dan. I want to start off by walking through the new segment reporting structure.

As Dan mentioned, we've refined the way we view and report our business operations. Beginning with this quarter, we're reporting financial results under five new segments. These segments are the HPDI JV, Light-Duty, High-Pressure Controls and Systems, Heavy-Duty OEM, and Corporate.

Financial results from the HPDI joint venture being counter-form under the equity method and are also supported by enhanced disclosures in our MD&A as well as in the notes to the financial statements.

Before I go over the quarterly results, I want to delve deeper and walk you through what is included in each of our new segments.

First, the HPDI JV represents our recently closed joint venture with Volvo Group. The financial information presented represents one month activity during the second quarter. Light-Duty segment manufactures LPG and CNG fuel storage solutions and supply fuel storage tanks to the aftermarket OEM and other market segments across a wide range of brands.

The Light-Duty segment includes the consolidated results from our delayed OEM, independent aftermarket, light-duty OEM operations, fuel storage, and electronics businesses.

Our High-Pressure Controls and Systems segment designs, develops, produces, and sells high-pressure components for the use of hydrogen and CNG fuels in transportation and industrial applications.

Finally, our Heavy-Duty OEM segment reflects the results from the HPDI business for the first five months of the year until the formation of the HPDI JV, which occurred on June 3, 2024. And going forward, the Heavy-Duty OEM segment will reflect revenue earnings from a transitional service agreement in place with the HPDI joint venture. This TSA is intended to support the HPDI joint venture in the short term as the organization transitions to its own operating entity.

Therefore, after completing -- the completion of the activities on the TSA, there will be no additional activity in the segment.

So to get a complete picture of the HPDI business presented for the quarter, combined HPDI JV in the Heavy-Duty OEM segments.

As Dan mentioned, the new segments are designed to support Westport's strategic priorities and provide heightened disclosure, specifically in areas of our business where we see outsized future growth.

We hope that the additional transparency provides our investors and analysts information to more accurately model and value Westport. To support this, we have included a recast of historical financials and supplementary information of our Q2 press release.

Moving on to our second quarter results.

In the quarter, we generated \$83.4 million of revenue, a 2% decrease compared to the prior-year period. This was primarily driven by decreased sales volumes in our delayed OEM and fuel storage businesses. This is partially offset by increased sales volumes in electronics, High-Pressure Controls and Systems, Light-Duty OEM, and Heavy-Duty OEM revenues in the quarter.

As a reminder, this is the first quarter with the HPDI joint venture, which impacted our Q2 revenue as Q2 reflects two months of HPDI sales activity in our financials with June activity being accounted for under the equity method of accounting for investments.

Gross margin increased to \$17.1 million, or 21% of revenue in the quarter. This is up from \$14.4 million, or 17% of revenue in Q2 of '23. This is largely driven by increases in sales to our European customers and a reduction in sales of developing regions in our Light-Duty business, in addition to seeing the initial results from our cost-cutting initiatives.

We continue to demonstrate improvement in our adjusted EBITDA. This quarter, we reported a loss of \$2 million, which was an improvement by \$2 million as compared to the same quarterly period last year.

The improvements in gross margin drove positive improvements in our adjusted EBITDA.

However, these improvements were partially offset by higher G&A costs in the second quarter, which included \$2 million in consulting and legal fees related to finalizing the HPDI joint venture. Light-Duty revenues for Q2 of '24 was \$69.5 million as compared to \$73.7 million for Q2 of '23. This decrease was driven by lower sales in our Delayed OEM, independent aftermarket and fuel storage businesses, and was partially offset by increased sales in our Light-Duty OEM and electronics businesses.

As expected, our Delayed OEM business continued to see a lower revenue in the quarter as a key customer continue to work through their existing inventory.

However, we began seeing sales to the key customers progressively increase through the quarter. Gross margin of Light-Duty business increased in the quarter to \$15.1 million, or 22% of revenue, as compared to \$12.7 million, or 17% of revenue in Q2 of 2023. This is primarily driven by a change in sales mix with an increase in sales to European customers and a reduction in sales to developing regions. This includes a full quarter of deliveries of Euro six LPG fuel systems to our global OEM partners. High-Pressure Controls and

Systems revenue for Q2 of '24 was \$3.4 million, which was an increase of \$600,000, as compared to \$2.8 million for Q2 of 2023.

This was primarily driven by increased sales volumes in product and service revenue. Gross margin increased slightly in the quarter to \$700,000, or 21% of revenue, compared to \$600,000, or 21% of revenue in Q2 of '23. The Heavy-Duty OEM revenue for second quarter of 2024 was \$10.5 million. This is up \$2 million compared to the prior year. The revenue increase was driven by an increase in product sales and engineering services for the two months in the quarter when the company wholly owned the HPDI business.

Additionally, we recorded one month of inventory sales from the company to the HPDI JV for \$500,000 under our transitional services agreement. Gross margin dollars in our Heavy-Duty OEM business in the second quarter of '24 is up slightly to \$1.3 million, or 12% of revenue, compared to \$1.1 million, or 13% of revenue in Q2 of '23. Regarding liquidity, our cash and cash equivalents at June 30, 2024, was \$41.5 million. This is a decrease of \$2.4 million as compared to the end of Q1 of '24. With respect to our cash balance, there's \$8.4 million related to the closing of the HPDI joint venture that was received in July.

And therefore, this amount is not reflected in our cash balance at the end of the quarter. Net cash provided by operating activities was \$1.5 million. That's an improvement of \$2.1 million over Q2 of last year. This improvement was achieved through continued reductions in net working capital. Net cash provided by investing activities was \$5.8 million.

Now this included the proceeds from the sale of our investments of \$20.4 million related to partial sales of our ownership interest in HPDI JV and the Minda-Westport JV. This was partially offset by capital contributions to the HPDI JV of \$9.9 million and capital expenditures of \$5.4 million.

In the quarter, net cash used in financing activities was \$8.9 million.

During the quarter, we reduced our use of the revolving credit facility by \$5.2 million and made \$3.7 million of principal repayments.

As a reminder, in Q2 of 2023, we repaid \$8.7 million to settle our long-term royalty obligation with Cartesian.

Going forward, we'll continue to do what is necessary to ensure we are adequately and fully capitalized.

We remain focused on our project pipeline designed to enhance our liquidity as we continue to prioritize solidifying our balance sheet.

We've been actively implementing cost-savings initiatives, and we are already seeing positive results. With that, thank you, and I will turn it back to Dan. Dan?

Dan Sceli^ (technical difficulty) Commitment to advancing decarbonization across the mobility sector remains steadfast.

As we look forward, we are invigorated by the possibilities that the future holds and are resolute in our pursuit of innovation and sustainability.

I want to take a moment to thank everyone for being here. And with that, I'll turn it over to the operator to open the call for questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from Eric Stine of Craig-Hallum.

Eric Stine^ Can you hear me? I know there's some weird stuff going on, on this call but audio wise. But okay. Good. Well so I know early days for the joint venture, you've had -- or it's been in place for, what, two months. Just curious if you could kind of rank the priorities as you see them now.

Have they changed at all? And could you give us an update on just thoughts of a new OEM since I know that, that was one of the objectives from the start.

Dan Sceli^ Sure, sure. In terms of priorities, we've launched this joint venture and our goals immediately are to get it functioning as a stand-alone business.

So putting in place the business systems, the ERP, all of those things are being put in place so that we can operate it separate from Westport management team was already organized around a separate entity. There's about a 9-month rollout of actions that make all those things happen to stand-alone.

So immediate priority is getting it functioning and running. But running parallel and equaling priority is bringing on a second OEM. And that activity continues. It's been ongoing for some time.

It was ongoing before actually, we closed the joint venture and it continues to be ongoing. And we're hoping that we'll be able to announce something as we continue to work towards winning that second OEM, which is a priority for both Westport and Volvo.

Eric Stine^ Got it. And then I have heard some talk in the market interest in HPDI in North America. And so I'm just curious, maybe this hasn't changed from when it was part of Westport.

But now that you are combined with Volvo in the joint venture, maybe how those plans are coming together? Does this help in that endeavor to get it to North America and what that might look like?

Dan Sceli^ Sure. So HPDI North America is one of those equal priorities, whether it's bringing on a second OEM or bringing the technology to North America through Volvo.

We're -- we continue to work through engineering and development to build a system that can cross all the continents, but specifically in North America, we see the market is more CNG-focused. And so we're working on a plan to fill that need and talk to other OEMs in North America. So our commercial activities will continue to move forward in building this business out.

Eric Stine^ Got it. I will -- I guess, I'll stay tuned on that. And maybe my last one, just more bookkeeping.

So when we think about OpEx and just the moving pieces of the -- of Westport going forward, so you said you had \$2 million that was -- that should not repeat. Was I correct in hearing that related to the formation of the joint venture? Okay. So \$2 million.

Bill Larkin^ Yes.

Eric Stine^ And then it looks like roughly \$5 million, \$6 million of the Heavy-Duty OEM business, that would be roughly the OpEx level that also comes out. I mean is this kind of an all-in OpEx \$15 million type of number per quarter?

Bill Larkin^ We're continuing to look at that. As Dan mentioned, we still have quite a few cost reduction initiatives that we're working on. And so we're -- that's across our business. \$15 million is about right for the current run rate, but we're going to continue to evaluate that.

Operator^ Our next question comes from Chris Dendrinis of RBC Capital Markets.

Chris Dendrinis^ I wanted to ask about -- there was a comment, I think, it was in the financial disclosure of the MD&A, and it looks like you all exited the JV with Weichai.

So if you could speak to that and what maybe the strategy shift was there and, I guess, thoughts going forward with them?

Bill Larkin^ Well I mean it's really two separate things. This is a JV that was formed a long time ago. And then more recently, we had a small ownership percentage, and they finally exited totally from the joint venture.

However, that doesn't change our relationship with Weichai and we continue to support their development activities.

Chris Dendrinis^ Got it. And then maybe just on the Light-Duty segment.

So it sounded like the mix of Light-Duty OEM was more heavily weighted to Europe and you noted a reduction in the sales in some of those developing regions.

Is there any sort of a strategic shift going on with, I guess, maybe that business line? And maybe where you're focused internationally and how that impacts your growth going forward?

Dan Sceli^ Sure, sure. So the Light-Duty business impacts this year, so Q1, Q2 and will flow through for a bit. The primary one was the OEM that imports vehicles and installs our systems. And they tripled the size of their business, and they're launching 14 new models in the middle of all this. And so the issue there was they were uncontrolled sitting on a pile of inventory that they didn't realize they had.

So they're bleeding that off. So the big hit we're taking there is just them bleeding off that inventory. We expect those volumes to come back.

We're waiting to see exactly when they're going to come back later this year, but we do expect them to come back. The other piece was the slower launch on the Euro six with our OEM over there.

And that has actually picked up and will be gaining volume. So we're actually fairly upbeat about the volume projections for Europe. But we're waiting to see specific numbers from the marketplace on that. So we don't see a major shift in the piece of that world that we play in. In fact, we see it getting a little bit stronger.

Chris Dendrinis^ Got it. I guess maybe one last one if I can sneak this in here, but I think there's a receivable from -- there's a receivable from Cummins that I think you...

Operator^ Our next question comes from Colin Rusch of Oppenheimer & Company.

Colin Rusch^ So give this another go. So guys, can you talk a little bit about what's going on with the vehicle customers for hydrogen on the off-road opportunity? It seems to me that as the mining industry starts to work towards zero emissions and the hydrogen industry starts to look at some dedicated facilities that there might be a meaningful opportunity for you guys. I just want to understand how that's developing.

Dan Sceli^ Yes. Sure. So we have been exploring opportunities in the off-road. Off-road is a growth segment, both inside the joint venture for HPDI and within our high-pressure components and systems world because there's a play there for that technology.

We do see some interesting opportunities coming together and have been in some discussions with some customers on how to help the mining industry transform their technology.

So it's early days for us on that, but it is an important priority for us, and we are starting to build out the commercial plan of how to pull it off.

Colin Rusch^ And just on the Light-Duty side, it seems to me that there's an opportunity around potentially licensing some of the IP that you guys have ending up with a little bit leaner model.

Can you talk a little bit about that opportunity and if that's a real thing that you guys are thinking about?

Dan Sceli^ About licensing, okay.

So we're currently building out the capitalization of Euro 6, Euro seven technology that's going to be ramping up over the next two years, two to three years. And that's been our primary focus.

In terms of licensing, I'm not sure who -- or what you're specifically referring to, but our goal is to expand that technology across multiple OEMs.

We do see a pendulum swing back the other way as I think the world sees the hydrogen ecosystem may be a little further out than we all want.

In the middle of that, we have solutions, whether it's propane gas, natural -- the natural gas groups, et cetera. And we're trying to position ourselves to be that bridge in between and bring solutions.

So we're going to continue to try and commercialize that across Europe, and of course, in our aftermarket around the world.

Colin Rusch^ I've got a couple of follow-ups. So I'll take them offline.

Operator^ (Operator Instructions) And our next question comes from Rob Brown of Lake Street Capital Markets.

Rob Brown^ First question is on the sort of demand environment in the European HPDI market. I think that's been sort of coming back. But what's sort of your sense on how that looks over the next 12 months and some of the macro drivers there?

Dan Sceli^ Yes. I think, obviously I mentioned just a moment ago, the view of where hydrogen is going to be coming in, in terms of the ecosystem, the entire ecosystem.

I think the European market is starting to adjust to that future being a little further off. Therefore, they're turning back to the alternative fuels aside from the fuel cells and the battery electric solutions. Clearly, alternative fuel ICE engines are going to be gaining some momentum and some market share in Europe.

And we're excited about that. We're also working to figure out how to get it in North America -- how to commercialize it with different OEMs in North America including Volvo. But I think the current HPDI system on LNG has a very strong future here in Europe.

Rob Brown^ Okay. And then on the cost reduction efforts, you talked a little bit about some progress, but could you give us a sense of sort of how far you are into that and how much is yet to go?

Dan Sceli^ Yes. We've been digging in pretty aggressively across the company, both at a corporate level for corporate costs, which Bill can talk a bit about, and then operationally across the various segments, whether it's the Light-Duty business or even the joint venture.

We're trying to make ourselves a much more rightsized and efficient business across the board. And one of the challenges is, I think we've talked about in previous calls, is the timing of making change in operations.

So for instance, in Europe, a lot of the cost savings that we want to initiate there, take capital and take time.

You can't just hit a switch and cost -- take costs out of a business in Europe like we could here, for instance.

So are we a third of the way into it? Probably, I'd say we're a third of the way into it. And so -- and it's also a balance, right, a balance between where we're cost cutting, where we're investing for the future to take advantage of growth opportunities. So it's a bit of both.

Operator^ Our next question comes from Jeff Osborne of TD Cowen.

Jeff Osborne^ Two questions. One is, do you have a sense of -- on the kits that are in inventory at your partner in Europe, what you've sold in versus the sell-through of those vehicles and how long that pressure will be there? Is that something that will be resolved this calendar year or no?

Dan Sceli^ Yes. We expect -- yes, go ahead, Bill.

Bill Larkin^ Yes. It's -- I can answer. So yes, it heavily impacted our first quarter. It did -- we did have some impact in the second quarter -- early in the second quarter.

We actually started seeing the volumes start ramping up throughout the quarter. And those will continue to increase throughout the third quarter as we work closely with our customer.

As Dan mentioned, they've just grown rapidly, and they haven't put the controls and processes in place to manage their inventory.

So we've gotten more actively engaged with our customer to be able to manage that and we have better foresight for their needs, their production needs inventory needs.

So that business has been recovering during the quarter and will continue in the third quarter.

Jeff Osborne^ Perfect. And then my last question is just how to think -- I think Eric asked questions on OpEx and how to think about that and how you're aiming to reduce that.

But how should we think about CapEx for the second half, that's unclear to me. Maybe it's buried in one of the documents. But what (inaudible) in the split of CapEx for associated with the JV?

Bill Larkin^ Well I think a big chunk of the CapEx investment this year -- historically, we've been in, call it, the \$13 million to \$15 million.

It's going to run a little higher this year because we've been investing in CapEx to support the -- our OEM customer for LPG components for Euro 6.

So we've been investing heavily in new CapEx.

I think for the back half of the year, it would just be slightly lower than what we spent in the first half of the year. And then I think that will be the bulk of the CapEx spending that we need to do to support our OEM customer for delivering six components.

And then as we go through this, we'll have to recast our CapEx run going forward now that the -- all the HPDI activities are in the JV, that will decline as well.

Jeff Osborne^ So is it feasible that, that number could be less than \$10 million next year?

Bill Larkin^ It could be. But we're actually just kicking off our annual budget process. And as part of that process, we do a deep dive in what our CapEx needs for the various programs. And so we're going through that right now.

Operator^ I'm showing no further questions at this time. I would like to turn it back to Dan Sceli for closing remarks.

Dan Sceli^ I'd like to thank everybody for joining us today. And I hope we answered all your questions and look forward to the further calls throughout the day. That's all. Thank you.

Operator^ This concludes today's conference call. Thank you for participating, and you may now disconnect.