# Conference Call Transcript

## Third Quarter 2020 Financial Results: November 10, 2020

## Operator

Welcome to the Westport Fuel Systems' Third Quarter 2020 Results Conference Call.

As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star and zero.

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

## CHRISTINE MARKS speaking

### Investor Relations Representative

Good morning, everyone.

Welcome to Westport Fuel Systems' third quarter conference call which is being held to coincide with the press release containing Westport Fuel Systems' financial results that was distributed yesterday.

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

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

You are reminded that certain statements made in this conference call and our responses to various questions may constitute forward-looking statements within the meaning of 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. Actual results may differ materially from those projected in the forward-looking statements, so you're cautioned not to place undue reliance on these statements. Information contained in this conference call is subject to and qualified in its entirety by information contained in the Company's public filings.

I'll now turn the call over to David. David?

# DAVID M. JOHNSON speaking

## Chief Executive Officer, Westport Fuel Systems

Thanks, Christine, and good morning, everyone. Thanks for joining our conference call to review Westport Fuel Systems' Q3 2020 results.

This is David Johnson speaking. With me on the line today is Richard Orazietti.

I sincerely hope that all of you and your loved ones are healthy and well, and that you stay healthy and well.

Last quarter, we talked about strong signals for our green recovery in multiple jurisdictions around the world, and stimulus spending to build a better, more resilient and low carbon economy. I'm pleased to say the momentum has continued. Despite the ongoing impacts of COVID-19 and the challenges of a second, or even a third wave, we are encouraged by signs of recovery in our sales volumes and signals of normalization across key markets. The pandemic has changed a lot of things, but the need for clean, economical transportation solutions and urgent action on climate change has not gone away.

We've made meaningful progress on a number of our business objectives this year, including engine certification in China, growth in our Indian market, and significant improvements to our balance sheet.

Although the global pandemic continued to have adverse impacts on business, in the third quarter we saw a recovery compared to the second quarter, with sales rebounding significantly, resulting in an 82% revenue increase relative to the second quarter of 2020, and net income, once again, in positive territory. Customer demand for our aftermarket products and growth in our HPDI sales volumes were quite encouraging.

Two of our three Italian plants are at higher risk zones in which travel restrictions were imposed just last week. These restrictions are designed to limit people from traveling between regions.

However, residents can still go to work, and are doing so. Our plants are operating at normal capacity. At this time, we don't expect our factories to close. We're closely monitoring guidance and direction from public health officials. I'm proud of our teams' resilience, hard work, and commitment to operational excellence as we continue to maintain a safe work environment for our team members and first-class service and support for our customers.

We expect continued positive momentum in the fourth quarter, largely driven by HPDI sales, as fleets improve the sustainability of their operations with our market-ready solutions that delivers comparable performance and reduces total cost of ownership.

That said, the extent, duration, and impact of COVID-19 is uncertain. Most of our production is from these three facilities located in Northern Italy and one in the Netherlands. Sales from these facilities are primarily to Europe in areas that have been significantly impacted by the virus, and continue to be challenged to contain the virus and keep the economy operating. We do expect our heavy-duty business to be less impacted than our aftermarket light-duty OEM business because of ongoing need for delivery of freight worldwide.

We've implemented a number of austerity measures, which I outlined last quarter, and we made excellent progress on shoring up our balance sheet and improving our cash position during this quarter including new loans with Export Development Canada, Unicredit, and Deutsche Bank, and a restructuring of our convertible notes which Richard will walk through in detail later.

Let’s turn to a few of the financial highlights.

Revenue was significantly impacted in Q2, and still in Q3, due to various shutdowns around the world, but for the three months ended September 30 of this year, revenue decreased 13% to $65 million from $75 million compared to the same period in 2019. Our light-duty OEM and delayed OEM businesses were most acutely affected, which directly reflects the reduced demand for light-duty vehicles in the markets we serve.

Net income was $0.8 million compared to net income of $5 million for the same period last year. We recorded positive net income in 2019, and had expected to improve upon this achievement in 2020. However, as I said earlier, the impact of COVID-19 has had a significant impact on 2020 results. That said, net income for this quarter was positive, and Adjusted EBITDA was $4 million for the quarter. Relative to the third quarter of this year, we're expecting continued improvement in revenue and earnings in the fourth quarter of 2020 and into 2021, but, of course, this will depend on the strength of the economic recovery and the uncertain, but continuing, impact of COVID-19.

As we respond to ramping customer demand for our products, we remain focused on cost reductions, disciplined cash management, and supporting our Global Team and their communities as we navigate this recovery period.

I'll update you next on a few of our key markets. Let's start with Europe.

Europe remains our largest market, representing about 70% of our sales. There are strong signals of market growth and geographic expansion. More and more fleets are producing LNG fuel to heavy-duty vehicles. With a strong business case, comparable diesel performance, and reduced greenhouse gas emissions, HPDI trucks are being deployed in high mileage applications and demanding duty cycles.

The European Commission is striving for climate neutrality by 2050. To take action today, fleet operators can choose from just four long-haul trucks of (inaudible 6:47) horsepower or more that run on natural gas or biomethane, but only HPDI-equipped engine offers full torque, drive-ability, and the efficiency of diesel engines that fleets demand.

We continue seeing growth in LNG vehicle registrations; an increase of 175% in 2019 alone according to NGVA Europe. There are currently 11,000 LNG-fueled trucks on the road in Europe. We know that the build-out of infrastructure is critical in the adoption of any technology. Here too, we see encouraging signals that point to faster ramp and market penetration for LNG. For example, with the LNG refueling network in Europe doubling since 2017, there are now 331 LNG refueling stations across Europe, spanning 21 countries.

By contrast, in the United States, they have just 70 stations, there is limited product choice, and the fuel price differential between natural gas and liquid fuels is not as compelling.

Purchase incentives of €20,000 in key markets like Italy and the extension of a road tolls in (inaudible 7:50) Germany for LNG trucks make already compelling fuel economics even more attractive for operators. Earlier this year, the German government extended road toll exemptions for heavy-duty, natural gas trucks into 2023. This toll exemption further strengthens the business case for HPDI trucks, and accelerates actions on the European Union's climate goals.

Recently, however, the EU Commission has announced that it has never approved the toll exemption for gas or electric hybrid trucks, and does not intend to support it through 2023.

Discussions between the Commission and the German Administrative of Transport, who continue to support the exemption, are ongoing. We, and others in the industries, believe that any attempt to reverse the legislation exemption will be rightly challenge by fleet transport companies and fueling station operators who have made significant investments in natural gas trucks and stations. We'll continue to monitor this closely.

Carbon neutrality will only be possible with policies that include the use of renewable and economic gaseous fuels. Major European companies in the retail and food sectors are increasingly switching to biomethane fuel trucks as an affordable solution that's available today and can reduce carbon emissions to net zero.

Liquefied biomethane, or bio-LNG, is now being produced in Sweden, Norway, the Netherlands, and France, with projects underway in more countries. Royal Dutch Shell's announcement to build 50 new LNG refueling stations in Germany, and a liquefaction plant, are significant investments in a de-carbonized freight sector, supplying a blend of a fossil and renewable natural gas, and making their LNG supply carbon neutral. Bio-LNG make trucks run cleaner, and effectively accelerates de-carbonization, and our hardware is fully capable for bio-LNG applications.

Work is underway within the European Commission to determine the—determine and finalize the CO2 baseline for commercial vehicle emissions. The Commission's expected to publish these baselines for each OEM manufacturer by April 30, 2021. The race (inaudible 9:50) on to achieve targets and avoid penalties, which come into effect in 2025.

During the first (inaudible 9:56) following the launch of HPDI in Europe, fleets placed orders for just a few trucks for evaluation purposes. Then, as evidence and confidence grew, orders increased to 10 at a time and 20 at a time. This year, fleet owners have further increased into the hundreds, and despite COVID, sales of HPDI have increase roughly 50% versus last year, which is a continuation of the growth rate we saw in 2018. Fleets are making the switch to natural gas, and especially HPDI.

Our heavy-duty products are not in a test or experimental phase. They're mainstream, for sale, and in use today around the world, and we believe they're an important part of the economic recovery in many markets. A high proportion of CO2 emissions come from long haul trucks which don't lend themselves to electrification. HPDI is the solution, and with our even modest market share growth of vehicles that use our technology, our revenues and profitability will keep growing.

In September, we announced our Weichai Westport joint venture and received government certification of the JV's HPDI-equipped engine. The next important step in the commercialization process is vehicle certification, which is the responsibility of the JV's customers; the vehicle OEMs. We expect this work to be completed and certification issued anywhere from the next few weeks to the next few months, and like you, we look forward to these announcements from the vehicle OEMs. We have a great partner, a great technology, and a large market to serve in China, and we're looking forward to ramping up sales in this important market in the coming years. The long-term potential of HPDI in China, the largest natural gas commercial market in the world, remains compelling.

We continue to work to serve the growth potential for natural gas-fueled vehicles in India, and are growing our business in India. In September, we announced we were combining our operations of our Rohan BRC business with our existing JV with UNO MINDA, a large, well-established, Tier 1 automotive supplier, to serve both our aftermarket and OEM customers like Maruti Suzuki. The combination provides synergies in sales, manufacturing, and operations.

The third quarter sales in India were robust. The country recovered from coronavirus shutdowns and automotive sales were strong. Third quarter sales in our Indian JV, which we do not consolidate, were about double their sales in Q3 2019. There are a number of factors at play here. Some of the sales growth is due to pent-up demand and reselling the inventory pipeline. The three-wheeler market is also growing.

With the introduction of Bharat Stage VI emissions regulations, the cost of diesel-powered vehicles has gone up, and some customers simply find it too expensive to have these vehicles in their fleet. CNG fuel price is 30% to 50% lower than diesel, CNG vehicles are easier to operate, and the number of CNG fueling stations continues to increase. It's too soon to predict how much of the Q3 sales increase is from coronavirus-related pent-up demand and how much is longer-term shift from diesel to CNG. This will play out in coming orders, but we're optimistic that a shift is happening.

We see similar positive momentum in Egypt, a growing market for our technology. Egyptian President Al-Sisi announced in July that Egypt will not issue licenses to any new cars unless they run natural gas. The decision, which Al-Sisi announced during the opening of a number of national projects, is intended to preserve the environment and natural resources of the state, and the lives of citizens. The decisions will apply to any car whether it's a minibus, private car, or taxi.

In August, Egypt's Ministry of Trade, an industry (inaudible 13:27) details of an initiative aiming to replace obsolete vehicles and convert cars to run with natural gas during a meeting with the Industry Committee at the House of Representatives. As a result, we're fielding new inquiries and continue to be encouraged by the adoption made of gaseous-fueled vehicles in multiple geographies.

We've also seen interest around hydrogen vehicles continue to grow. We already participate in the hydrogen market across all transportation applications, and currently sell hydrogen components, engineered in Canada and manufactured in our facility in Italy, to Tier 1 suppliers. While hydrogen faces many of the same challenges that natural gas faced 10 to 15 years ago, fleets need product choices.

Our goal is to provide economic and compelling choices that offer comparable efficiency to diesel, and also deliver substantial CO2 reductions. HPDI, with renewable natural gas, is the only commercially available solution that does that today. Our specialty is working with gaseous fuels with a robust patent portfolio and decades of engineering experience, and we continue to invest in research and development to power our cleaner tomorrow. We're working to apply HPDI to deliver hydrogen for internal combustion engine applications. Preliminary simulation and modeling shows performance and product attributes comparable to our existing HPDI platform.

Hydrogen use in an internal combustion engine with our HPDI fuel system could offer another cost-competitive pathway to reduce CO2 emissions from transportation if hydrogen becomes more affordable, and the efficient use of that fuel in the internal combustion engine, as the HPDI system is capable of delivering, could provide for a competitive alternative to a fuel sales, while providing a similar greenhouse gas emissions reduction profile.

While it's early stages, we have a proven internal combustion engine platform that could be used with either natural gas or hydrogen is certainly an exciting direction with optionality for the future. We're currently completing modeling, and plan to begin testing in Q1.

We have spent the better part of two decades successfully tackling similar heavy-duty vehicle obstacles as what we see in the hydrogen market; a lack of fueling infrastructure, a challenge to efficiently produce hydrogen, substantial incremental vehicle costs, and scaling up vehicle production. Irrespective of the technology direction that is ultimately successful, we're poised to take advantage of green hydrogen's potential, and that's an exciting place, from my perspective.

Now, let me turn it over to Richard to review our financials.

## RICHARD J. ORAZIETT speaking

### Chief Financial Officer, Westport Fuel Systems

Thank you, David.

As David highlighted, consolidated revenue for the third quarter rebounded from $36 million in the second quarter to $65 million, driven mainly by growing HPDI sales volumes and a steady recovery in independent aftermarket sales since the reopening of our factories in Northern Italy. Year-over-year, consolidated revenue was 13% lower compared to $75 million in the third quarter of 2019, mainly due to lower independent aftermarket sales as customer demand continues to recover. The ramp in HPDI revenue continues to grow through higher sales volumes through our initial launch partner, partially offset by lower average selling price of HPDI components due to contractual price reductions and lower engineering service revenues compared to the prior-year quarter.

Gross margin in the third quarter decreased significantly by $7.9 million to $10 million, mainly due to lower independent aftermarket and light-duty OEM sales volumes, lower HPDI engineering services, and a one-time charge for approximately $1 million for a field service campaign. The decrease in margin was partially offset by a significant increase in HPDI sales volumes from the growing demand for clean transportation in long haul trucking in Europe.

Consolidated operating expenses of $13.2 million for the current quarter were $6 million lower than the third quarter in 2019 mainly due to the continuing austerity measures, and government COVID-19 relief wage subsidies of $1.2 million.

In addition, we had an unrealized foreign exchange gain of $2.3 million due to the appreciation of the Canadian dollar.

Net income was $0.8 million for the third quarter 2020 compared to $5 million for the same period in 2019. In addition to the impact of COVID-19, the third quarter 2019 results benefited from better margins, including about $1 million in higher earnings from the CWI joint venture. Prior-year earnings were also boosted by a one-time $3.3 million gain on the forgiveness of government debt for the development of the HPDI technology.

EBITDA was $4.9 million for the third quarter compared to $11.7 million. After adjusting for non-cash and non-recurring items such as the foreign exchange gain and the one-time gain on the debt settlement to better reflect the change in performance, Adjusted EBITDA was $4 million compared to $9.4 million for the same period last year.

Turning to our business segment performance, OEM revenue was $37.4 million during the current quarter, which increased modestly by 3.3% year-over-year mainly due to the growth in HPDI sales volumes, partially offset by lower average selling price of the HPDI components and lower engineering service revenues that I spoke about previously. We expect to see continued growth in our HPDI sales volumes in the fourth quarter.

Although light-duty OEM continues to recover since the reopening of our factories in the second quarter, revenues were approximately 35% lower year-over-year. Consequently, our OEM business generated an operating loss of $4.8 million compared to a loss of $0.9 million in the prior year. Included in that operating loss is the one-time charge for the field service campaign.

Independent aftermarket revenue was $28 million for the third quarter of 2020, a decrease of $11.2 million, or 29%, year-over-year mainly due to lower sales volumes caused by the impact of COVID-19 on customer demand. Customer demand has been recovering steadily as quarter-over-quarter revenues improved by 66% over the second quarter. The resurgence of the pandemic in Europe could potentially dampen the recovery during the fourth quarter as new social distancing measures get implemented. Due to austerity measures and government wage subsidies, independent aftermarket generated an operating income of $1.7 million.

CWI's operating income of $6.2 million was comparable to the prior year. Gross margins were 16% lower year-over-year due to the higher sales mix of lower margin engine sales versus parts revenues. Margin pressure was mostly offset by lower operating expenses. Equity income for the quarter from the joint venture was $4.9 million, which was down approximately half a million, or 9%, from the prior year.

Turning to liquidity, despite a challenging business environment, we generated adjusted operational cash flows of $0.3 million compared to $1.2 million in the same period in the prior year. The impact to adjusted operating cash flow from the loss of gross margins was partially offset by wage subsidies of $1.2 million and the austerity measures we took to weather the immediate impact of the pandemic. We also had a buildup of receivables from increasing HPDI sales volumes, and a general recovery in sales in our other businesses.

During the quarter, we had a net cash inflow of $17.4 million, bringing our cash on hand at the end of the period to $46 million, mainly due to the numerous financing activities undertaken in the second and third quarters to secure our short-term liquidity and offset the impact of COVID-19.

As part of our plan to ensure we have sufficient liquidity during these uncertain times, we have launched an at-the-market program yesterday to prudently issue shares to raise capital from time to time if needed. We have also expanded our credit facility with one of our lenders to help us manage working capital pressure from our growing HPDI demand.

Due to the continued growth of our HPDI sales volumes, the need for investment in production capacity, and R&D for developing new technology for solutions like hydrogen, we continue to evaluate our financing needs to ensure alignment to the long-term growth plans of our business.

With that, I turn it back to you, David.

# DAVID M. JOHNSON speaking

## Chief Executive Officer, Westport Fuel Systems

Thanks, Richard.

To recap, we have made substantial progress on our business plans despite COVID-19, and we remain focused on a few key priorities for the last months of the year; the successful launch of HPDI in China, continued cost reduction, new light and heavy-duty businesses in key market geographies, and the profitable growth of our light-duty business with the aftermarket and OEM channels. I'm confident in our team, and we are committed to delivering.

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

# Operator

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

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

## Eric Stine - Analyst, Craig-Hallum Capital Group

Hi, David. Hi, Richard.

## DAVID M. JOHNSON speaking

### Chief Executive Officer, Westport Fuel Systems

Good morning.

## Eric Stine - Analyst, Craig-Hallum Capital Group

Good morning. I guess with my questions I'll stick with HDPI. Just one thing I did want to confirm from your remarks, so did you say HPDI volume's up 50%, and if so, was that third quarter year-over-year, or is that year-to-date?

## DAVID M. JOHNSON speaking

### Chief Executive Officer, Westport Fuel Systems

Yes, that's an annual figure, just a rough number to give you an idea of the growth we're seeing from that business in Europe. It's quite exciting to us, considering the COVID crisis that we all faced with shutdowns, both ourselves and our customers, but to see the market come back with that strong return after a very good year last year of our first full year in 2019, so we're encouraged by that, and it's really been a shining star for us as we look at the outlook for our business going forward into '21.

## Eric Stine - Analyst, Craig-Hallum Capital Group

Yes, and I mean, I guess that implies—given that Q2 was pretty much nonexistent, that implies a growth rate even higher than that for the third quarter. Just curious, when you think about that number, how do you kind of break that down? I mean, clearly, you've got fleets that are, as you said, going from the 10s and the 20s to looking at orders of 100 plus. You've also got that the baseline was finalized. This is the first quarter it's been finalized, and curious if that means you're seeing more of a push from Volvo in the market; maybe just how that breaks down in your view.

## DAVID M. JOHNSON speaking

### Chief Executive Officer, Westport Fuel Systems

Yes. I guess, as I try to pull back from the day-to-day and look at the broad picture of what's going on, and then I try in my head to say, okay, and if COVID didn't happen, what would really be right now, because COVID's an externality, of course, that we all have to get through, but it doesn't have anything to do with HPDI or trucks or freight, so when I look at that, we are launching a product that's a new technology for the marketplace.

We are a standout products, patent-protected, nobody else has—really competes with us, and I think what we're seeing, Eric, more than anything else is this adoption cycle that I can remember talking about in my first days with the Company, which was when a new technology's introduced, especially a powertrain technology in the trucking industry, and any market around the world, there is a significant adoption cycle where basically these are large capital purchases for fleets, and they're going to buy one or two and try it out, perhaps for an extended period before they buy more, and so I'm really encouraged by these hundred-unit orders, and the little signs that we see in the marketplace, because we don't get such rich data from our customer in terms of what they're doing and how they run their business.

It's really their business, of course, but the signs we do see and the volumes we do see, and the growth coming back after the shutdown in Q2 are really compelling to us, and again, I just point to the fact that really have one customer in one market, and this is a technology that can—is delivering already, and has the potential, when it's delivered with the right biomethane fuel, to be a net carbon—a net zero carbon solution that's affordable and realistic and delivers for customers, so to me, the signs are very compelling, and we're looking forward to getting beyond COVID and getting into '21 and continuing that launch curve and growth of this important product.

## Eric Stine - Analyst, Craig-Hallum Capital Group

Got it, and then maybe last for me, just turning to China, I mean, I know you're waiting on now this vehicle certification that's out of your hands, but confident that that's either weeks or months. Just curious, from what you see, what type of actions have been taken, well, certainly by you, but by Weichai, and also by some of the truck OEMs? I mean, is this something once that certification is achieved, that you expect that volumes could start pretty soon thereafter, or how do you see that playing out?

## DAVID M. JOHNSON speaking

### Chief Executive Officer, Westport Fuel Systems

Yes. Of course, vehicle certification is an important step in the process, but then those vehicle OEMs will have to sell products and take orders from their customers' fleets in China, and I do expect there's an adoption curve there that perhaps could be a little bit more aggressive than what we had seen so far in Europe because the market is already well familiar with natural gas trucking in China with nearly 100,000 trucks per year being sold these days with our joint venture's spark-ignited technology. Nonetheless, this is a new technology and so there will be a ramp curve, and some conservatism, even in China, about taking up new technology, improving how people are buying tens, or even hundreds, of vehicle.

At the same time, another key factor in that is we do expect multiple OEMs to come—multiple truck OEMs to buy engines from our JV using the HPDI technology, and so that could make the ramp a bit more aggressive, so that's—those are the factors in terms of the actual plans and scale and timing, and we really are dependent on our customers to take those actions, but they are—they're also global players and they see what's happening in Europe, and they're familiar with our products and they're eager to have them.

## Eric Stine - Analyst, Craig-Hallum Capital Group

Yes. Okay. Very helpful. Thanks.

## DAVID M. JOHNSON speaking

### Chief Executive Officer, Westport Fuel Systems

Thank you, Eric. Good to hear you.

## Operator

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

## Robert Brown - Analyst, Lake Street Capital Markets

Good morning.

## DAVID M. JOHNSON speaking

### Chief Executive Officer, Westport Fuel Systems

Hey, Rob.

## Robert Brown - Analyst, Lake Street Capital Markets

Just sticking with HPDI in China, how many vehicles are being in the process of getting certification at this point?

## DAVID M. JOHNSON speaking

### Chief Executive Officer, Westport Fuel Systems

Yes, unfortunately, I can't go into the numbers of our JV's customers, so unfortunately, I don't have that number to share with you, but it's not a one at a time activity. I can confirm that.

## Robert Brown - Analyst, Lake Street Capital Markets

Okay. Okay. That's helpful, and then on the margins, they were pretty low in the quarter. There was some one-time stuff, but how—I guess how much of this margin compression is quickly turning around and how much is a result of the ASP decline, and takes time for volume to ramp, and I guess where do you see gross margins settling now over time?

## RICHARD J. ORAZIETT speaking

### Chief Financial Officer, Westport Fuel Systems

Hi, Rob. It's Richard. It's a changing thing, so the—we had significant margin reductions, close to, call it, 30% over a six—call it, nine-month period, and the idea always was those margins were going to be offset by cost reductions that were going to—that were contractual in terms of increasing volume and the scale, so in terms of settling, I mean, we'd like to be north of 20%. Right now we're not there. The volumes are growing very quickly, so our European partner is doing well with the product, so we're getting good line of sight. China is critical to this process. I just want to reiterate, we have a relationship with Weichai, and it's very important for us with regards to being able to generate the sales volumes there to help us reduce the cost of our—the cost of producing our components.

## Robert Brown - Analyst, Lake Street Capital Markets

Okay. Okay. Good. Thank you very much.

# RICHARD J. ORAZIETT speaking

## Chief Financial Officer, Westport Fuel Systems

You're welcome.

# Operator

The next question comes from Colin Rusch with Oppenheimer. Please go ahead.

# Colin Rusch - Analyst, Oppenheimer & Co., Inc.

Thanks so much, guys. Just continuing on on this gross margin question, and the cadence for it, obviously you're not providing forward guidance, but how should we think about the volume levels that you need to get to before we start seeing some of that gross margin expansion, and I have a follow-up around the supply chain?

# RICHARD J. ORAZIETT speaking

## Chief Financial Officer, Westport Fuel Systems

Yes, let me...

# DAVID M. JOHNSON speaking

## Chief Executive Officer, Westport Fuel Systems

Yes, why don't you handle that, Richard? I do know the number. It's a question of confidentiality.

# RICHARD J. ORAZIETT speaking

## Chief Financial Officer, Westport Fuel Systems

Yes. No, we're in a growth phase, and yes, we have a number, but we won't be sharing it today. Fundamentally, we need the—a second customer who need our volume in China to come along to help us get the economies of scale to get the cost down to get the margin up. It’s, I would say, a pretty straightforward relationship that's easy to understand, but we'd love to see these things happen faster, but there's work to be done in terms of getting the product to the marketplace and getting the volumes up and the cost out, and so that's an important part of our business plan. There are activities right now as we continue to work with all our suppliers, and also work with our customers to get the volumes up and—so we can achieve those economies of scale with the margins that we've targeted.

# Colin Rusch - Analyst, Oppenheimer & Co., Inc.

Okay, actually, I'll take the supply chain question offline, but just in terms of the customer interest around hydrogen and the designs, you've identified or talked about the fact that you're already selling into certain programs around having the best vehicles, but could you talk about the customer activity in the space, the design activity, and how active you are in terms of building a pipeline of business in that area?

# DAVID M. JOHNSON speaking

## Chief Executive Officer, Westport Fuel Systems

Yes. It's a great question. Thanks for asking, Colin, so the hydrogen market in various parts of the world, Europe being amongst them, but the—not lost on the Asian region, or North America, for that matter, is very, let's say, exciting and interesting. There's lots of people doing works in labs on developing products and getting ready for the availability of a hydrogen refueling, and certainly, the advent of green hydrogen at scale, so there's lots of things to be done, but we are working today with leading OEMs, as well as their supply base, so in some cases with Tier 2 to Tier 1, and providing them with product types and developing specific hardware for them on the fuel system side, basically getting fuel from a tank to a fuel cell, or perhaps, also, to engines, in some cases, because there are already some evaluations going on around the potential use of hydrogen into a combustion engine.

As I mentioned earlier in the call, we see an opportunity to leverage our HPDI technology with respect to hydrogen and really have a very compelling product. Our modeling looks very, very good to us. We should have something to offer the market that could have some significant legs and really offer some choice to the marketplace in terms of what kind of technology choices, including the potential, of course, to reuse existing engine architectures, and yet develop a green hydrogen internal combustion engine that could have really excellent economics, so we look forward to sharing with the market more news on that as it develops and we have the data to share with you.

## Colin Rusch - Analyst, Oppenheimer & Co., Inc.

Okay. Thanks so much, guys.

## DAVID M. JOHNSON speaking

### Chief Executive Officer, Westport Fuel Systems

Thank you.

## Operator

Our next question comes from Sameer Joshi with H.C. Wainwright. Please go ahead.

# Sameer Joshi - Analyst, H. C. Wainwright & Co., LLC

Hey, guys. Thanks for taking my questions. Can you elaborate a little bit on the India opportunity, the consolidation that you have done there, and what levels of revenues or contribution as a percent of total revenues do you expect from India and for the next few years?

# DAVID M. JOHNSON speaking

## Chief Executive Officer, Westport Fuel Systems

Sure. Glad to talk about it. This is, from our perspective, a very important development. Let me just talk to kind of the general theme and what we're doing and strategy and our operations there, and I'll let Richard comment a bit on the numbers that we don't consolidate, so they end up off the income statement in terms of any details, but in terms of our strategy, so first of all, the market in India has been a natural gas market for quite some time, and they've been in—developing the infrastructure, so you're probably aware there's on the order of almost approaching 2,000 CNG stations across the country, and they're—have a build-out plan for that, which is a national plan of 10,000 stations, and they're proceeding along that plan.

Natural gas vehicles, both light-duty and heavy-duty, are already in the marketplace, and we're supporting all the different customers that make those today, and we see a tremendous opportunity of growth, and the impetus for that growth is not just the infrastructure, but the infrastructure coupled with the economics that are now fully in play because of the advent of the Bharat Standard VI emission standards, so that's the standard that's like Euro 6, and what it causes is—I would tell you the dominant engine and fuel in India today is diesel fuel, but when you go from Euro 6 or Bharat—excuse me, Euro 4 to Euro 6, or Bharat IV to Bharat Standard VI, there's a significant cost increase in terms of after treatment that really erodes the competitiveness of the diesel engine, and therefore, puts a spotlight on natural gas fueled engines, so we have been in the market for a long time in India with a division named Rohan BRC that started out as the joint venture that then became a wholly-owned subsidiary of ours, and what we've done is we've rolled that into another entity that we have in partnership with UNO MINDA.

UNO MINDA is more than $1 billion Tier 1 supplier to the automotive industry in a number of areas, certain number of sectors, technology sectors, but with us, we work on natural gas product and support; customers like Maruti Suzuki, and so we rolled in our capability from our standalone sub into our JV with UNO MINDA, and we think that positions us quite well to serve the market even better than we could do on our own, and so it's a bit of a consolidation right at the time when the market's starting to pop, and frankly, we're truly pleased with the results we saw in Q3 with the growth in that market and our progress there, frankly, faster than I thought it would come following COVID in India, because COVID's not actually over in India, as it isn't over anywhere else in the world, and so that's an ongoing pressure, but nonetheless, the numbers were quite positive and we were pleased about that, so we think we're strategically positioned well and have a great partner, and we have a market that's really expanding right now as a result of the new emission regulations that came into effect just this year.

## Sameer Joshi - Analyst, H. C. Wainwright & Co., LLC

Understood. Richard, were you going to talk about the revenue contribution?

## RICHARD J. ORAZIETT speaking

### Chief Financial Officer, Westport Fuel Systems

Yes. Why don't we do that on our call separately, then?

## Sameer Joshi - Analyst, H. C. Wainwright & Co., LLC

Then, during the last quarter you mentioned the ESG report and (inaudible 38:36). Has there been any—can you give us an update on that, and is there investor interest activity on that front?

# DAVID M. JOHNSON speaking

## Chief Executive Officer, Westport Fuel Systems

Sorry, I missed the first part of your question. Could you say it again?

# Sameer Joshi - Analyst, H. C. Wainwright & Co., LLC

Oh, the ESG initiative, just an update on that.

# DAVID M. JOHNSON speaking

## Chief Executive Officer, Westport Fuel Systems

Yes, so we consider ourselves born and raised as an ESG company, and the nature of what we do is trying to clean up transportation around the world, and so having a report to then chronicle the work that we've been doing over the past decades and show our progress on various metrics is something we're proud to have and we’re pleased to release that report early this year, and so we're committed to continuing to do that and to continue to build our positioning as a—and I'll say not just positioning, but actually having people know, through the best basis of our reporting, about our ESG credentials, if you will, in the marketplace, so that's an important part of what we're doing as a Company.

# Sameer Joshi - Analyst, H. C. Wainwright & Co., LLC

Understood. I'll take my questions offline. Thanks.

# Operator

Once again, if you have a question, please press star, then one.

The next question comes from Jeff Osborne with Cowen & Co. Please go ahead.

# Jeffrey Osborne - Analyst, Cowen & Company, LLC

Hey. Good morning, guys. A couple of questions on my end. I was wondering if you could just touch on the CWI margins. There's been a lot of discussion about HPDI, but can you just touch on what the moving pieces were sequentially on CWI?

# RICHARD J. ORAZIETT speaking

## Chief Financial Officer, Westport Fuel Systems

The major difference, Jeff, was the—just there was a greater proportion of the sales mix for engine sales versus parts, and that drives most of the margin difference. The joint venture tried to offset that with, we'll call it, just managing their operating costs. We're expecting that trend to reverse a little bit in the fourth quarter we're—and get back to more normal margins that you would have seen at the first half of the year.

# Jeffrey Osborne - Analyst, Cowen & Company, LLC

Yes. That's helpful, and then can you just talk about the linearity within the quarter, and the reason I ask is normally your day sales outstanding are less than 90 days. Obviously, last quarter was a bit of a challenge, and I would assume it was a back-end loaded quarter, but can you just touch on—this quarter, the receivables seem to be a bit bloated relative to normal times, so was that the stimulus on the path car side kicking in, or was HDPI back-end loaded? Can you just touch on what drove the higher receivable account in terms—as measured by day sales outstanding?

## RICHARD J. ORAZIETT speaking

### Chief Financial Officer, Westport Fuel Systems

For sure, the—so the DSO is increasing specifically because of the European launch partners. There's a traditional 90-day, and it depends on when a sale falls in, that that creates a little bit of low working capital pressure. You would have heard me mention, actually, that we increased—we have a credit facility. We don't factor our receivables, but we actually borrow against them, and then the—when we collect money from the customer, can then—we pay down the facility, so it's fairly cheap financing, but we increased that by $10 million because of the sales are starting to increase, and we're paying our vendors 45 days, so there—we, unfortunately, have an asymmetry with regards to when we receive money versus when we're paying out, and so we're trying to address that with the customer.

## Jeffrey Osborne - Analyst, Cowen & Company, LLC

Got it. Then, I think you alluded in a prior question that pricing—as you have greater volume, pricing goes down based on pre-determined contracts, and you need China to kick in. A two-part question; was it down 30%? I thought I heard that number, was part one of the question, and part two is, is there subsequent breakpoints? Hypothetically, if volume doubles or quadruples here, does it go down another 30%? I'm just trying to understand what the trajectory is, especially if China is slow to ramp up for whatever reason.

## RICHARD J. ORAZIETT speaking

### Chief Financial Officer, Westport Fuel Systems

They're contractual. They're time-based, so they're not volume-based with the customer, and that's the way they were negotiated back in the day to attract a customer. I guess there was a view and a risk that was taken, so there is no—there is—there are some future ones, but they're small. The biggest ones have been taken away with that particular contract. With regards to that, I think we're okay for the time being, so now the question is how much volume we will get with the European customer, and then, obviously, Weichai, which things are progressing along.

We have this $18,000 take-and-pay agreement that we're currently negotiating with them to figure out what's the right cadence of what we will sell into the JV.

# Jeffrey Osborne - Analyst, Cowen & Company, LLC

Got it, and the last question I had was just can you touch on—you alluded to, in your prepared remarks, stimulus. Can you touch on what you saw in the past (inaudible 44:01) side as it relates to either Germany or France, or any individual countries that might have been bright spots in the third quarter?

# RICHARD J. ORAZIETT speaking

## Chief Financial Officer, Westport Fuel Systems

Bright spots for us—definitely, the Italian market is a big one for us, which is roughly 20%, so that's where we're definitely seeing the recovery. We've got a great distribution outlook and a sales team that sells into that, and we saw that recovery. It was quite significant from the second quarter. Effectively, Europe was almost comatose for quite a bit of it in the second quarter. That is coming back, and then look, they actually had a—even a strong October, which is—which was promising. The reason why we provided some caution in our statements is because of the sort of resurgence of COVID-19 you would have seen in—throughout Europe. There's, we'll call it, people are taking a pause again to stop the virus' propagation, so that's—Jeff, that's our biggest concern right now, so it is doing well. Turkey for us is doing well. Russia, as well, as a market, improved significantly, but it's a lot—it's very dependent, more so right now, on peoples' ability to go out and feel comfortable and go to their local shop and buy one of our systems with regards to independent aftermarket.

# Jeffrey Osborne - Analyst, Cowen & Company, LLC

Got it. Thank you. That's all I had.

## RICHARD J. ORAZIETT speaking

### Chief Financial Officer, Westport Fuel Systems

Okay.

## Operator

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

## CHRISTINE MARKS speaking

### Investor Relations Representative

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

## Operator

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