

MANAGEMENT'S DISCUSSION AND ANALYSIS

BASIS OF PRESENTATION

This Management's Discussion and Analysis ("MD&A") covers the interim consolidated financial statements for Westport Innovations Inc. ("Westport", "the Company", "we") for the three months ended June 30, 2007 and provides an update to our annual MD&A for the fiscal year ended March 31, 2007. This information is intended to assist readers in analyzing our financial results and should be read in conjunction with the audited annual consolidated financial statements, including the accompanying notes, for the fiscal year ended March 31, 2007 and our annual MD&A dated May 31, 2007. Our consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Additional information relating to Westport, including our Annual Information Form, is available on SEDAR at www.sedar.com. This MD&A is dated July 30, 2007. All financial information is reported in Canadian dollars unless otherwise noted.

This report contains forward-looking statements, including statements regarding the future success of our business and technology strategies and future market opportunities. These statements are neither promises nor guarantees, but involve known and unknown risks and uncertainties that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activities, performance or achievements expressed in or implied by these forward-looking statements. These risks include risks related to our revenue growth, operating results, industry and products as well as other factors discussed below and elsewhere in this report. Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date they were made. We disclaim any obligation to publicly update or revise such statements to reflect any change in our expectations or in events, conditions or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those set forth in the forward-looking statements.

FINANCIAL OVERVIEW

Westport's business operations and strategy are substantially unchanged from March 31, 2007. We are engaged in the research, development and marketing of high performance, low-emissions engine and fuel systems which use gaseous fuels such as natural gas, propane or hydrogen. Our strategy is to develop our technologies and products in cooperation with the world's leading engine and vehicle manufacturers and fuel infrastructure providers.

Our strategy is broken down into four "pillars":

1. profitably growing Cummins Westport Inc ("CWI");
2. launching our liquefied natural gas ("LNG") systems for heavy-duty trucks in North America and Australia;
3. developing new OEM and strategic supply relationships; and
4. maintaining our technology leadership.

Our consolidated revenues for the three months ended June 30, 2007 compared to the three months ended June 30, 2006 increased by 48% to \$15.7 million from \$10.6 million. CWI product revenues increased by \$3.5 million as the result of increased shipments of engines and kits to Asia and CWI parts revenue also increased by \$0.9 million. We also followed up our initial launch of LNG systems for heavy duty trucks in the fourth quarter of 2007 with 11 LNG systems shipped in the three months ended June 30, 2007 and recognised \$1.1 million in non-CWI revenues.

Our net loss for the three months ended June 30, 2007 was \$4.7 million, or (\$0.06) per share, down \$0.7 million from \$5.4 million, or (\$0.07) per share, in the same period in fiscal 2007. CWI's revenues increased by \$4.4 million and related gross margins increased by \$1.1 million but our 50% share of net contribution from CWI decreased slightly from \$0.8 million to \$0.6 million after taking into account a \$0.5 million increase in operating expenses and the impact of foreign exchange on US dollar denominated cash, accounts receivable and future income tax assets. Excluding CWI, Westport's net loss improved by \$0.9 million primarily as the result of higher gross margins, lower research and development expenses and increased government funding in the quarter totaling approximately \$1.0 million and a gain of \$0.7 million on the sale of approximately 4% of our shareholdings in Clean Energy Fuels Corp. ("Clean Energy"), offset by \$0.8 million in interest and amortization of discount on our long-term convertible note.

Our cash balance as at June 30, 2007 was \$19.9 million compared to \$23.1 million as at March 31, 2007, a change of \$3.2 million. Cash used in operations and for capital expenditures for the three months ended June 30, 2007 was \$4.7 million compared to \$3.8 million in the comparable period of the prior year, with the increase primarily driven by increased working capital requirements (\$1.2 million). Operating cash usage was offset by \$1.1 million in proceeds received from our sale of Clean Energy shares and \$0.6 million in proceeds received on the issuance of shares on conversion of employee stock options.

Subsequent to June 30, 2007, Perseus, L.L.C. ("Perseus"), through its affiliates exercised the conversion option on the approximately \$22.1 million of secured, subordinated convertible debentures (the "Notes") held by them in order to acquire approximately 16.5 million common shares of Westport which were sold to third parties at a price of \$3.10 per share for total gross proceeds of approximately \$51.3 million with all proceeds going to Perseus and its affiliates. As an inducement for them to convert, we agreed to pay to Perseus an amount equal to 50% of the interest that would otherwise have been payable on the converted Notes, on December 31, 2007 and June 30, 2008. These payments, including any interest amounts accrued to the date of conversion, are expected to total approximately \$884,000 and may be made, at Westport's option, in a combination of Common Shares, additional Notes and, in certain circumstances, cash.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with Canadian GAAP, which require us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements. We have identified several policies as critical to our business operations and in understanding our results of operations. These policies, which require use of estimates and assumptions in determining their reported amounts, include our accounting of CWI as a variable interest entity, the valuation of long-term investments, equipment, furniture and leasehold improvements, intellectual property, inventory and warranty. The application of these and other accounting policies are described in note 2 of our fiscal 2007 annual consolidated financial statements. There have been no significant changes in our critical accounting estimates from what was previously disclosed in our MD&A for the year ended March 31, 2007 except as noted below in the "Changes in Accounting Policy" section. Actual amounts may vary significantly from estimates used.

CHANGES IN ACCOUNTING POLICY

The accounting policies used in the unaudited consolidated interim financial statements for the three months ended June 30, 2007 are unchanged from the year ended March 31, 2007 except as noted below.

Financial Instruments

In April, 2005, the Canadian Institute of Chartered Accountants (“CICA”) issued Section 3855 Financial Instruments – Recognition and Measurement, applicable to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006.

Under Section 3855, financial assets and liabilities, including derivative instruments, are initially recognised and subsequently measured based on their classification as held-for-trading, available for sale financial assets, held-to-maturity loans and receivables, or other financial liabilities as follows:

- Held-for-trading financial instruments are measured at their fair value with changes in fair value recognised in net income for the period.
- Available for sale financial assets are measured at their fair value and changes in fair value are included in other comprehensive income until the asset is removed from the balance sheet.
- Held-to-maturity investments, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest rate method.
- Derivative instruments, including embedded derivatives, are measured at their fair value with changes in fair value recognised in net income for the period unless the instrument is a cash flow hedge and hedge accounting applies, in which case changes in fair values are recognised in other comprehensive income.

We adopted this section effective April 1, 2007. Short-term and long-term investments have been classified as “available for sale” and, except where fair value is not determinable, are being measured at fair value with changes in fair value included in other comprehensive income until the asset is removed from the balance sheet. Deferred transaction costs related to the Perseus convertible note have been netted against the long-term debt and are being amortized using the effective interest method. As the result of adopting Section 3855, long-term investments increased by \$20.5 million, deferred transaction costs decreased by \$0.9 million, opening accumulated deficit decreased by \$0.1 million and long-term debt decreased by \$0.8 million. We have also added a separate statement entitled “Consolidated Statements of Shareholders’ Equity and Comprehensive Income (Loss)” and added the caption “Accumulated other comprehensive income (loss)” to the shareholders’ equity section of our balance sheet. Other comprehensive loss for the three months ended June 30, 2007, was \$6.7 million, which includes our net loss of \$4.7 million, an unrealised loss on available for sale securities of \$1.2 million and a reclassification of \$0.7 million to realised gains as a result of the sale of available for sale securities.

Comprehensive Income

CICA Section 1530 introduced new standards for the reporting and presentation of comprehensive income, which is the change in equity, or net assets, of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by, and distributions to, owners. We adopted Section 1530 effective April 1, 2007.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

We have disclosure controls and procedures in place that are designed to provide reasonable assurance that material information relating to us is disclosed on a timely basis. We have reviewed our disclosure controls and concluded that they were effective during the reporting period. We have also designed internal controls over financial reporting to provide us with reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. We expect that our financial reporting policies, processes and systems will continue to evolve in our fiscal year

2008 as we continue our shift from research and development to shipping product at increasing volume levels. In particular, our inventory and warranty processes and systems are expected to change over the next few quarters. However, no material changes were made in our internal controls over financial reporting during the interim period ended June 30, 2007.

RESULTS FROM OPERATIONS

Product revenue for the three months ended June 30, 2007 compared to the three months ended June 30, 2006 increased by 55% to \$11.8 million from \$7.6 million. CWI product revenues increased by \$3.5 million as the result of increased shipments of engines and kits to Asia, with a total of 522 engines shipped in the quarter compared to 341 engines shipped in the same quarter last fiscal year. Over 50% of sales were made outside of North America. We also followed up our initial launch of LNG systems for heavy duty trucks in the fourth quarter of 2007 with 11 LNG systems shipped in the three months ended June 30, 2007, recognising \$1.1 million in non-CWI revenues compared to \$0.4 million in the same period in the prior year. Foreign exchange had a negative impact of approximately 3% as the US dollar declined by that amount on average quarter over quarter.

	Three months ended June 30	
	2007	2006
	(unaudited)	(unaudited)
Total units shipped	533	341
Product	11,842	7,644
Parts revenue	3,888	2,978
	15,730	10,622

	Three months ended June 30	
	2007	2006
	(unaudited)	(unaudited)
North America	49%	72%
Asia	30%	6%
Rest of the world	21%	22%

Parts revenue for the three months ended June 30, 2007 compared to June 30, 2006 increased to \$3.9 million from \$3.0 million as a result of change of mix in parts sold and timing.

Cost of revenue for the three months ended June 30, 2007 increased by 58% to \$10.4 million compared to \$6.6 million in the same period last year, primarily reflecting higher revenues and product mix. Included in cost of revenues was a \$0.6 million warranty adjustment (Q107 - \$0.4 million).

Gross margin increased to \$5.3 million from \$4.0 million on higher revenues. Gross margin percentage decreased from 38% in the three months ended June 30, 2006 to 34% primarily as the result of product and geographical mix and with parts, kits and LNG systems generally selling at lower margins on a percentage, though not necessarily dollar, basis than CWI engines. In addition, parts gross margin percentage decreased by 6 percentage points year over year due to the mix of parts sold.

Research and development expenses, on a net basis, for the three months ended June 30, 2007 were \$5.4 million compared to \$6.0 million for the same period last year. Non-CWI research and development expenses (R&D) decreased by \$0.9 million as the result of higher government funding recognised in the period (\$0.5 million) related to the extension of our funding agreement with the Industrial Technologies Office (ITO), formerly Technology Partnerships Canada. Gross R&D expenses in the period ending June 30, 2006 also contained an accrual for \$0.3 million for royalty payments to ITO that, under the terms of the extension, will now not come into effect until April 1, 2008. CWI R&D expenses increased by \$0.3 million with increased testing and production readiness activity around the launch of the ISL-G.

	Three months ended June 30	
	2007	2006
	(unaudited)	(unaudited)
Research and development expenses	6,731	6,775
Program funding	(1,290)	(777)
Net research and development expenses	5,441	5,998

General and administrative expenses for the first quarter of fiscal year 2008 were down \$0.3 million to \$1.1 million from \$1.4 million primarily due to timing of travel, conferences and other similar activities.

Sales and marketing expenses increased by \$0.8 million to \$1.8 million in the three months ended June 30, 2007 from \$1.0 million in the same period last year. Half of this increase was attributable to increased sales and marketing activities in CWI with the launch of the ISL-G and continuing support for the L-Gas plus. Non-CWI sales and marketing expenses also increased with increased business development activities in Asia and California.

Foreign exchange loss of \$0.5 million in the three months ended June 30, 2007 primarily reflects the realised net loss on foreign currency transactions and the net unrealised losses on our US dollar denominated assets and liabilities, which as at March 31, 2007 was comprised mainly of cash, accounts receivable and warranty. From March 31, 2007 to June 30, 2007, the US dollar weakened by 8%. In the three months ended June 30, 2006, the US dollar decreased by approximately 1%. However, at that time, we had a net US dollar liability position which resulted in a gain of \$0.1 million.

Depreciation and amortization for the three months ended June 30, 2007 was consistent with the comparable period in the prior year at \$0.4 million.

Interest on long-term debt and amortization of discount was \$0.8 million in the three months ended June 30, 2007 and relates primarily to the interest and the accretion on the \$22.1 million in convertible Notes. The first issuance of these Notes of \$5.5 million occurred on June 12, 2006 and, accordingly, the interest in the corresponding period of the prior year was nominal. The full amount of the Notes was converted into shares subsequent to June 30, 2007.

Gain on sale of long-term investment of \$0.7 million in the three months ended June 30, 2007 arose on the sale of 92,575 shares of Clean Energy for proceeds of \$1.1 million.

Joint Venture Partner's share of income from joint venture reflects Cummins' 50% share of CWI net operating contribution in the period.

Income tax expense of \$0.4 million in the three months ended June 30, 2007 relates primarily to the translation of CWI's US dollar denominated future income tax asset into Canadian dollars. Due to the 8% decline in the US dollar from March 31, 2007, the asset has declined in value by \$0.3 million in Canadian dollar terms.

CAPITAL REQUIREMENTS, RESOURCES AND LIQUIDITY

As at June 30, 2007, our cash, cash equivalents and short-term investment position was \$19.9 million.

During the three months ended June 30, 2007, we used \$3.4 million for operating purposes, \$1.2 million for working capital purposes and \$0.2 million for purchases of equipment, furniture and leasehold improvements. Working capital includes \$1.5 million used to pay down trade accounts payable from March 31, 2007 tied primarily to inventory and other trade purchases (\$1.1 million) and annual employee bonuses. We also sold approximately 4% of our holdings in Clean Energy for \$1.1 million and received \$0.6 million on the exercise of employee share options in the period.

We believe that our current cash, cash equivalents and short-term investments, and our investment in Clean Energy provide us with sufficient capital to meet our committed milestones and obligations for our current programs. In addition, we have a \$13 million credit facility with our bank, which has been drawn down by our demand instalment loan of \$1.5 million and a \$0.6 million letter of credit.

Westport's capital requirements will vary depending on a number of factors, including the timing and volume of orders for our LNG systems, our ability to successfully launch product on time, our success in executing our business plan, relationships with current and potential strategic partners, commercial sales and margins, product reliability, progress on research and development activities, capital expenditures and working capital requirements.

We expect our working capital requirements to increase for inventory purposes as we commercialize our products and solutions. We also review investment and acquisition opportunities on a regular basis for technologies, businesses and markets that would complement our own products or assist us in our commercialization plans. Significant new or expanded engine programs, acquisitions or investments could require additional funding. If such additional funding is not available to us, or if we have significant overspending in our programs, we may be required to delay, reduce or eliminate certain research and development activities and possibly forego new program, acquisition or investment opportunities. Any of those circumstances could potentially result in a delay of the commercialization of our products in development.

This "Capital Requirements, Resources and Liquidity" section contains certain forward looking statements. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Readers are encouraged to read the "Basis of Presentation" section of this MD&A which discusses forward-looking statements and the "Risks and Uncertainties" section of our Annual Information Form.

CONTINGENT OFF-BALANCE SHEET ARRANGEMENTS

Commitments and contingencies have been disclosed in our annual MD&A dated May 31, 2007 and are substantially unchanged.

SHARES OUTSTANDING

For the three months ended June 30, 2007, the weighted average number of shares used in calculating the loss per share was 75,745,692. Actual shares outstanding as of June 30, 2007 were 76,164,737 with 2,655,288 warrants outstanding, 4,850,386 share options outstanding at a weighted average price of \$1.94 and 3,164,616 performance share units outstanding. Of the share options outstanding, 2,769,914 were exercisable at a weighted average price of \$2.29. Of the performance share units outstanding, 1,964,616 were exercisable.

As at July 30, 2007, there were 93,068,927 shares outstanding, 4,774,997 share options outstanding at a weighted average price of \$1.97 and 3,164,616 performance share units outstanding. Of the share options outstanding, 3,031,193 were exercisable at a weighted average price of \$2.28. Of the performance share units outstanding, 1,964,616 were exercisable.

SELECTED QUARTERLY FINANCIAL DATA (unaudited)

The selected table provides summary financial data for our last eight quarters:

Three months ended	30-Sep-05	31-Dec-05	31-Mar-06	30-Jun-06	30-Sep-06	31-Dec-06	31-Mar-07	30-Jun-07
Units shipped	384	245	388	341	414	629	617	533
Average foreign exchange rate (C\$:US\$)	\$ 1.19	\$ 1.17	\$ 1.15	\$ 1.11	\$ 1.12	\$ 1.14	\$ 1.17	\$ 1.10
<i>(Expressed in thousands of Canadian dollars except per share)</i>								
Product revenue	\$ 9,095	\$ 5,147	\$ 8,684	\$ 7,644	\$ 10,327	\$ 13,568	\$ 15,656	\$ 11,842
Parts revenue	\$ 3,134	\$ 3,466	\$ 3,512	\$ 2,978	\$ 3,401	\$ 3,248	\$ 3,658	\$ 3,888
Total revenue	\$ 12,229	\$ 8,613	\$ 12,196	\$ 10,622	\$ 13,728	\$ 16,816	\$ 19,314	\$ 15,730
Gross margin	\$ 4,295	\$ 3,680	\$ 4,225	\$ 4,037	\$ 4,776	\$ 5,398	\$ 7,888	\$ 5,338
	35%	43%	35%	38%	35%	32%	41%	34%
Net income (loss) for the period	\$ (3,329)	\$ (3,607)	\$ (3,711)	\$ (5,420)	\$ (1,840)	\$ (5,778)	\$ 1,731	\$ (4,724)
Basic and diluted earnings (loss) per share ⁽¹⁾	\$ (0.05)	\$ (0.05)	\$ (0.05)	\$ (0.07)	\$ (0.02)	\$ (0.08)	\$ 0.02	\$ (0.06)
Cash from (used in) operations before change in non-cash operating working capital	\$ (1,463)	\$ (2,225)	\$ (1,954)	\$ (3,685)	\$ (3,760)	\$ (4,448)	\$ 568	\$ (3,372)
Company's 100% share of CWI net income	\$ 1,516	\$ 502	\$ 1,035	\$ 1,528	\$ 1,392	\$ 806	\$ 8,389	\$ 1,160
Joint Venture Partner's share of CWI net income	\$ 758	\$ 251	\$ 518	\$ 764	\$ 696	\$ 403	\$ 4,194	\$ 580

⁽¹⁾ Fully diluted loss per share is not materially different as the effect of stock options, warrants and performance share units would be anti-dilutive.

Our quarterly results are impacted by the timing of product deliveries, completion of engineering milestones, government and partner funding, timing of sale of investments, financing related transactions and foreign exchange gains and losses. CWI income or loss, and our resulting 50% share, will vary from quarter to quarter depending on the timing of unit sales, product and customer mix, and the timing of completion of engineering milestones and related government funding.

RISKS AND UNCERTAINTIES

Business risks and uncertainties related to product development, competitive and regulatory environments, economic and industry factors are described in detail in our 2007 Annual Information Form and are substantially unchanged.