

## **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 and nine months ended December 31, 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](http://www.sedar.com). All financial information is reported in Canadian dollars unless otherwise noted. This third quarter fiscal year 2008 MD&A is dated January 31, 2008.

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 "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.

For the three months ended December 31, 2007, consolidated revenues were \$19.3 million, up from \$16.8 million in the same quarter of the prior year. The increase in revenues resulted from increased CWI shipments in North America and Europe which offset lower shipments to Asia. US dollar revenue growth was 34% but with the US dollar weakening over the period, in Canadian dollar terms, revenue growth was 15%.

Consolidated net income for the three months ended December 31, 2007 was \$7.4 million, or \$0.08 earnings per share (\$0.07 on a fully diluted basis), compared to a net loss of \$5.8 million, or \$0.08 loss per share, for the three months ended December 31, 2006. Included in net income for the three months ended December 31, 2007 is a gain on the sale of long-term investments of \$9.4 million, including a \$6.7 million gain on the sale of approximately 600,000 of our 2 million shares of Clean Energy Fuels Corp. ("Clean Energy"), and a \$2.7 million gain on the sale of substantially all of our shares of Wild River Resources Inc. ("Wild River"). CWI also recognised \$5.9 million in future income tax benefits, 50% of which, after deducting our joint venture partner's share, is included in our net income number. Excluding the effects of the gains and our share of the tax benefit, our net loss for the third quarter was \$5.0 million compared to \$5.8 million in the same period of the prior year. The \$0.8 million improvement was primarily due to higher revenues and gross margins and lower interest and amortization expense.

For the nine months ended December 31, 2007, consolidated revenues were up 37% to \$56.2 million compared to \$41.2 million in the same period in the prior year on higher CWI shipments and the launch of Westport's LNG systems for heavy-duty trucks. US dollar revenue growth was 49% but this increase was offset by the decline in the US dollar in the period.

Our net loss for the nine months ended December 31, 2007 was \$2.2 million compared to \$13.0 million in the same period of the prior year. The \$10.8 million decrease in net loss was primarily attributable to a \$10.1 million gain recognised on the sale of approximately a third of our interest in Clean Energy and substantially all of our remaining shares in Wild River compared to a \$3.9 million gain on the sale of 45% of our interest in Wild River in the nine months to December 31, 2006, and CWI's recognition of future income tax benefits discussed above. Excluding the gains on sale of investments and CWI's recognition of future tax benefits, net loss improved by \$1.9 million to \$15.0 million from \$16.9 million, primarily because of higher gross margins (\$3.7 million), lower research and development costs (\$1.6 million) and higher net interest and other income (\$0.5 million) offset by higher sales and marketing expenses (\$1.2 million) and foreign exchange loss of \$1.1 million. Cummins' share of CWI before taxes also increased by \$1.7 million as CWI's pre-tax income for the nine months ended December 31, 2007 increased by \$3.5 million to \$7.2 million.

Our cash and short term investments balance as at December 31, 2007 was \$24.9 million compared to \$23.1 million as at March 31, 2007, an increase of \$1.8 million. During the quarter, we sold approximately 600,000 shares of Clean Energy for proceeds of \$9.4 million. We also sold substantially all of our shares in Wild River for proceeds of \$6.7 million, which were applied against our related limited recourse bank loan of \$6.7 million, fully repaying the loan. During the quarter, we also received a limited recourse loan, repayable only from certain receipts of sales of LNG systems, from a partner for \$4.0 million to allow us to produce approximately 50 LNG systems in anticipation of deliveries to customers in 2008.

On July 26, 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 then 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 Perseus's conversion of the Notes, we agreed to pay them an amount equal to 50% of the interest that would otherwise have been payable on the Notes, on December 31, 2007 and June 30, 2008, had the Notes not been converted. Interest accrued to July 25, 2007 of \$0.1 million and the inducement payment of \$0.8 million totaled approximately \$0.9 million and can be settled at Westport's option, in a combination of common shares, new Notes and, in certain circumstances, cash. On conversion, the long-term debt portion and value of the conversion option were moved to share capital and the inducement, which was allocated to the conversion option based on the relative fair values of the debt and equity features of the notes, was charged

directly to accumulated deficit. Subsequent to December 31, 2007, we issued 156,816 shares to settle \$0.5 million of the amounts payable to Perseus, net of any applicable taxes.

On October 26, 2007, we announced the formation of a 51:49 equity joint venture with OMVL SpA, an Italian company that designs, manufactures and markets complete fueling systems for new vehicles and for the aftermarket conversion of engines from gasoline (petrol) to CNG and LPG. The new venture will design, produce and sell alternative fuel engines in the sub-5 litre class for global applications. Under the terms of the joint venture agreement, we are obligated to invest \$1.5 million by April 1, 2008 and will receive 49% of future profits.

On January 24, 2008, we announced that the Kenworth Truck Company (“Kenworth”), a division of PACCAR Inc., will begin production of Kenworth T800 LNG trucks at its manufacturing facility in Renton, Washington, in 2009 with our LNG fuel system technology adapted for the Cummins ISX-15-liter engine. In order to support the Kenworth factory initiative, we plan to open a new assembly center in the Metro Vancouver area in the first half of 2008 to produce LNG engines and fuel systems. This new arrangement, which will increase our capital expenditures in the near term, will allow us to increase our production capacity from several hundred units per year to thousands of units per year.

## **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 and BTIC Westport Inc. (“BWI”) as variable interest entities, 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 and nine months ended December 31, 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. As the result of adopting Section 3855, as at April 1, 2007, long-term investments increased by \$20.4 million, and opening accumulated deficit decreased by \$0.1 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 income for the three months ended December 31, 2007, was \$0.8 million, which includes our net income of \$7.4 million, a reclassification from unrealised gains to net income of \$6.5 million related to investments sold and an unrealised loss on available for sale securities of \$0.1 million. For the nine months ended December 31, 2007, comprehensive loss was \$7.4 million.

### **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.

### **Hedging**

CICA Section 3865 specifies the circumstances under which hedge accounting is permissible and how hedge accounting may be performed. As we are not currently engaged in hedging activities, adoption of this new standard has no impact on the consolidated financial statements.

## **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, particularly around inventory, warranty and sales, 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 the nine months ended December 31, 2007, we implemented certain inventory modules of our enterprise resource planning system which will allow us to more efficiently track cost of sales. Our primary internal controls and processes over inventory remained unchanged. We have also automated parts of our warranty tracking processes for LNG systems and are in the process of reviewing requirements for a sales order system. No material changes were made in our internal controls over financial reporting during the interim period ended December 31, 2007.

## RESULTS FROM OPERATIONS

**Product revenue** for the three months ended December 31, 2007 compared to the three months ended December 31, 2006 increased by 14% to \$15.5 million from \$13.6 million. CWI product revenues increased by \$1.9 million to \$14.8 million from \$12.9 million the prior year as the result of increased sales in North America and Europe offsetting a decrease in shipments to Asia. In the quarter ended December 31, 2007, CWI shipped a total of 798 units compared to 629 units shipped in the same quarter of the prior year. CWI US dollar revenues increased by \$3.7 million but this increase was offset by a 14% decline in the US dollar in the period. Non-CWI product and engineering revenues were relatively unchanged at \$0.6 million, which included 3 LNG systems shipped in the quarter.

For the nine months ended December 31, 2007 and 2006, product revenues were \$44.0 million and \$31.5 million respectively. CWI revenues increased to \$40.0 million from \$30.1 million with the successful launch of the ISL-G engine in North America and increased sales to Asia accounting for much of the increase. Non-CWI revenues increased by \$2.5 million with commercial sales of our Westport LNG systems accounting for approximately \$3.1 million and offsetting the \$0.6 million decrease in revenues earned from contract engineering and other services.

<b>Revenue</b>				
<i>(expressed in thousands of Canadian dollars except for units)</i>				
	<b>Three months ended December 31</b>		<b>Nine months ended December 31</b>	
	<b>2007</b> (unaudited)	<b>2006</b> (unaudited)	<b>2007</b> (unaudited)	<b>2006</b> (unaudited)
Unit shipments	801	629	2,201	1,384
Product revenue	15,488	13,568	43,969	31,539
Parts revenue	3,822	3,248	12,240	9,627
	<b>19,310</b>	<b>16,816</b>	<b>56,209</b>	<b>41,166</b>

<b>Product Revenue by Geographic Region</b>				
<i>(As a percentage of revenue dollars)</i>				
	<b>Three months ended December 31</b>		<b>Nine months ended December 31</b>	
	<b>2007</b> (unaudited)	<b>2006</b> (unaudited)	<b>2007</b> (unaudited)	<b>2006</b> (unaudited)
North America	77%	61%	60%	65%
Asia	7%	31%	22%	19%
Rest of the world	16%	8%	18%	16%

**Parts revenue** for the three and nine months ended December 31, 2007 compared to December 31, 2006 was \$3.8 million and \$12.2 million compared to \$3.2 million and \$9.6 million, respectively. The increase in parts revenue year to date is due to distributors stocking new parts for the newly launched ISL-G engine, modifications related to the L-Gas engine, an increasing and aging engine population, product mix and timing.

**Cost of revenue** for the three and nine months ended December 31, 2007 were \$12.8 million and \$38.3 million respectively, up from \$11.4 million and \$27.0 million respectively, reflecting the increase in sales. Included in CWI's cost of revenue of \$12.5 million and \$35.2 million for the three and nine months ended December 31, 2007 were net positive adjustments to warranty of \$0.4 million and \$1.4 million respectively. In the nine months ended December 31, 2006, there were net positive adjustments to warranty of \$0.3 million. These adjustments reflect our growing claims data for CWI products, which allows us to better estimate our warranty liability. However, with the launch of new products such as HPDI LNG systems and the new ISL-G engine, warranty numbers are still subject to fluctuations from quarter to quarter.

**Gross margin** dollars in the three and nine months ended December 31, 2007 compared to the three and nine months ended December 31, 2006 increased to \$6.6 million and \$17.9 million respectively from \$5.4 million and \$14.2 million on higher revenues. Gross margin percentage in the three months ended December 31, 2007 increased to 34% from 32% primarily as the result of net adjustments to warranty in the period. For the nine months ended December 31, 2007, gross margin percentage declined primarily because of product and geographical mix and with parts, kits and LNG systems generally selling at lower margins on a percentage basis relative to CWI engines. CWI gross margin percentages have also declined in the year with the launch of the ISL-G engine in the year, which, being a new product, launched with more conservative warranty estimates than its predecessor, the C-Gas Plus. Foreign exchange has also had an impact on LNG systems margins in the year with inventories purchased when the US dollar was stronger and sales occurring when the US dollar is weaker. In addition, parts gross margin percentage has decreased year over year due to the mix of parts sold.

**Research and development** expenses, on a net basis, for the three months ended December 31, 2007 were \$6.0 million compared to \$6.3 million for the same period last year. Non-CWI research and development expenses (R&D) increased by \$0.8 million as the result of higher spending on testing and certification costs related to the launch of our '07 product and increased supply chain and other production activities. Gross R&D expenses in the period ending December 31, 2006 also contained an accrual for \$0.3 million for royalty payments to the Industrial Technologies Office "ITO" (formerly Technology Partnerships Canada), which, under the terms of our extension agreement with them, will now not come into effect until April 1, 2008. CWI R&D expenses decreased by \$1.1 million with the launch of the ISL-G engine. For the nine months ended December 31, 2007, research and development expenses are down \$1.6 million primarily because of the timing of funding recognised under the ITO extension and lower CWI R&D offset by higher development costs associated with the commercial launch of our LNG systems. We have recognised approximately \$1.0 million in ITO funding to December 31, 2007 and have reached our maximum claimable amount of \$18.9 million under our agreement with ITO.

<b>Research and Development Expenses</b>				
<i>(expressed in thousands of Canadian dollars)</i>				
	<b>Three months ended December 31</b>		<b>Nine months ended December 31</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Research and development expenses	6,290	6,948	19,379	20,212
Program funding	(350)	(612)	(2,920)	(2,145)
Research and development, net	5,940	6,336	16,459	18,067

**General and administrative** expenses for the three and nine months ended December 31, 2007 were \$1.9 million and \$4.1 million, respectively, compared to \$1.4 million and \$4.3 million in the same periods in the prior year. Expenses increased in the quarter due to timing and higher consulting and travel expenses. Year to date, expenses were down \$0.2 million primarily due to lower stock based compensation expense and timing of expenses.

**Sales and marketing** expenses in the three and nine months ended December 31, 2007 were \$2.3 million and \$6.4 million compared to \$2.2 million and \$5.1 million in the same periods in the prior year. The increase in sales and marketing expenses are primarily attributable to increased sales and marketing activities in CWI with the launch of the ISL-G engine and continuing support for the L-Gas plus and non-CWI sales and marketing expenses associated with business development activities in Asia and California.

**Foreign exchange loss (gain)** of \$0.04 million gain and \$1.0 million loss in the three and nine months ended December 31, 2007 primarily reflected the realised net loss on foreign currency transactions and the net unrealised losses on our US dollar denominated assets and liabilities such as cash, accounts receivable and warranty. From March 31, 2007 to December 31, 2007, the US dollar weakened by 14%. In the nine months ended December 31, 2006, the US dollar decreased by approximately 2%. However, at that time, we had a net US dollar liability position which resulted in a gain of \$0.1 million. With the accumulation of CWI profits in US dollars, we are currently in a net US dollar position with US dollar cash and receivables offsetting US dollar payables and warranty liability.

**Depreciation and amortization** for the three and nine months ended December 31, 2007 were consistent with the comparable period in the prior year at \$0.4 million (2006 - \$0.4 million) and \$1.1 million (2006 - \$1.0 million).

**Interest on long-term debt and amortization of discount** was nil (2006 - \$0.4 million) and \$1.0 million (2006 - \$0.9 million) in the three and nine months ended December 31, 2007 and related primarily to the interest and the accretion on the \$22.1 million in convertible notes, the first issuance of which occurred June 12, 2006. The full amount of the Notes was converted into shares on July 26, 2007, at which point we retired the debt and ceased to accrue interest and to amortize the discount.

**Gain on sale of interest in subsidiary** in the second quarter of fiscal 2007 of \$3.9 million related to the reorganization and disposition of 45% of Wild River, a former wholly owned subsidiary of the Company.

**Gain on sale of long-term investment** of \$9.4 million in the three months ended December 31, 2007 arose on the sale of approximately 600,000 shares of Clean Energy for net proceeds of \$9.4 million, which resulted in a net gain of \$6.7 million, and on the sale of substantially all of our

shares in Wild River for proceeds of \$6.7 million, which resulted in a gain of \$2.7 million. In the nine months ended December 31, 2007, we recognised a total gain on sale of long-term investments of \$10.1 million, which includes a gain on approximately 93,000 shares of Clean Energy disposed of in the three months ended June 30, 2007.

**Income tax recovery** in the three and nine months ended December 31, 2007 of \$5.9 million and \$5.4 million relates primarily to the future income tax benefit from its loss carryforwards fully recognised by CWI in the period offset by changes in foreign exchange rates and actual taxes paid or accrued. CWI has been taxable since 2004 and has determined that it is more likely than not that they will be able to fully utilize their net operating tax loss carryforwards before they expire. Accordingly, no valuation allowance has been taken against tax loss carryforwards and the full amount has been recognised as a future income tax asset.

**Joint venture partners' share of income from joint ventures** reflects Cummins' 50% share of CWI's net operating contribution in the period and includes Cummins' share of CWI's future income tax benefit. It also includes BTIC's 50% share of BWI's net operating loss in the period.

## CAPITAL REQUIREMENTS, RESOURCES AND LIQUIDITY

As at December 31, 2007, our cash, cash equivalents and short-term investment position was \$24.9 million. Cash and cash equivalents consist of guaranteed investment certificates, bankers acceptances, and term deposits with maturities of 90 days or less when acquired. Short-term investments consist of investment grade commercial paper. We invest primarily in short-term paper issued by Schedule 1 Canadian banks, R1 high rated corporations and governments. While we do not hold asset backed securities directly, these parties may be exposed in varying degrees to asset backed securities and US sub-prime mortgages. We continually monitor our portfolio and diversify our investments.

During the three months ended December 31, 2007, we used \$3.3 million for operating purposes before changes in working capital and \$0.3 million for purchases of equipment, furniture and leasehold improvements. We used \$6.8 million for working capital, primarily as the result of an increase in accounts receivable of \$5.3 million and increased inventory of \$2.9 million offset by an increase in accounts payable and warranty liabilities. Accounts receivable increased primarily because of increasing quarterly cashflow being generated by CWI and our and Cummins intent to review the process by which the quarterly payments are settled between CWI and the joint venture partners.

During the three months ended December 31, 2007, we also disposed of approximately 30% of our position in Clean Energy for proceeds of \$9.4 million and substantially all of our shares of Wild River for \$6.7 million. The proceeds from Wild River were used to repay our limited recourse bank loan of \$6.7 million. We also drew an additional \$2.0 million against our demand instalment loan to fund inventory purchases and obtained a limited recourse loan of \$4.0 million from Clean Energy to produce approximately 50 completed and upfitted LNG systems. The loan is repayable only from the receipts from sale of those units.

For the nine months ended December 31, 2007, we used \$9.4 million for operating purposes and \$0.5 million for capital expenditures. Working capital used was \$6.8 million, primarily because of increases in inventory (\$3.9 million) for LNG systems and net increases in accounts receivable (\$2.8 million) arising from an increase in amounts due from Cummins offset by collections from ITO. To date, we have sold approximately a third of our position in Clean Energy for \$10.5 million and have received \$1.0 million on the exercise of employee share options.

On January 24, 2008, we announced that Kenworth will be beginning production of Kenworth T800 LNG trucks at its manufacturing facility in Renton, Washington, in 2009 with our LNG fuel system technology adapted for the Cummins ISX-15-liter engine. In order to support the Kenworth factory initiative, we will open a new LNG Fuel System Assembly Center in the Metro Vancouver area in the first half of 2008. This initiative is expected to increase capital costs by approximately \$3.5 million over the next six months with funding coming from existing cash resources and existing credit facilities. We also expect increases in working capital for inventory purposes and are also committed to invest \$1.5 million into our joint venture with OMVL on or before April 1, 2008.

We believe that our current cash, cash equivalents and short-term investments, and our investment in Clean Energy, valued at \$21.2 million on a fair value basis as at December 31, 2007, 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 \$4.1 million and a \$0.6 million letter of credit. During the year, we re-negotiated the interest rate payable on our credit facility from prime to prime minus 0.25% for borrowings up to \$5 million. Further rate reductions apply if borrowings exceed \$5 million. Clean Energy is listed on NASDAQ and its share price is subject to fluctuations with changes in its business, general economic factors and/or market conditions.

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, supply chain and manufacturing requirements, 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 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 this MD&A and 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 with the following updates. In the three months ended December 31, 2007, we entered into a commitment for a new five year lease for expanded facilities with total basic rent payments of \$0.9 million over the term of the lease. In addition, under the terms of a joint venture agreement signed in October with OMVL, an Italian company, we are committed to invest \$1.5 million on or before April 1, 2008.

## SHARES OUTSTANDING

For the three and nine months ended December 31, 2007, the weighted average number of shares used in calculating basic earnings (loss) per share was 93,189,608 and 85,860,327 respectively. The weighted average number of shares used in calculating diluted earnings per share was 99,550,030. Actual shares outstanding as of December 31, 2007 was 93,304,278 with 2,655,288 warrants outstanding with an exercise price of \$1.30, 1,479,375 warrants outstanding with an exercise price of \$1.40, 4,423,627 share options outstanding at a weighted average price of \$1.96 and 3,065,433 performance share units outstanding. Of the share options outstanding, 3,043,201 were exercisable at a weighted average price of \$2.19. Of the performance share units outstanding, 1,965,435 were exercisable.

Subsequent to December 31, 2007, 2,067,333 warrants were exercised on a cashless basis resulting in the issuance of 1,171,488 common shares from treasury. We also issued 156,816 shares in settlement of \$0.5 million in inducement and interest payable to Perseus as at December 31, 2007. As at January 31, 2008, there were 94,640,165 shares outstanding, 587,955 warrants outstanding with an exercise price of \$1.30, 1,479,375 warrants with an exercise price of \$1.40, 4,383,866 share options outstanding at a weighted average price of \$1.96, and 3,065,433 performance share units outstanding. Of the share options outstanding, 3,003,440 were exercisable at a weighted average price of \$2.20. Of the performance share units outstanding, 1,965,435 were exercisable.

## SELECTED QUARTERLY FINANCIAL DATA (unaudited)

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

Three months ended	31-Mar-06	30-Jun-06	30-Sep-06	31-Dec-06	31-Mar-07	30-Jun-07	30-Sep-07	31-Dec-07
Units shipped	388	341	414	629	617	533	867	801
Average foreign exchange rate (C\$:US\$)	\$ 1.15	\$ 1.11	\$ 1.12	\$ 1.14	\$ 1.17	\$ 1.10	\$ 1.04	\$ 0.98
<i>(Expressed in thousands of Canadian dollars except per share)</i>								
Product revenue	\$ 8,684	\$ 7,644	\$ 10,327	\$ 13,568	\$ 15,656	\$ 11,842	\$ 16,639	\$ 15,488
Parts revenue	\$ 3,512	\$ 2,978	\$ 3,401	\$ 3,248	\$ 3,658	\$ 3,888	\$ 4,530	\$ 3,822
Total revenue	\$ 12,196	\$ 10,622	\$ 13,728	\$ 16,816	\$ 19,314	\$ 15,730	\$ 21,169	\$ 19,310
Cost of sales	\$ 7,971	\$ 6,585	\$ 8,952	\$ 11,418	\$ 11,426	\$ 10,392	\$ 15,116	\$ 12,756
Gross margin	\$ 4,225	\$ 4,037	\$ 4,776	\$ 5,398	\$ 7,888	\$ 5,338	\$ 6,053	\$ 6,554
	35%	38%	35%	32%	41%	34%	29%	34%
Net income (loss) for the period	\$ (3,711)	\$ (5,420)	\$ (1,840)	\$ (5,778)	\$ 1,731	\$ (4,724)	\$ (4,867)	\$ 7,401
Earnings (loss) per share:								
Basic	\$ (0.05)	\$ (0.07)	\$ (0.02)	\$ (0.08)	\$ 0.02	\$ (0.06)	\$ (0.05)	\$ 0.08
Diluted	\$ (0.05)	\$ (0.07)	\$ (0.02)	\$ (0.08)	\$ 0.02	\$ (0.06)	\$ (0.05)	\$ 0.07
Cash from (used in) operations before change in non-cash operating working capital	\$ (1,954)	\$ (3,685)	\$ (3,760)	\$ (4,448)	\$ 568	\$ (3,372)	\$ (2,645)	\$ (3,339)
Company's 100% share of CWI net income	\$ 1,035	\$ 1,528	\$ 1,392	\$ 806	\$ 8,389	\$ 1,160	\$ 2,412	\$ 8,870
Joint Venture Partner's share of CWI net income	\$ 518	\$ 764	\$ 696	\$ 403	\$ 4,194	\$ 580	\$ 1,206	\$ 4,435

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.

Net income (loss) for the three month periods ending September 30, 2006 through to the quarter ending September 30, 2007 include interest and amortization related to the Perseus convertible note, which was converted July 26, 2007. Upon conversion, the note was retired and interest and

amortization ceased. In the three months ended March 31, 2007, we recognised a \$4.2 million dilution gain related to the partial sale and dilution of our interest in Wild River and we also recognised \$2.2 million in funding from ITO and reversed a royalty accrual of \$1.3 million on receipt of the approved extension in our funding contract with them.

## **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. In addition, the value of our short and long-term investments are subject to market fluctuations, which may have an adverse effect on our financial condition.