Consolidated Financial Statements
(Expressed in Canadian dollars)

WESTPORT INNOVATIONS INC.

Years ended March 31, 2007 and 2006

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Westport Innovations Inc. as at March 31, 2007 and 2006 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP (signed)

Chartered Accountants

Vancouver, Canada

May 4, 2007

WESTPORT INNOVATIONS INC.

Consolidated Balance Sheets
(Expressed in Canadian dollars)

March 31, 2007 and 2006

	2007	2006
Assets		
Current assets:		
Cash and cash equivalents	$ 1,702,350	$ 1,045,752
Short-term investments	21,378,852	6,786,182
Accounts receivable	10,880,580	6,136,760
Inventories (note 3)	2,815,993	852,945
Prepaid expenses	783,297	721,583
Current portion of future income tax asset (note 16)	1,778,400	-
	39,339,472	15,543,222
Long-term investments (note 4)	13,114,807	9,133,876
Equipment, furniture and leasehold improvements (note 5)	3,862,870	3,960,173
Intellectual property (note 6)	718,913	863,223
Deferred charges (note 7)	920,163	-
Future income tax asset (note 16)	1,677,244	-
	$ 59,633,469	$ 29,500,494
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 6,030,223	$ 3,270,553
Deferred revenue	364,884	1,425,328
Demand instalment loan (note 8)	1,612,917	2,506,935
Current portion of long-term debt (note 9)	6,816,418	169,227
Current portion of warranty liability	3,823,758	3,117,881
Current portion of financial instruments (note 12)	-	4,100,060
	18,648,200	14,589,984
Warranty liability	3,147,381	2,652,221
Financial instruments (note 12)	4,000,000	-
Long-term debt (note 9)	13,780,832	150,433
Other long-term obligations (note 10)	1,719,534	694,557
Joint Venture Partner's share of net assets from joint venture (note 17)	7,719,001	1,661,664
Shareholders' equity:		
Share capital (note 13):		
Authorised:		
Unlimited common shares, no par value		
Unlimited preferred shares in series, no par value		
Issued:		
75,686,085 (2006 - 74,391,779) common shares	232,830,193	231,180,069
Other equity instruments (note 14)	12,352,113	2,359,483
Additional paid in capital	5,300,955	4,770,252
Deficit	(239,864,740)	(228,558,169)
	10,618,521	9,751,635
Commitments and contingencies (notes 11 and 18)		
Subsequent event (note 4(a))		
	$ 59,633,469	$ 29,500,494

See accompanying notes to consolidated financial statements.
Approved on behalf of the Board:

"Henry Bauermeister" Director **"John A. Beaulieu"** Director

WESTPORT INNOVATIONS INC.

Consolidated Statements of Operations and Deficit
(Expressed in Canadian dollars)

Years ended March 31, 2007 and 2006

	2007	2006
Product revenue	$ 47,195,072	$ 29,932,153
Parts revenue	13,285,360	13,620,224
	60,480,432	43,552,377
Cost of revenue and expenses:		
Cost of revenue	38,381,347	28,642,133
Research and development (notes 14 and 15)	21,890,956	16,938,502
General and administrative (note 14)	6,881,529	4,866,227
Sales and marketing (note 14)	7,077,471	5,849,127
Foreign exchange gain	(102,416)	(92,591)
Depreciation and amortization	1,409,741	2,752,409
Bank charges, interest and other	408,172	313,896
	75,946,800	59,269,703
Loss before undernoted	(15,466,368)	(15,717,326)
Interest on long-term debt and amortization of discount	(1,718,400)	-
Interest and other income	763,614	449,955
Gain on sale and dilution of interest in subsidiary (note 4(b))	8,120,485	-
Loss before income taxes and Joint Venture Partner's share of income from joint venture	(8,300,669)	(15,267,371)
Income tax recovery (expense) (note 16):		
Current	(404,208)	-
Future	3,455,644	-
	3,051,436	-
Loss before Joint Venture Partner's share of income from joint venture	(5,249,233)	(15,267,371)
Joint Venture Partner's share of net income from joint venture (note 17)	(6,057,338)	(1,592,794)
Loss for the year	(11,306,571)	(16,860,165)
Deficit, beginning of year	(228,558,169)	(211,698,004)
Deficit, end of year	$ (239,864,740)	$ (228,558,169)
Basic and diluted loss per share (note 13(e))	$ (0.15)	$ (0.23)
Weighted average common shares outstanding	75,174,826	74,228,495

See accompanying notes to consolidated financial statements.

WESTPORT INNOVATIONS INC.

Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)

Years ended March 31, 2007 and 2006

	2007	2006
Cash flows from operations:		
Loss for the year	$ (11,306,571)	$ (16,860,165)
Items not involving cash:		
Depreciation and amortization	1,409,741	2,752,409
Stock-based compensation expense	2,089,656	2,933,842
Accretion of TPC warrants	571,428	1,142,857
Future income tax recovery	(3,455,644)	-
Change in deferred lease inducements	(164,077)	(153,971)
Gain on sale and dilution of interest in subsidiary	(8,120,485)	-
Joint Venture Partner's share of net income from joint venture	6,057,338	1,592,794
Interest on long-term debt and amortization of discount	1,663,077	-
Other	(69,497)	(69,113)
	(11,325,034)	(8,661,347)
Changes in non-cash operating working capital:		
Accounts receivable	(4,743,820)	(96,734)
Inventories	(1,963,048)	628,568
Prepaid expenses	(61,714)	(169,352)
Accounts payable and accrued liabilities	2,352,935	(1,196,108)
Deferred revenue	128,610	(1,213,988)
Warranty liability	1,201,037	(958,751)
	(14,411,034)	(11,667,712)
Cash flows from investments:		
Purchase of equipment, furniture and leasehold improvements	(1,174,626)	(396,106)
Proceeds on disposition of equipment, furniture and leasehold improvements	11,946	92,854
Proceeds on sale (used in purchase) of short-term investments, net	(14,592,670)	13,184,695
Purchase of long-term investments	(51,000)	-
Proceeds on disposition of long-term investments	605,000	-
Proceeds from sale of interest in subsidiary	4,197,875	-
Transaction costs incurred	(764,185)	-
	(11,767,660)	12,881,443
Cash flows from financing:		
Issue of demand instalment loan	-	1,235,000
Repayment of demand instalment loan	(894,018)	(980,785)
Increase in bank loan	7,346,280	-
Repayment of bank loan	(605,000)	-
Repayment of other long-term debt	(184,560)	(742,000)
Issuance of convertible notes	22,092,000	-
Finance costs incurred	(914,567)	-
Share issue costs	(4,843)	-
	26,835,292	(487,785)
Increase in cash and cash equivalents	656,598	725,946
Cash and cash equivalents, beginning of year	1,045,752	319,806
Cash and cash equivalents, end of year	$ 1,702,350	$ 1,045,752
Supplementary information:		
Interest paid	$ 379,060	$ 221,736
Non-cash transactions:		
Purchase of equipment, furniture and leasehold improvements by assumption of capital lease obligation	-	260,149
Shares issued on exercise of performance share units	555,089	801,135
Shares issued for settlement of financial instruments	601,993	-
Shares issued for settlement of interest on convertible notes	497,885	-

See accompanying notes to consolidated financial statements.

1. Nature of operations:

Westport Innovations Inc. (the "Company") was incorporated under the Business Corporations Act (Alberta) on March 20, 1995.

The Company is involved in the research, development and commercialization of environmental technologies, including high-pressure direct injection ("HPDI") combustion technology that allows diesel engines to operate on cleaner burning gaseous fuels such as natural gas without sacrificing performance or fuel economy. The Company also has a joint venture interest in Cummins Westport Inc. ("CWI"), a joint venture with Cummins Inc. ("Cummins"), founded in 2001 (note 17). CWI develops, supports and markets a comprehensive product line of low-emission, high performance engines and ancillary products using proprietary intellectual property developed by the Company and Cummins.

These consolidated financial statements have been presented on a going concern basis, which assumes the realisation of assets and the settlement of liabilities in the normal course of operations. To date, the Company has financed its operations primarily by equity and debt financing and margins on the sale of products and parts. If the Company does not have sufficient funding from internal or external sources, it may be required to delay, reduce or eliminate certain research and development programs and forego acquisition of certain equipment. The future operations of the Company are dependent upon its ability to produce, distribute and sell an economically viable product to attain profitable operations.

2. Significant accounting policies:

(a) Basis of presentation:

The consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and CWI. Intercompany accounts and transactions have been eliminated.

Interests in Variable Interest Entities ("VIE") are consolidated by the Company if the Company is the primary beneficiary. The Company has identified CWI as a VIE and determined that the Company is the primary beneficiary. Accordingly, the Company has consolidated CWI. The other 50% interest held by Cummins is reflected as "Joint Venture Partner's share of net assets from joint venture" in these consolidated financial statements.

These financial statements are presented in accordance with Canadian generally accepted accounting principles.

(b) Cash and cash equivalents:

Cash and cash equivalents includes cash and term deposits with maturities of ninety days or less when acquired.

(c) Short-term investments:

Short-term investments, consisting principally of investment grade commercial paper, are recorded at cost plus accrued interest.

2. Significant accounting policies (continued):

(d) Inventories:

The Company's inventory consists of the Company's fuel system products, parts, work-in-progress, and CWI engine products. Inventories are recorded at the lower of cost and net realizable value. Cost of engine product inventory is determined on a specific identification basis. Cost of fuel system products and parts inventory is determined on a weighted average cost basis. The cost of fuel system product inventories and work-in-progress include materials, labour and production overhead. An inventory obsolescence provision is provided to the extent cost of inventory exceeds net realizable value. In establishing the amount of inventory obsolescence provision, management estimates the likelihood that inventory carrying values will be affected by changes in market demand and technology, which would make inventory on hand obsolete.

(e) Equipment, furniture and leasehold improvements:

Equipment, furniture and leasehold improvements are stated at cost. Depreciation is provided as follows:

Assets	Basis	Rate
Computer equipment and software	Straight-line	3 years
Furniture and fixtures	Straight-line	5 years
Machinery and equipment	Straight-line	8 years
Leasehold improvements	Straight-line	Lease term

(f) Long-term investments:

The Company accounts for long-term investments in entities which are not consolidated using the equity method to the extent that the Company has significant influence over the investee's strategic operating, financing and investing policies. Under the equity method, the Company's proportionate share of income or loss is included in the statement of operations and any dividends received are recorded as a reduction of the investment. All other long-term investments are accounted for using the cost method, whereby income is recognised in the statement of operations only to the extent dividends are received during the year. All long-term investments are currently carried at cost. Long-term investments are reduced to their fair value only to the extent that the loss in value is other than temporary.

(g) Research and development costs:

Research costs are expensed as incurred and are recorded net of government funding received or receivable. Development costs are deferred only if they meet certain stringent criteria generally related to technical feasibility, market definition and financing availability for future development; otherwise they are expensed as incurred. Related investment tax credits reduce research and development expenses in the same year in which the related expenditures are charged to earnings, provided there is reasonable assurance the benefits will be realised. As at March 31, 2007 and 2006, no development costs had been deferred.

2. Significant accounting policies (continued):

(h) Government assistance:

The Company periodically applies for financial assistance under available government incentive programs which is recorded in the period it is received or receivable. Government assistance relating to the purchase of equipment, furniture and leasehold improvements is reflected as a reduction of the cost of such assets. Government assistance related to research and development activities is recorded as a reduction of the related expenditures.

(i) Intellectual property:

Intellectual property, consisting primarily of the cost of acquired patents, licenses and other intellectual property, is amortized over their estimated useful lives, which currently does not exceed seven years.

(j) Impairment of long-lived assets:

The Company reviews for impairment of long-lived assets, including equipment, furniture, and leasehold improvements and intellectual property, to be held and used whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If such conditions exist, assets are considered impaired if the sum of the undiscounted expected future cash flows expected to result from the use and eventual disposition of an asset is less than its carrying amount. An impairment loss is measured at the amount by which the carrying amount of the asset exceeds its fair value. When quoted market prices are not available, the Company uses the expected future cash flows discounted at a rate commensurate with the risks associated with the recovery of the asset as an estimate of fair value.

(k) Warranty liability:

Estimated warranty costs are recognised at the time the Company sells its products, and are included in cost of revenue. The Company provides warranty coverage on products sold for a period of two years from the date the products are put into service by customers. Warranty liability represents the Company's best estimate of warranty costs expected to be incurred during the warranty period. Furthermore, the current portion of warranty liability represents the Company's best estimate of the costs to be incurred in the next twelve month period. The Company uses historical failure rates and cost to repair defective products together with information on known product issues to estimate the warranty liability. The ultimate amount payable by the Company and the timing will depend on actual failure rates and cost to repair failures of its products. Since many of the Company's products are new in the market, historical data may not necessarily reflect actual costs to be incurred and exposes the Company to the potential for significant fluctuations in the warranty liability.

(l) Extended warranty:

The Company sells extended warranty contracts which provide coverage in addition to the basic two year coverage. Proceeds from the sale of these contracts are deferred and amortized over the extended warranty period commencing at the end of the basic warranty period. On a periodic basis, management reviews the estimated warranty costs expected to be incurred related to these contracts and recognises a loss to the extent such costs exceed the related deferred revenue.

2. Significant accounting policies (continued):

(m) Revenue recognition:

Product and parts revenue is recognised, net of estimated costs of returns, allowances, and sales incentives, when the products are shipped and title passes to the customers. Revenue also includes fees earned from performing research and development activities for third parties, as well as for granting technology licenses to third parties. Revenue from research and development activities is recognised as the services are performed. Revenue from technology licenses is recognised over the duration of the licensing agreement. Amounts received in advance of revenue recognition are recorded as deferred revenue.

(n) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on temporary differences between the accounting and tax basis of the assets and liabilities and for loss carry forwards, and are measured using the tax rates expected to apply when these tax assets and liabilities are recovered or settled. The effect on future tax assets and liabilities of a change in tax rate is recognised in income in the period that includes the substantive enactment date. A valuation allowance is recorded against any future income tax asset if it is not "more likely than not" that the benefit of these assets will be realised.

(o) Stock-based compensation plans:

The Company has a stock option plan, which is described in note 13(c). The Company accounts for stock-based compensation related to stock options granted to employees and directors using the fair value method and recognises stock-based compensation in results from operations over the vesting period. The Company has an employee share purchase plan, which is described in note 13(d). The Company matches the employees' contribution and recognizes this cost as an expense in the period it is incurred.

The Company has a Performance Share Unit ("PSU") Plan as described in note 14. The value of the units is calculated based on the market price of the Company's common shares on the date of grant and is recorded as compensation expense in the period earned, which generally is the period over which the PSU's vest.

(p) Post-retirement benefits:

The Company has implemented a group registered retirement savings plan ("RRSP") in which full-time employees of the Company are eligible to participate. Eligible employees may make contributions up to their personal eligible contribution room under the Canadian Income Tax Act. The Company contributes up to a maximum combined total of 5% of the employee's regular base pay to the RRSP and/or the employee share purchase plan and recognises this cost as an expense in the period it is incurred. During the year ended March 31, 2007, the Company recognised $355,887 (2006 - $317,113) of expense associated with the RRSP.

2. Significant accounting policies (continued):

(q) Foreign currency:

Monetary items denominated in foreign currency are translated into Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in results from operations.

(r) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Significant areas requiring the use of estimates include amortization of equipment, furniture and leasehold improvements, the determination of future cash flows and discount rates for impairment of long-lived assets, valuation of long-term investments, valuation of future income tax assets and the accrual of warranty liability. Actual results could differ from estimates used in the preparation of the consolidated financial statements.

(s) Loss per share:

Basic loss per share is calculated using the weighted average number of shares outstanding during the period. Diluted loss per share is computed similarly to basic loss per share, except that the weighted average number of shares outstanding are increased to include additional shares from the assumed exercise of conversion options, stock options, warrants, and performance share units, if dilutive. For stock options, warrants and performance units, the number of additional shares is calculated by assuming that outstanding stock options, warrants, and performance share units were exercised at the beginning of the year or when granted and that the proceeds from such exercises were used to repurchase shares of common stock at the average market price during the period. For conversion options, the Company uses the if-converted method which assumes that the conversion of options are exercised at the beginning of the year or when granted.

(t) Comparative amounts:

Certain comparative amounts have been reclassified to conform with the presentation adopted in the current year.

(Expressed in Canadian dollars)

3. Inventories:

	2007	2006
Parts	$ 2,360,124	$ -
Work-in-progress	455,869	-
Engine inventory	-	852,945
	$ 2,815,993	$ 852,945

4. Long-term investments:

	2007	2006
Clean Energy Fuels Corp. (a)	$ 9,133,876	$ 9,133,876
Wild River Resources Ltd. (b)	3,980,931	-
	$ 13,114,807	$ 9,133,876

(a) As at March 31, 2007, the Company owned an approximate 6% (2006 - 8%) interest in Clean Energy Fuels Corp. ("CEFC") prior to CEFC's initial public offering and carries this investment at cost. Subsequent to March 31, 2007, CEFC priced its initial public offering of 10,000,000 common shares at US$12 per share, diluting the Company's interest in CEFC to approximately 5%. CEFC is an owner and operator of natural gas refueling facilities.

(b) The Company also has a 15.86% (2006 - 100%) interest in Wild River Resources Ltd. ("WRRL") (formerly Westport Research Inc. ("WRI"), a wholly owned subsidiary of the Company prior to June 13, 2006), an oil and gas company, and carries this investment at cost. On June 13, 2006, the Company entered into an agreement with Matco Capital Ltd. ("Matco"), an unrelated party, to reorganize WRI. As part of the reorganization, the Company substantially transferred all of the assets, liabilities and operations of WRI to another wholly owned subsidiary of the Company which carries on the business previously carried on by WRI. WRI was then renamed WRRL. Pursuant to the agreement with Matco, the Company sold 45% of its investment in WRRL to Matco for cash consideration. This transaction resulted in a net gain of $3,891,376. Subsequently, on February 8, 2007, WRRL issued shares to third parties further diluting the Company's interest from 55% to 17.38%. This transaction resulted in a net dilution gain of $4,004,461. The Company sold a further 1.52% interest in WRRL for a gain of $224,648 reducing its investment to 15.86% of the outstanding shares of WRRL. Effective February 8, 2007, the Company no longer controls WRRL. Accordingly, the Company no longer consolidates WRRL and accounts for this investment on a cost basis.

(Expressed in Canadian dollars)

5. Equipment, furniture and leasehold improvements:

2007	Cost	Accumulated depreciation	Net book value
Computer equipment and software	$ 5,142,232	$ 4,742,707	$ 399,525
Furniture and fixtures	1,181,947	1,066,546	115,401
Machinery and equipment	19,882,210	16,905,893	2,976,317
Leasehold improvements	8,149,345	7,777,718	371,627
	$ 34,355,734	$ 30,492,864	$ 3,862,870

2006	Cost	Accumulated depreciation	Net book value
Computer equipment and software	$ 4,945,991	$ 4,677,347	$ 268,644
Furniture and fixtures	1,163,256	1,010,545	152,711
Machinery and equipment	19,709,074	16,554,947	3,154,127
Leasehold improvements	8,021,813	7,637,122	384,691
	$ 33,840,134	$ 29,879,961	$ 3,960,173

As at March 31, 2007, equipment with a cost of $223,743 (2006 - $464,394) and a net book value of $100,956 (2006 - $252,246) is held under capital lease.

6. Intellectual property:

	2007	2006
Intellectual property acquired from:		
University of British Columbia	$ 1,550,000	$ 1,550,000
Edge Technologies, Inc.	750,100	750,100
GVH (note 12(b))	1,697,214	1,697,214
Other	324,080	324,080
	4,321,394	4,321,394
Accumulated amortization	(3,602,481)	(3,458,171)
Intellectual property, net of amortization	$ 718,913	$ 863,223

(Expressed in Canadian dollars)

7. Deferred charges:

Deferred charges relate to the expenses associated with the issue of convertible notes (note 9(c)) and the Matco transaction (notes 4(b) and 9(b)) and will be expensed over the term of the convertible notes or in the period the Company disposes of its remaining 15.86% interest in WRRL, as applicable.

8. Demand instalment loan:

The Company has a credit facility for maximum borrowings of $13,000,000. Borrowings may be drawn in the form of demand instalment loans, lease financing, letters of credit, foreign exchange contracts, corporate credit cards and operating lines of credit. Outstanding amounts of the demand instalment loans drawn under this credit facility bear interest at prime and are repayable over a 60-month period. As at March 31, 2007, the outstanding amount payable of $1,612,917 is included in current liabilities as it is repayable on demand by the bank.

9. Long-term debt:

	2007	2006
Capital lease obligations (a)	$ 135,100	$ 319,660
Bank loan (b)	6,741,280	-
Subordinated convertible notes (c)	13,720,870	-
	20,597,250	319,660
Current portion	6,816,418	169,227
	$ 13,780,832	$ 150,433

(a) The Company has capital lease obligations which have terms of two to five years at interest rates ranging from 1.15% to 6.17%. The capital lease obligations require the following minimum annual payments during the respective fiscal years:

2008	$ 75,138
2009	53,973
2010	4,895
2011	3,672
	137,678
Amount representing interest	(2,578)
	$ 135,100

9. Long-term debt (continued):

(b) Under the terms of the agreement with Matco (note 4(b)), Matco facilitated access to a limited recourse credit facility up to $7,346,280. Interest was payable at prime plus 1% until December 31, 2006, after which time the interest is payable by Matco. Repayments of the amount drawn under this credit facility will be made only from the proceeds related to the sale by the Company of its interest in WRRL and any remaining balance outstanding under the credit facility is due on or before January 31, 2008. During the year, the Company drew the maximum available under the credit facility of $7,346,280 and re-paid $605,000 to March 31, 2007, leaving a balance of $6,741,280. If no further proceeds are received from the sale of the Company's interest in WRRL by December 31, 2007, Matco is obligated to acquire the Company's remaining shares in WRRL for $6,741,280 which will be used to repay any amounts remaining under the credit facility.

(c) On June 12, 2006, the Company agreed to issue up to $22,092,000 in five year secured, subordinated convertible notes with a coupon rate of 8% to funds managed by Perseus, L.L.C. ("Perseus"), a private equity fund management group. The notes were issued in two tranches of $13,800,000 and $8,292,000, respectively, with the closings of the first tranche having been completed on June 12, 2006 and July 14, 2006 and the second tranche closing on January 16, 2007. Interest is payable semi-annually in arrears on June 30 and December 31, in additional notes or shares, at the Company's option, for the first two years. After the first two years, interest will be calculated at a rate of 8% on the outstanding principal amount only for the number of trading days in the period on which the share price is below $3.00 and is payable semi-annually in cash, additional convertible notes or shares at the Company's option. The number of shares to be issued if interest is paid in shares will be based on the market price of the common shares on the date interest is due. The first tranche is convertible to common shares at a conversion price of $1.30 at any time during the term of the notes and the second tranche is convertible to common shares at a conversion price equal to $1.40. At the time of issuance of the notes, the noteholder also received warrants to acquire, at an exercise price equal to the conversion price of the accompanying notes, common shares of the Company equal to 25% of the number of common shares into which the notes were convertible. The warrants expire four years from the date of issuance and include a cashless exercise provision which would allow the noteholder to receive the number of common shares having a value equal to the net gain that would be realized by the noteholder had the warrant been exercised for cash and the related shares sold at the market price on the date the option is exercised. Any warrants converted under the cashless exercise provision will be cancelled.

On June 12, 2006, the Company issued $5,500,000 of the first tranche of notes and 1,062,115 warrants. On July 14, 2006, the Company issued the remaining $8,300,000 of the first tranche of notes and 1,593,173 warrants. On January 16, 2007, the Company issued $8,292,000 of the second tranche of notes and 1,479,375 warrants. Of the $22,092,000 cash proceeds received in the year, the Company assigned $7,568,465 to the conversion option, $1,420,302 to the warrants and $13,103,233 to the convertible notes. The amount assigned to the convertible notes is being accreted to the principal amount using the effective interest rate method over the term to maturity.

During the year, $553,208 of interest was paid to Perseus of which $55,323 was paid in cash and $497,885 paid in common shares. On March 31, 2007, interest of $406,735 was payable to Perseus and included in accounts payable and accrued liabilities.

(Expressed in Canadian dollars)

10. Other long-term obligations:

	2007	2006
Deferred lease inducements (a)	$ 530,480	$ 694,557
Deferred revenue (b)	1,189,054	-
	$ 1,719,534	$ 694,557

(a) The Company renegotiated its existing long-term lease agreements for its corporate offices and research facilities in 2004 and 2005 which included certain lease inducements. These inducements included leasehold improvements and other costs funded by the lessor and periods with reduced rental payments. The amounts related to leasehold improvements funded by the lessor are amortized on a straight-line basis over the term of the lease as a reduction to rent expense. For lease contracts with escalating lease payments, total rent expense for the lease term is expensed on a straight line basis over the lease term. The difference between amounts expensed and amounts paid is recorded as an increase or reduction in deferred lease inducements.

(b) The Company receives cash in advance including upfront fees, customer deposits, fees for research and development activities and extended warranty contracts which are included in deferred revenue and are recognised into earnings over the contract period, as research and development activities are completed or over the warranty period as applicable.

11. Government assistance:

From time to time, the Company enters into agreements for financial assistance with government agencies. During the years ended March 31, 2007 and 2006, government assistance of $5,150,357 and $8,689,159, respectively, was received or receivable by the Company, which has been recorded as a reduction of related research and development expenditures (note 15).

Included in the above amounts is funding of $2,204,590 (2006 - $2,623,346) from Industry Canada’s Industrial Technologies Office (formerly Technology Partnerships Canada) (“TPC”) and $3,779,040 remains receivable from TPC at March 31, 2007 (2006 - $1,574,450). Under the terms of the original TPC funding agreement entered into on March 27, 2003, TPC will fund 30% of the eligible costs of, among other research projects, the adaptation of the Company’s technology to diesel engines with a scheduled project completion date of March 31, 2006. During the year, the Company was in discussions to extend the project completion date and extend the agreement by two years. In the fourth quarter of fiscal 2007, TPC substantially completed its review of the proposed amended statement of work and approval has been received from TPC. Under the amended terms of the agreement, from fiscal 2009 to fiscal 2015, inclusive, the Company is obligated to pay annual royalties equal to the greater of $1,350,000 or 0.33% of the Company’s annual gross revenue from all sources, provided that gross revenue exceeds $13,500,000 in any of the aforementioned fiscal years. The royalty payment period may be extended until the earlier of March 31, 2018 or until cumulative royalties total $28,189,000. In addition, the Company is required to provide TPC with common share purchase warrants having a value of $4,000,000 as at September 30, 2008 calculated based on the Black-Scholes option pricing model. The value of the warrants have been accreted on a straight-line basis to September 30, 2006, the original issuance date, as a charge to research and development expenses.

(Expressed in Canadian dollars)

11. Government assistance (continued):

The Company is also obligated to pay royalties to the Government of Canada's Department of Natural Resources and British Columbia's Green Economy Development Fund relating to funding received in prior years. The royalty to the Department of Natural Resources is 1% of future revenue from engines for power generators until the earlier of ten years from the project completion date (August 30, 2004) or when cumulative royalties total $1,000,000. As at March 31, 2007, there have been no revenue from the sales of engines for power generators and, therefore, no royalty payments have been paid or are payable. The royalty to the Green Economy Development Fund is 0.75% of gross revenue received by the Company on certain natural gas fuel systems and the obligation will cease on the earlier of the seventh anniversary of the funding contribution date (April 10, 2001) or when the cumulative royalties paid by the Company equal $800,000. As at March 31, 2007, no royalties have been paid or are payable.

12. Financial Instruments:

	March 31, 2007	March 31, 2006
Value assigned to TPC warrants (a)	$ 4,000,000	$ 3,428,571
Shares to be issued (b)	-	671,489
	4,000,000	4,100,060
Current portion	-	4,100,060
	$ 4,000,000	$ -

(a) TPC warrants:

Under the terms of the agreement with TPC, the Company has an obligation to issue warrants with a fair value of $4,000,000 based on the Black-Scholes option pricing model. The value of these warrants was recognized on a straight-line basis from the date of the original agreement to September 30, 2006, the original issuance date. For the year ended March 31, 2007, accretion totaling $571,428 (2006 - $1,142,857) has been included in research and development expenses. The Company negotiated a two year extension to the TPC agreement and, as a result, will not issue the warrants until September 30, 2008. Accordingly, the amount has been classified as a long-term liability as at March 31, 2007.

(b) Shares to be issued:

Under the terms of the agreement with GVH Entwicklungsgesellschaft für Verbrennungsmotoren und Energietechnik mbH ("GVH") the Company had an obligation to pay certain milestone payments to GVH through issuance of shares. The entire obligation was settled during the year.

(Expressed in Canadian dollars)

13. Share capital:

(a) Authorised:
Unlimited common shares, no par value
Unlimited preferred shares issuable in series, no par value

(b) Issued and outstanding:

	Number of shares	Amount
Balance, March 31, 2005	73,964,088	$ 230,378,934
Performance share units exercised for no additional consideration	427,691	801,135
Balance, March 31, 2006	74,391,779	231,180,069
Shares issued to GVH (note 12(b))	609,104	601,993
Performance share units exercised for no additional consideration	283,682	555,089
Shares issued for settlement of accrued interest (note 9(c))	401,520	497,885
Share issue costs	-	(4,843)
Balance, March 31, 2007	75,686,085	$ 232,830,193

(c) Share options:

The Company has an incentive share option plan for employees, directors, officers and consultants. The options are granted with an exercise price not less than the market price of the Company's common shares on the date immediately prior to the date of grant. The exercise period of the options may not exceed eight years from the date of grant and, subject to certain exceptions, vest in three equal annual amounts on the anniversary date of the grant. Vesting periods of the options are at the discretion of the board of directors and may be based on fixed terms, achieving performance milestones or reaching specified share price targets.

A summary of the status of the Company's share option plan as of March 31, 2007 and 2006 and changes during the years then ended is presented as follows:

	2007		2006	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding, beginning of year	4,968,563	$ 2.05	2,402,415	$ 3.63
Granted	585,872	1.18	3,178,218	1.48
Cancelled / expired	(325,442)	(2.82)	(612,070)	(5.24)
Outstanding, end of year	5,228,993	$ 1.91	4,968,563	$ 2.05
Options exercisable, end of year	1,479,465	$ 2.98	1,544,266	$ 3.22

(Expressed in Canadian dollars)

13. Share capital (continued):

(c) Share options (continued):

The following table summarises information about share options outstanding at March 31, 2007:

Range of exercise prices	Number outstanding, March 31, 2007	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable March 31, 2007	Weighted average exercise price
$0.92 to $1.40	930,419	7.0	$ 1.19	186,809	$ 1.14
$1.50 to $1.55	2,905,259	6.0	1.51	239,339	1.50
$1.62 to $2.22	679,202	4.9	1.88	339,204	1.83
$2.61 to $3.94	362,978	3.6	3.31	362,978	3.31
$4.14 to $5.89	240,569	2.6	4.80	240,569	4.80
$7.00 to $8.35	110,566	3.2	7.72	110,566	7.72
$0.92 to $8.35	5,228,993	5.65	$ 1.91	1,479,465	$ 2.98

The fair value of the options granted was determined using the Black-Scholes option pricing model using the following weighted average assumptions: expected dividend yield - nil% (2006 - nil%); expected stock price volatility - 59% (2006 - 65%); risk free interest rate - 4.79% (2006 - 4.20%); expected life of options - 5 years (2006 - 5 years). The weighted average grant date fair value was $0.70 for options granted for the year ended March 31, 2007 (2006 - $0.87). During the year ended March 31, 2007, the Company recognized $530,704 (2006 - $1,851,684) in stock-based compensation related to stock options.

(d) Employee share purchase plan:

The Company has an employee share purchase plan ("ESPP") in which full-time employees of the Company are eligible to participate. Eligible employees may make contributions to the ESPP of up to 10% of their regular base pay. The Company contributes up to a maximum combined total of 5% of the employee's regular base pay to the employee's RRSP and/or ESPP. Shares contributed to the ESPP are purchased by the Company on a semi-monthly basis on the open market. Shares purchased on behalf of the employee with the employee's contribution vest with the employee immediately. Shares purchased with the Company's contribution vest on December 31st of each year, so long as the employee is still employed with the Company.

(e) Loss per share:

Diluted loss per share does not differ from basic loss per share as the impact of dilutive securities, including all conversion options, stock options, warrants, and performance share units, is anti-dilutive.

(Expressed in Canadian dollars)

14. Other equity instruments:

	2007	2006
Value assigned to Performance Share Units	$ 3,363,346	$ 2,359,483
Value assigned to warrants (note 9(c))	1,420,302	-
Value assigned to conversion options (note 9(c))	7,568,465	-
	$ 12,352,113	$ 2,359,483

Value assigned to performance share units ("Units") relates to Units granted pursuant to the Company's 2003 Performance Share Unit Plan ("2003 Unit Plan") as amended and restated (the "Amended and Restated Unit Plan"). At the Company's 2006 annual general meeting, the shareholders of the Company ratified and approved the Amended and Restated Unit Plan and reserved 7,500,000 common shares under this plan. The Amended and Restated Unit Plan is in addition to the Performance Share Unit Plan approved by the shareholders on September 10, 2001 (the "2001 PSU Plan"). Each performance share issued pursuant to the Amended and Restated Unit Plan or the 2001 PSU Plan is exercisable into one common share of the Company for no additional consideration. Any employee, contractor, director or executive officer of the Company who is selected by the Board of Directors of the Company is eligible to participate in the Amended and Restated Unit Plan. The Executive and Senior Management Total Compensation Program sets out provisions where the Units will be granted to the Company's executive management if performance milestones are achieved as determined at the discretion of the Human Resources and Compensation Committee of the Company's Board of Directors in consultation with the Company's management. These performance milestones are focused on achievement of key cash management, profitability and revenue growth objectives. Vesting periods for each Unit granted pursuant to the Amended and Restated Unit Plan is at the discretion of the Board of Directors and may include time based, share price or other performance targets.

The value assigned to issued Units and the amounts accrued are recorded as other equity instruments. As Units are exercised and the underlying shares are issued from treasury of the Company, the value is reclassified to share capital. During the year ended March 31, 2007, the Company recognised $1,558,952 (2006 - $1,082,158) of stock-based compensation associated with the 2001 PSU Plan and the Amended and Restated Unit Plan.

The stock-based compensation associated with the Unit plans and the stock option plan as described in note 13(c) is included in operating expenses as follows:

	2007	2006
Research and development	$ 348,212	$ 1,603,525
General and administrative	1,494,242	946,025
Sales and marketing	247,202	384,292
	$ 2,089,656	$ 2,933,842

(Expressed in Canadian dollars)

14. Other equity instruments (continued):

A summary of the status of the PSU's issued under the 2001 PSU Plan and the 2003 PSU Plan as of March 31, 2007 and 2006, and changes during the years then ended is as follows:

	Units
Outstanding, March 31, 2005	1,041,897
Units exercised	(427,691)
Units granted	816,919
Outstanding, March 31, 2006	1,431,125
Units exercised	(283,682)
Units granted	915,716
Outstanding, March 31, 2007	2,063,159

As at March 31, 2007, 1,763,162 PSU's are vested and exercisable.

15. Research and development expenses:

Research and development expenses are recorded net of program funding received or receivable. For the years ending March 31, 2007 and 2006, the following research and development expenses had been incurred and program funding received or receivable:

	2007	2006
Research and development expenses	$ 27,041,313	$ 25,627,661
Program funding	(5,150,357)	(8,689,159)
Research and development	$ 21,890,956	$ 16,938,502

In 2007, program funding is comprised mainly of funding from TPC, the Hydrogen Early Adopters Program, Sustainable Development Technology Canada, National Renewable Energy Laboratory, South Coast Air Quality Management District and the Australian Greenhouse Office which was used to fund research and demonstration projects including the adaptation of the Company's technologies to diesel engines. In 2006, program funding is comprised mainly of funding from TPC, National Renewable Energy Laboratory, and South Coast Air Quality Management District.

(Expressed in Canadian dollars)

16. Income taxes:

(a) The Company's income tax recovery differs from that calculated by applying the combined Canadian federal and provincial statutory income tax rates for manufacturing and processing companies of 34.1% (2006 – 34.5%) as follows:

	2007	2006
Loss before income taxes and Joint Venture Partner's share of income from joint venture	$ 8,300,669	$ 15,267,371
Expected income tax recovery	$ 2,830,528	$ 5,248,637
Reduction (increase) in income taxes resulting from:		
Non-deductible interest on long-term debt and amortization of discount	(210,615)	-
Non-deductible stock-based compensation	(712,573)	(1,011,589)
Non-deductible expenses	(375,340)	(425,958)
Change in enacted rates	(5,692,054)	(191,879)
Foreign tax rate differences	(526,731)	(168,383)
Change in valuation allowance	7,738,221	(3,450,828)
	$ 3,051,436	$ -

(b) The tax effects of the significant temporary differences which comprise tax assets and liabilities, at March 31, 2007 and 2006, are as follows:

	2007	2006
Future tax assets:		
Net operating loss carry forwards	$ 19,365,441	$ 36,049,145
Scientific research and development expenditures carry forwards	-	27,377,225
Long-term investments	4,100,068	807,778
Intellectual property	2,123,134	849,233
Equipment, furniture and leasehold improvements	291,976	3,488,532
Financing and share issue costs	189,751	452,273
Warranty liability	2,437,678	2,267,650
Deferred revenue	497,377	-
Capital lease obligations	42,894	109,004
Total gross future tax assets	29,048,319	71,400,840
Valuation allowance	(25,592,675)	(71,400,840)
Total future tax asset	$ 3,455,644	$ -
Allocated as follows:		
Current future tax asset	1,778,400	-
Long term future tax asset	1,677,244	-
Total future tax asset	$ 3,455,644	$ -

(Expressed in Canadian dollars)

16. Income taxes (continued):

(b) Continued:

In determining the valuation allowance, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realised. The ultimate realisation of future tax assets is dependent on the generation of income during the future periods in which those temporary differences become deductible. Since evidence does not exist that the future income tax assets will be fully realised, a valuation allowance has been recorded. A portion of the valuation allowance related to CWI has been reversed as CWI has generated taxable income for two consecutive tax years and the Company expects that CWI will generate taxable income in the future.

Current tax expense consists of $404,208 payable outside of Canada. Future income tax recovery relates to temporary differences in the United States.

(c) The Company has non-capital loss carry forwards in Canada available to offset future taxable income which expire as follows:

2008	$	56,635
2009		1,504,498
2010		2,235,179
2014		2,703,304
2015		2,508,377
2026		2,354,294
2027		15,184,941
	$	26,547,228

CWI has net operating loss carry forwards in the United States totalling $31,247,704 of which $12,193,160 expire in 2022, $17,208,028 expire in 2023, and $1,846,516 expire in 2024.

(d) The Company has no unclaimed scientific and experimental and investment tax credits.

17. Investment in Cummins Westport Inc.:

The Company entered into a joint venture with Cummins on March 7, 2001. The joint venture, CWI, was formed to explore a range of product and technology opportunities using natural gas as the primary fuel. The Company provided personnel, financing and key technologies for the venture, while Cummins provided an existing product line, manufacturing, product distribution and customer service functions, as well as key management and engineering personnel.

From inception until December 31, 2003, the Company was responsible for all capital contributions to fund operations. Initially and to December 31, 2003, the Company owned 100% of the common shares and Cummins owned 100% of the non-participating preferred shares which were convertible into common shares for no consideration at the option of Cummins.

(Expressed in Canadian dollars)

17. Investment in Cummins Westport Inc. (continued):

On December 16, 2003, the Company and Cummins amended the joint venture agreement to have CWI focus on and develop markets for alternative fuel engines. In addition, the two companies signed a Technology Partnership Agreement that creates a flexible arrangement for future technology development between Cummins and the Company. Under the terms of the amended joint venture agreement, Cummins exercised the conversion feature of the preferred shares effective January 1, 2004. However, the Company remained responsible for funding the profit and loss of CWI through CWI's fiscal 2004 year which ran from January 1 to December 31, 2004. Based on its economic interest in CWI, the Company continued to consolidate 100% of the results of operations from CWI until December 31, 2004.

Subsequent to December 31, 2004, Cummins shares equally in the profits and losses of CWI. However, the Company has determined that CWI is a VIE and that the Company is the primary beneficiary. Accordingly, the Company continues to consolidate CWI with Cummins' share of CWI's income and losses included as "Joint Venture Partner's share of net income from joint venture".

Assets, liabilities, revenue and expenses of CWI included in the consolidated financial statements of the Company as at and for the periods presented are as follows:

	2007	2006
Current assets:		
Cash and cash equivalents	$ 42,761	$ 146,656
Short-term investments	8,017,357	-
Accounts receivable	5,770,970	2,766,068
Inventory	-	852,945
Prepaid expenses	354,050	219,659
Current portion of future income tax asset	1,778,400	-
	15,963,538	3,985,328
Future income tax asset	1,677,244	-
Equipment, furniture and leasehold improvements	183,521	60,249
	$ 17,824,303	$ 4,045,577
Current liabilities:		
Accounts payable and accrued liabilities	$ 760,538	$ 511,196
Deferred revenue	302,679	1,383,363
Current portion of warranty liability	3,767,183	3,117,881
	$ 4,830,400	$ 5,012,440
Long term liabilities:		
Warranty liability	$ 3,090,805	$ 2,652,221

(Expressed in Canadian dollars)

17. Investment in Cummins Westport Inc. (continued):

	2007	2006
Product revenue	$ 44,745,842	$ 28,633,983
Parts revenue	13,285,360	13,620,224
	58,031,202	42,254,207
Cost of revenue and expenses:		
Cost of revenue	36,195,405	27,343,963
Research and development	8,073,503	6,576,840
General and administrative	855,949	1,249,168
Sales and marketing	4,215,866	4,005,743
	49,340,723	39,175,714
Income before undernoted	8,690,479	3,078,493
Interest and investment income	111,794	-
Effect of foreign currency translation	62,063	107,095
Income before taxes	8,864,336	3,185,588
Current income tax expense	(205,304)	-
Future income tax recovery	3,455,644	-
Income for the year	12,114,676	3,185,588
Joint Venture Partner's share of net income from joint venture	(6,057,338)	(1,592,794)
Company's share of income	$ 6,057,338	$ 1,592,794

18. Commitments and contingencies:

(a) The Company has obligations under operating lease arrangements which require the following minimum annual payments during the respective fiscal years:

2008	$ 1,077,629
2009	904,444
2010	175,567
2011	101,654
2012	97,500
Thereafter	219,375
	$ 2,576,169

(b) The Company has an outstanding letter of credit of $600,000.

(c) Under the Company's signed Joint Venture Agreement with Beijing Tianhai Industry Co. Ltd., the Company is committed to contributing US$400,000 to the formation of a joint venture.

19. Financial instruments:

(a) Fair values:

The carrying amounts reported in the balance sheets for cash and cash equivalents, short-term investments, accounts receivable, and accounts payable and accrued liabilities approximate their fair values due to the short terms to maturity of these instruments. The carrying value of the warranty obligation represents management's best estimate of its fair value.

The carrying value reported in the balance sheets for obligations under capital lease, which is based upon discounted cash flows, approximates its fair value. The fair value of the Company's demand instalment loan and other long-term debt obligations is not materially different from its carrying value based on market rates of interest.

Clean Energy Fuels Corp., as described in note 4(a) is now listed on the NASDAQ and the Company's investment has an estimated fair value as at March 31, 2007 of approximately $29,225,000.

The fair value of the Company's long-term investment in WRRL, a private company, as described in note 4(b) is not determinable with sufficient reliability due to the absence of a readily available market for the shares of WRRL.

The fair value of the Company's subordinated convertible notes as described in note 9(c) is not determinable with sufficient reliability due to the absence of a readily available market for similar instruments.

The fair value of the Company's financial instruments as described in note 12 represents management's best estimate of its fair value.

(b) Concentrations of credit risk:

The Company is exposed to credit risk only with respect to uncertainties as to timing and amount of collectability of accounts receivable. 50% (2006 - 57%) of accounts receivable relates to government grants receivable and 43% (2006 - 38%) is due from Cummins relating to proceeds for the sale of products collected by Cummins on the Company's behalf.

(c) Foreign currency risk:

Foreign currency risk is the risk to the Company's results from operations that arises from fluctuations in foreign currency exchange rates. All of the revenue realised and a significant portion of the expenses incurred by CWI, and recorded by the Company, are denominated in United States dollars. The warranty liability is also denominated in United States dollars. The Company has not entered into foreign exchange contracts to hedge against gains and losses from foreign currency fluctuations.

20. Segmented information:

The Company currently operates in one operating segment which involves the research and development and the related commercialization of engines and fuel systems operating on gaseous fuels. The majority of the Company's equipment, furniture and leasehold improvements are located in Canada. For the year ended March 31, 2007, 72% (2006 - 82%) of the Company's revenue was from sales in North America, 13% (2006 - 4%) from sales in Asia, and 15% (2006 - 14%) from sales elsewhere.