

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Proterra Inc:

Opinion on the Financial Statements

We have audited the accompanying balance sheets of Proterra Inc (the Company) as of December 31, 2020 and 2019, the related statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2020, and the related notes (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2020, in conformity with U.S. generally accepted accounting principles.

Change in Accounting Principle

As discussed in note 2 to the financial statements, the Company changed its method of accounting for leases as of January 1, 2020 due to the adoption of Accounting Standards Codification Topic 842, *Leases*.

Basis for Opinion

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 are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 2012.

Santa Clara, California
April 7, 2021

PROTERRA INC
BALANCE SHEETS
(in thousands, except share and per share data)

	December 31,	
	2020	2019
Assets:		
Cash and cash equivalents	\$ 110,719	\$ 40,240
Accounts receivable, net	51,716	44,500
Short-term investments	68,990	39,877
Inventory	92,330	94,042
Prepaid expenses and other current assets	7,455	6,684
Deferred cost of goods sold	2,037	1,240
Restricted cash, current	8,397	5,970
Total current assets	341,644	232,553
Property, plant, and equipment, net	53,587	47,515
Operating lease right-of-use assets	10,310	—
Restricted cash, non-current	4,581	7,439
Other assets	4,789	6,366
Total assets	<u>\$ 414,911</u>	<u>\$ 293,873</u>
Liabilities and Stockholders' Equity:		
Accounts payable	\$ 25,074	\$ 37,865
Accrued liabilities	19,736	14,635
Deferred revenue, current	16,015	10,358
Operating lease liabilities, current	3,153	—
Debt, current	—	—
Total current liabilities	63,978	62,858
Debt, non-current	133,252	24,574
Derivative liability	70,870	—
Warrant liability	39,670	—
Deferred revenue, non-current	12,206	8,264
Operating lease liabilities, non-current	7,891	—
Other long-term liabilities	12,578	11,198
Total liabilities	340,445	106,894
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Convertible preferred stock, \$0.0001 par value; 129,572,982 shares authorized and 129,003,889 shares issued and outstanding as of December 31, 2020 and 2019; liquidation preference \$631.3 million as of December 31, 2020 and 2019	13	13
Common stock, \$0.0001 par value; 175,100,000 shares authorized and 6,361,952 shares issued and outstanding as of December 31, 2020; 170,000,000 shares authorized and 4,400,247 shares issued and outstanding as of December 31, 2019	1	—
Additional paid-in capital	682,671	668,178
Accumulated deficit	(608,219)	(481,212)
Total stockholders' equity	74,466	186,979
Total liabilities and stockholders' equity	<u>\$ 414,911</u>	<u>\$ 293,873</u>

See accompanying notes to financial statements.

PROTERRA INC
STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Year Ended December 31,		
	2020	2019	2018
Product revenue.	\$ 190,411	\$ 172,295	\$ 119,314
Parts and other service revenue.	6,532	8,989	3,896
Total revenue.	196,943	181,284	123,210
Product cost of goods sold	181,987	173,428	130,660
Parts and other service cost of goods sold	7,417	9,467	3,767
Total cost of goods sold	189,404	182,895	134,427
Gross profit (loss)	7,539	(1,611)	(11,217)
Research and development	36,233	35,477	31,504
Selling, general and administrative.	67,139	56,132	46,343
Asset impairment charge.	121	6,440	—
Total operating expenses.	103,493	98,049	77,847
Loss from operations.	(95,954)	(99,660)	(89,064)
Interest expense, net	15,413	2,704	3,476
Loss on valuation of derivative and warrant liabilities	12,989	—	—
Other expense (income), net	2,629	(812)	(918)
Loss before income taxes	(126,985)	(101,552)	(91,622)
Provision for income taxes	22	—	—
Net loss	\$ (127,007)	\$ (101,552)	\$ (91,622)
Net loss per share of common stock, basic and diluted	\$ (25.85)	\$ (25.06)	\$ (32.36)
Shares used in computing net loss per share of common stock, basic and diluted	4,913	4,052	2,831

See accompanying notes to financial statements.

PROTERRA INC
STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)

	Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
Balance, December 31, 2017 . . .	88,165	\$ 9	2,282	\$ —	\$ 386,541	\$ (288,038)	\$ 98,512
Adoption of accounting standards	—	—	—	—	587	—	587
Issuance of stock, net of costs . . .	28,262	2	1,218	—	178,625	—	178,627
Stock-based compensation	—	—	—	—	5,376	—	5,376
Net loss	—	—	—	—	—	(91,622)	(91,622)
Balance, December 31, 2018 . . .	116,427	11	3,500	—	571,129	(379,660)	191,480
Issuance of stock, net of costs . . .	12,577	2	900	—	88,388	—	88,390
Issuance of warrants	—	—	—	—	141	—	141
Stock-based compensation	—	—	—	—	8,520	—	8,520
Net loss	—	—	—	—	—	(101,552)	(101,552)
Balance, December 31, 2019 . . .	129,004	13	4,400	—	668,178	(481,212)	186,979
Issuance of stock, net of costs . . .	—	—	1,962	1	4,211	—	4,212
Stock-based compensation	—	—	—	—	10,282	—	10,282
Net loss	—	—	—	—	—	(127,007)	(127,007)
Balance, December 31, 2020 . . .	<u>129,004</u>	<u>\$ 13</u>	<u>6,362</u>	<u>\$ 1</u>	<u>\$ 682,671</u>	<u>\$ (608,219)</u>	<u>\$ 74,466</u>

See accompanying notes to financial statements.

PROTERRA INC
STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2020	2019	2018
Cash flows from operating activities:			
Net loss	\$ (127,007)	\$ (101,552)	\$ (91,622)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	15,536	12,643	9,254
Loss on disposal of fixed assets	143	527	793
Asset impairment charge	121	6,440	—
Stock-based compensation	10,282	8,520	5,376
Amortization of debt discount and issuance costs	6,045	306	247
Accretion of debt end of term charge and PIK interest	3,501	604	1,196
Loss on valuation of derivative and warrant liabilities	12,989	—	—
Others	(153)	(284)	(335)
Changes in operating assets and liabilities:			
Accounts receivable	(7,216)	(9,005)	(23,196)
Inventory	2,182	(15,692)	(23,642)
Prepaid expenses and other current assets	(1,043)	563	(5,002)
Deferred cost of goods sold	(797)	4,207	(3,356)
Operating lease right-of-use assets and liabilities	87	—	—
Other assets	1,575	(4,746)	(718)
Accounts payable and accrued liabilities	(4,090)	(1,025)	12,545
Deferred revenue, current and non-current	9,599	132	11,780
Other non-current liabilities	2,176	1,068	3,001
Net cash used in operating activities	(76,070)	(97,294)	(103,679)
Cash flows from investing activities:			
Purchase of investments	(108,960)	(71,817)	(34,152)
Proceeds from maturities of investments	80,000	50,400	16,200
Purchase of property and equipment	(25,565)	(13,810)	(16,698)
Net cash used in investing activities	(54,525)	(35,227)	(34,650)
Cash flows from financing activities:			
Proceeds from debt, net of issuance costs	219,471	21,362	—
Repayment of debt	(22,787)	(26,708)	—
Repayment of finance obligation	(484)	(452)	(452)
Proceeds from government grants	275	522	1,507
Proceeds from exercise of stock options	4,168	1,726	1,916
Proceeds from issuance of stock, net of issuance costs	—	86,746	173,659
Net cash provided by financing activities	200,643	83,196	176,630
Net increase (decrease) in cash and cash equivalents, and restricted cash	70,048	(49,325)	38,301
Cash and cash equivalents, and restricted cash at the beginning of period	53,649	102,974	64,673
Cash and cash equivalents, and restricted cash at the end of period	\$ 123,697	\$ 53,649	\$ 102,974
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$ 5,827	\$ 4,881	\$ 2,648
Cash paid for income taxes	9	—	—
Non-cash investing and financing activity:			
Issuance of warrants in connection with debt borrowing	\$ —	\$ 141	\$ —
Assets acquired through accounts payable and accrued liabilities	659	4,017	1,146
Non-cash transfer of vehicles from inventory to internal use	—	967	—
Non-cash transfer of leased assets to inventory	635	—	—

See accompanying notes to financial statements.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization and Description of Business

Proterra Inc (“Proterra” or the “Company”) is a leading developer and producer of electric vehicle technology for commercial application. Proterra designs, develops, manufactures, and sells electric transit buses as an original equipment manufacturer for North American public transit agencies, airports, universities, and other commercial transit fleets. It also designs, develops, manufactures, sells, and integrates proprietary battery systems and electrification solutions for global commercial vehicle manufacturers. Additionally, Proterra provides fleet-scale, high-power charging solutions for our customers. Proterra was originally formed in June 2004 as a Colorado limited liability company and converted to a Delaware corporation in February 2010. The Company operates from its headquarters and battery production facility in Burlingame, California. The Company also has manufacturing and product development facilities in Greenville, South Carolina and City of Industry, California.

The Company has incurred net losses and negative cash flows from operations since inception. As of December 31, 2020, the Company has an accumulated deficit of \$608.2 million, and \$179.7 million of cash and cash equivalents and short-term investments. The Company has funded operations primarily through a combination of equity and debt financing. Management believes that the Company’s currently available resources will be sufficient to fund its cash requirements for at least the next twelve months. However, there can be no assurance that future financings will be successfully completed or completed on terms acceptable to the Company. These financial statements do not include any adjustments that may result from the outcome of this uncertainty.

Basis of Presentation

The Company prepared the financial statements in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”).

The Company has not experienced any significant impact to estimates or assumptions as a result of the COVID-19 pandemic. We will continue to monitor impacts of the pandemic on an ongoing basis. While the COVID-19 pandemic has not had a material adverse impact on our financial condition and results of operations to date, the future impact of the COVID-19 pandemic on our operational and financial performance will depend on certain developments, including the duration and spread of the pandemic, impact on our customers and effect on our suppliers, all of which are uncertain and cannot be predicted.

Segments

The Company operates in the United States and started to expand its business to the European Union in 2018 and Canada in 2019. The revenue generated outside of the United States was not material for the years ended December 31, 2018 and 2019. The revenue generated outside of the United States was about 28% of total revenue or \$55.9 million for the year ended December 31, 2020, which was primarily generated from Canada.

The Company’s chief operating decision maker is its Chief Executive Officer (CEO), who reviews financial information presented at the entity level. Accordingly, the Company has determined that it has a single reportable segment.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires the use of estimates and judgments that affect the reported amounts in the financial statements and accompanying notes. U.S. GAAP requires the Company to make estimates and judgments in several areas including, but not limited to, those related to revenue recognition, collectability of accounts receivable, valuation of inventories, valuation of Convertible Notes (See Note 3), warranty liability, contingent liabilities, stock-based compensation expense, useful lives of property, plant, and equipment, recoverability of assets, residual value of leased assets, and the valuation of deferred tax assets. These estimates are based on historical facts and various other assumptions that the Company believes are reasonable. Actual results could differ materially from those estimates.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

Foreign Currency Transactions

The U.S. dollar is the Company's functional currency. Monetary assets and liabilities denominated in currencies other than the U.S. dollar are remeasured to the U.S. dollar at period end, and transaction gains and losses are recorded in other expense (income), net in the statements of operations. Net gains or losses resulting from foreign exchange transactions were not material for the years ended December 31, 2018 and 2019. The net losses resulting from foreign exchange transactions were \$1.1 million for the year ended December 31, 2020.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Accounts Receivable and Allowance for Credit Losses

Accounts receivable are recorded at the invoiced amount and do not bear interest. The Company determines the allowance for credit losses based on historical write-off experience, an analysis of the aging of outstanding receivables, customer payment patterns and expectations of changes in macroeconomic conditions that may affect the collectability of outstanding receivables. The allowance for credit losses was not material as of December 31, 2020 and 2019.

Short-Term Investments

The Company's primary objectives for investment activities are to preserve principal, provide liquidity, and maximize income without significantly increasing risk. The Company classifies its short-term investments as available-for-sale at the time of purchase because it is intended that these investments are available for current operations. Investments with maturities of one year or less from the balance sheet date are classified as short-term investments.

Investments are reported at fair value and are subject to periodic impairment review. Unrealized gains and losses related to changes in the fair value of these securities are recognized in accumulated other comprehensive loss. The ultimate value realized on these securities is subject to market price volatility until they are sold. Realized gains or losses from short-term investments are recorded in other expense (income), net.

As of December 31, 2020 and 2019, short-term investments were \$69.0 million and \$39.9 million, respectively.

Restricted Cash

The Company maintains certain cash amounts restricted as to withdrawal or use. The restricted cash is primarily collateral for performance bonds issued to certain customers. The collateral is provided in the form of a cash deposit to either support the bond directly or to collateralize a letter of credit that supports the performance bonds. As of December 31, 2020 and 2019, restricted cash was \$13.0 million and \$13.4 million, respectively.

Credit Risk and Concentration

Our financial instruments that are potentially subject to concentrations of credit risk consist primarily of cash, cash equivalents, restricted cash, short-term investments, and accounts receivable. Cash and cash equivalents and short-term investments are maintained primarily at two financial institutions, and deposits exceed federally insured limits. Risks associated with cash and cash equivalents, and short-term investments are mitigated by banking with creditworthy financial institutions. The Company has not experienced any losses on its deposits of cash and cash equivalents or its short-term investments.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

Cash equivalents consist of short-term money market funds, corporate debt securities, and debt securities issued by the U.S. Treasury, which are deposited with reputable financial institutions. The Company's cash management and investment policy limits investment instruments to investment-grade securities with the objective to preserve capital and to maintain liquidity until the funds can be used in business operations.

Accounts receivable are typically unsecured and are generally derived from revenue earned from transit agencies, universities and airports in North America and global commercial vehicle manufacturers in both North America and the European Union. The Company periodically evaluates the collectability of its accounts receivable and provides an allowance for potential credit losses as necessary.

Given the large order value for customers and the relatively low number of customers, revenue and accounts receivable have typically been concentrated with a limited number of customers.

	Revenue			Accounts Receivable	
	Year Ended December 31,			December 31,	
	2020	2019	2018	2020	2019
Number of customers accounted for 10% or more*	1	—	3	2	4

* One customer accounted for 21% of total revenue for year ended December 31, 2020 and 33% of the accounts receivable, net as of December 31, 2020. No other individual customer accounted for more than 20% of total revenue for years ended December 31, 2020, 2019 and 2018, or accounts receivable, net as of December 31, 2020 and 2019.

Single source suppliers provide the Company with a number of components that are required for manufacturing of our current products. In other instances, although there may be multiple suppliers available, many of the components are purchased from a single source. If these single source suppliers fail to meet the Company's requirements on a timely basis at competitive prices, the Company could suffer manufacturing delays, a possible loss of revenue, or incur higher cost of sales, any of which could adversely impact the Company's operating results.

Fair Value of Financial Instruments

The carrying value of the Company's financial instruments, including cash and cash equivalents, accounts receivable, short-term investments, accounts payable, and accrued and other current liabilities, approximates fair value due to the short period of time to maturity, receipt, or payment. The carrying amount of the Company's debt, except for Convertible Notes, approximates its fair value as the stated interest rates approximate market rates currently available to the Company.

In August 2020, the Company issued Convertible Notes that contain embedded features subject to derivative accounting. These embedded features are composed of conversion options that have the economic characteristics of a contingent early redemption feature settled in a variable number of shares of the Company's stock. These conversion options are bifurcated and accounted for as a derivative liability separately from the host debt instrument. Embedded derivatives are recognized as a derivative liability on the balance sheet. The derivative liability is measured at fair value and subject to remeasurement at each balance sheet date.

The warrants issued in connection with the Convertible Notes are classified as a liability because they can become exercisable into common stock upon a Qualified Initial Public Offering ("QIPO") or into convertible preferred stock after 5 years from issuance date in the event that there is no QIPO during such period. Such warrants are measured at fair value, subject to remeasurement at each balance sheet date.

Inventories

Inventories are recorded at the lower of cost and net realizable value using the first-in, first-out method. Inventory costs consist primarily of the cost of materials, manufacturing support costs, including labor and factory overhead associated with such production, and shipping costs. The costs of vehicles, charger equipment or prototype

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

products delivered to customers that have not yet met revenue recognition criteria are also included in inventories. We assess the valuation of inventory and periodically record a provision to adjust inventory to its estimated net realizable value, including when we determine inventory to be obsolete or in excess of anticipated demand. Once inventory has been written-off or written-down, it creates a new cost basis for the inventory that is not subsequently written-up.

Deferred Cost of Goods Sold

Deferred cost of goods sold primarily includes incurred costs for charging system installations that have not met revenue recognition criteria.

Property, Plant, and Equipment

Property, plant, and equipment, including leasehold improvements, are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets, as follows:

Property, Plant, and Equipment	Estimated Useful Life
Computer hardware	3 years
Computer software	3 to 5 years
Internally used vehicles and charging systems	over the shorter of their estimated useful lives or 5 years
Machinery and equipment	5 to 12 years
Office furniture and equipment	5 years
Tooling	5 years
Leasehold improvements	over the shorter of their estimated useful lives or the terms of the related leases
Leased batteries	over the shorter of the terms of the related leases or 12 years
Leased vehicles and charging systems	over the shorter of the terms of the related leases or 5 years

In the fourth quarter of 2019, we completed a review of the estimated useful lives of vehicles and charging equipment used for demonstration purposes. Based on this review, we revised the estimated useful lives of demo vehicles from 12 years to five years effective on November 1, 2019, after considering the condition of assets and our long-term strategy for operating such assets. We believe this change in estimate is appropriate, as it is based on actual experience and the expectations for the ongoing productive use of these assets. The impact to depreciation expense caused by this change in estimate is not material to selling, general and administrative expense on the statement of operations for the year ended December 31, 2019 or future periods.

If the estimated useful life of an asset is less than the stated number of years in our capitalization policy, the depreciation expense will be recorded over the shorter period.

Upon the retirement or sale of property, plant, and equipment, the cost and associated accumulated depreciation are removed from the balance sheet, and the resulting gain or loss is reflected on the statement of operations. Maintenance and repair expenditures are expensed as incurred while major improvements that increase the functionality, output, or expected life of an asset are capitalized and depreciated ratably over the identified useful life.

Impairment of Long-Lived Assets

The Company evaluates the recoverability of property, plant, and equipment and right-of-use assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of these assets is measured by a comparison of the carrying amounts to the future undiscounted cash flows the assets are expected to generate. If such review indicates that the carrying amount of long-lived assets is not recoverable, the carrying amount of such assets is reduced to fair value.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

In addition to the recoverability assessment, the Company periodically reviews the remaining estimated useful lives of property, plant, and equipment. If the estimated useful life assumption for any asset is reduced, the remaining net book value is depreciated over the revised estimated useful life.

The Company reviews long-lived assets for impairment at the lowest level for which separate cash flows can be identified. During the fourth quarter of 2019, due to the introduction of new products and related technology advancements, we determined that an impairment analysis of certain assets leased to customers was required to be performed. The estimated undiscounted future cash flows generated by these assets were less than their carrying amounts. The carrying amounts of the assets were reduced to fair value, which resulted in an impairment charge of \$6.4 million recorded in the statement of operations for the year ended December 31, 2019.

No impairment charge was recognized in 2018. We recorded \$0.1 million impairment charge associated with a facility lease for the year ended December 31, 2020.

Deferred Revenue

Deferred revenue consists of billings or payments received in advance of revenue recognition that are recognized as revenue once the revenue recognition criteria are met. In some instances, progress billings are issued upon meeting certain milestones stated in the contracts. Accordingly, the deferred revenue balance does not represent the total contract value of non-cancelable arrangements. Invoices are typically due within 30 to 40 days.

Deferred revenue was \$28.2 million and \$18.6 million as of December 31, 2020 and 2019, respectively. For the year ended December 31, 2020, \$16.5 million revenue was recognized from the deferred revenue balance as of December 31, 2019. The reduction in deferred revenue was offset by new billings for products and extended warranty services for which revenue had not been recognized as of December 31, 2020. The current portion of deferred revenue represents the amount that is expected to be recognized as revenue within one year from the balance sheet date.

Revenue Recognition

We derive revenue primarily from the sale of vehicles and charging systems, the installation of charging systems, the sale of battery systems and powertrain components to other vehicle manufacturers, as well as the sale of spare parts and other services provided to customers. Product revenue consists of revenue earned from vehicles and charging systems, battery systems and powertrain components, installation of charging systems, and revenue from leased vehicles, charging systems, and batteries under operating leases. Leasing revenue recognized over time was approximately \$2.3 million, \$3.8 million and \$3.0 million for the years ended December 31, 2020, 2019 and 2018, respectively. Parts and other service revenue includes revenue earned from spare parts, the design and development of battery systems and drive systems for other vehicle manufacturers, and extended warranties.

Goods and services that are promised in our contracts include vehicles, charging systems, battery systems and powertrain components to other vehicle manufacturers, installation of charging systems, spare parts, and extended warranty. We assess the products and services promised in contracts at contract inception, and identify performance obligations for each promise to transfer to the customer a product or service that is distinct. If a product or service is separately identifiable from other items in the bundled arrangement and a customer can benefit from the product or service on its own or with other resources that are readily available to the customer, then such product or service is considered distinct. Customer contracts typically have multiple performance obligations. Generally, our goods and services are considered separate performance obligations. Depending on the contractual arrangement, the charging systems and related installation services if purchased by customer are typically considered as one performance obligation, as they represent inputs of a combined integrated output which benefits the customer. Development services are typically sold on a stand-alone basis and are not bundled with other goods or services.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

The transaction price of the contract is allocated to each performance obligation in a manner depicting the amount of consideration to which the Company expects to be entitled in exchange for transferring the goods or services to the customer (the “allocation objective”). If the allocation objective is met at contractual prices, no further allocations are made. Otherwise, the Company allocates the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis.

To determine the standalone selling price of its promised products or services, we conduct an analysis to determine whether its products or services have an observable standalone selling price. In determining the observable standalone selling price, the Company requires that a substantial majority of the standalone selling prices for a product or service fall within a reasonably narrow range. If there is no directly observable standalone selling price for a particular product or service, then we estimate a standalone selling price by using the estimated cost plus margin or by reviewing external and internal market factors including, but not limited to, pricing practices including historical discounting, major service groups, and the geographies in which we offer products and services.

We recognize revenue when or as it satisfies a performance obligation by transferring control of a product or service to a customer.

Revenue from product sales is recognized when control of the underlying performance obligations is transferred to the customer. Revenue from vehicles and charging systems, and installation of charging systems is typically recognized upon acceptance by the customer. Under certain contract arrangements, the control of the performance obligations related to the charging systems is transferred over time, and the associated revenue is recognized over the installation period using an input measure based on costs incurred to date relative to total estimated costs to completion. Spare parts revenue is recognized upon shipment. Extended warranty revenue is recognized over the life of the extended warranty using the time elapsed method. Development service contracts typically include the delivery of prototype products to customers. The performance obligation associated with the development of prototype products as well as battery systems and powertrain components to other vehicle manufacturers, is satisfied at a point in time, typically upon shipping.

Revenue derived from performance obligations satisfied over time from charging systems and installation was \$6.0 million, \$7.2 million and \$0.6 million in the years ended December 31, 2020, 2019, and 2018, respectively. Extended warranty revenue is not material to date.

Typically, the Company does not have contract assets, as rights to consideration in exchange for goods or services that have transferred to a customer are not conditional on anything other than the passage of time. In certain cases, there is a condition that requires a contract asset to be recognized. As of December 31, 2020 and 2019, the contract assets balance was \$2.8 million and \$0.6 million, respectively. The contract assets are expected to be billed within the next twelve months and are recorded in the prepaid expenses and other current assets on the balance sheets.

As of December 31, 2020, the amount of remaining performance obligations that have not been recognized as revenue was \$229.4 million, of which 67% was expected to be recognized as revenue over the next 12 months and the remainder thereafter. This amount excludes the value of remaining performance obligations for contracts with an original expected length of one year or less.

Lease Arrangements

The Company offers customers leasing alternatives outside of the standard sales contracts for vehicles, charging equipment and batteries used in the vehicles. The leasing arrangements are typically bundled together with the sales contracts. We assessed the nature of the bundled arrangements under the revenue accounting standard. For arrangements that contain a lease, we determined the classification of the lease in accordance with Topic 840, Leases, prior to the adoption of Topic 842, Leases, on January 1, 2020. A lease arrangement that transfers substantially all of the benefits and risks incident to ownership of the products is classified as a sales-type lease based on the criteria established by the accounting standard; otherwise the lease is classified as an operating lease.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

For sales-type leases, product revenue is recognized upon customer acceptance of the underlying leased assets. The current portion of net investment in sales-type leases is recorded in Accounts Receivable, and the non-current portion is recorded in Other Assets on the Company's balance sheets. The discounted unguaranteed residual value of underlying leased assets is not material to the net investment in lease balance.

For operating leases, the leasing revenue is recognized on a straight-line basis over the lease term, which is commenced upon customer acceptance.

We monitor the performance of customers who leased batteries and are subject to ongoing payments. No allowance was recorded for the receivables under the leasing arrangements.

We adopted the new lease accounting standard, Topic 842, Leases, on January 1, 2020. We determine whether an arrangement is or contains a lease at inception. Short-term leases with a term of less than 12 months will not be recognized in the right-of-use assets or lease liabilities. The lease and non-lease components are not separated for all leases regardless of whether the Company is the lessee or a lessor to the lease. Refer to Note 6, Leases, for additional information.

Cost of Goods Sold

Cost of goods sold includes direct material and labor costs, manufacturing overhead including depreciation expense, freight costs, and reserves for estimated warranty expenses. Cost of goods sold also includes charges to write-down the carrying value of inventory when it exceeds its estimated net realizable value and to provide for on-hand inventory that is either obsolete or in excess of forecasted demand. Costs of development services are expensed as incurred. Costs of development services incurred in periods prior to the finalization of an agreement are recorded as research and development expense. Once an agreement is finalized, these costs are recorded in cost of goods sold.

Sales and Other Taxes

Taxes assessed by various government entities, such as sales, use, and value added taxes, collected at the time of sale are excluded from revenue.

Shipping Costs

Amounts billed to customers related to shipping and handling are classified as revenue, and the related shipping and handling costs are included in cost of goods sold.

Research and Development Costs

Research and development costs are expensed as incurred. Research and development expense consists primarily of payroll and benefits of those employees engaged in research, design, and development activities, costs related to prototype parts and design tools, license expenses related to intellectual property, supplies and services, depreciation, and other occupancy costs.

Advertising Expenses

Advertising costs are expensed as incurred. Advertising expenses were \$0.6 million, \$0.9 million, and \$0.8 million for the year ended December 31, 2020, 2019 and 2018, respectively.

Product Warranties

The Company provides a limited warranty to customers on vehicles, charging systems, and battery systems. The limited warranty ranges from one to 12 years depending on the components. Separately, the Company also periodically performs field service actions related to product service campaigns. Pursuant to these warranties and

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

field service actions, we will repair, replace, or adjust the parts on the products that are defective in factory-supplied materials or workmanship. A warranty reserve for the products sold is recorded at the point of revenue recognition, which includes the best estimate of the projected costs to repair or replace items under the limited warranty and field service actions. These estimates are based on actual claims incurred to date and an estimate of the nature, frequency and costs of future claims. These estimates are inherently uncertain given the relatively short history of sales. Changes to the historical or projected warranty experience may cause material changes to the warranty reserve in the future. The warranty reserve does not include projected warranty costs associated with the vehicles under operating leases, as the costs to repair these warranty claims are expensed as incurred. The portion of the warranty reserve expected to be incurred within the next 12 months is included within accrued liabilities while the remaining balance is included within other long-term liabilities on the balance sheets.

Warranty expense is recorded as a component of cost of goods sold. Accrued warranty activity consisted of the following (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Warranty reserve – beginning of period	\$ 14,926	\$ 10,602	\$ 2,581
Warranty costs incurred	(4,214)	(6,031)	(2,653)
Net changes in liability for pre-existing warranties, including expirations.	(3,392)	(840)	—
Provision for warranty	11,262	11,195	10,674
Warranty reserve – end of period	<u>\$ 18,582</u>	<u>\$ 14,926</u>	<u>\$ 10,602</u>

Stock-Based Compensation

The Company uses the fair value method for recording stock-based compensation expense. Stock-based compensation expense for stock options is estimated at the grant date based on each stock option's fair value as calculated using the Black-Scholes option pricing model. The stock-based compensation expense for stock option grants is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The Company adjusts these reserves when facts and circumstances change, such as the closing of a tax audit or the refinement of an estimate. The provision for income taxes includes the effects of any reserves that are considered appropriate.

Accrued interest and penalties related to unrecognized tax benefits are classified as income tax expense.

Government Incentives

The Company receives incentives from the federal and state government agencies in the form of grants. Incentives are recorded in the financial statements in accordance with their purposes, either as a reduction of expense or a reduction of the cost of the capital investment. The benefit of these incentives is recorded when performance is complete and all conditions as specified in the agreement are fulfilled.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

California and certain other states provide incentives to accelerate the purchase of cleaner, more efficient buses in the form of point-of-sale discounts to vehicle purchasers. These incentives are included in the customer contract value, and recognized as revenue once all revenue recognition criteria are met.

Other Comprehensive Income (Loss)

The Company did not have other comprehensive income (loss) for the years ended December 31, 2020, 2019 and 2018, respectively.

2. Adoption of New Accounting Standards

Topic 842, *Leases*. This standard provides guidance on the recognition, measurement, presentation, and disclosure of leases. The new standard supersedes the present U.S. GAAP standard on leases and requires substantially all leases to be reported on the balance sheet as right-of-use assets and lease obligations. The Company elected to adopt the new lease accounting standard on January 1, 2020 using the optional transition method, recognizing a cumulative-effect adjustment to the balance sheet and not adjusting comparative information for prior periods. Refer to Note 6, *Leases*, for additional information.

ASU No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This standard requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. The Company adopted this standard on January 1, 2020, and it had no material impact on the financial statements.

ASU No. 2018-13, *Changes to Disclosure Requirements for Fair Value Measurement (Topic 820)*. This standard improves the effectiveness of disclosure requirements for recurring and nonrecurring fair value measurements. This standard removes, modifies, and adds certain disclosure requirements. The Company adopted this standard on January 1, 2020, and it had no material impact on the financial statements.

ASU No. 2018-15, *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. This standard aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract requiring the capitalization of implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The Company adopted this standard on January 1, 2020, and it had no material impact on the financial statements.

ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The amendments in this standard provide optional guidance for a limited time to ease the potential burden in accounting for reference rate reform. The new guidance provides optional expedients and exceptions for applying U.S. GAAP to contracts, hedging relationships and other transactions affected by reference rate reform if certain criteria are met. The amendments apply only to contracts and hedging relationships that reference the London Interbank Offered Rate (LIBOR) or another reference rate expected to be discontinued due to reference rate reform. These amendments are effective from March 2020 through December 31, 2022. The amendments have no material impact on the financial statements.

Recent Accounting Pronouncements Not Yet Adopted

ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. This standard simplifies the accounting for income taxes, eliminates certain exceptions within Topic 740, *Income Taxes*, and clarifies certain aspects of the current guidance to promote consistency among reporting entities. The Company will adopt this standard on January 1, 2021, and expect no material impact on the financial statements.

ASU No. 2020-06, *Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*. This standard simplifies the accounting for convertible instruments by removing certain separation models in ASC 470-20, *Debt — Debt with Conversion and Other Options*. This standard updates the guidance on certain embedded

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

2. Adoption of New Accounting Standards (cont.)

conversion features that are not required to be accounted for as derivatives under Topic 815, *Derivatives and Hedging*, or that do not result in substantial premiums accounted for as paid-in capital, such that those features are no longer required to be separated from the host contract. The convertible debt instruments will be accounted for as a single liability measured at amortized cost. This will also result in the interest expense recognized for convertible debt instruments to be typically closer to the coupon interest rate when applying the guidance in Topic 835, *Interest*. Further, this standard made amendments to the EPS guidance in Topic 260 for convertible instruments, the most significant impact of which is requiring the use of the if-converted method for diluted earnings per share calculation, and no longer allowing the net share settlement method. This standard also made revisions to Topic 815-40, which provides guidance on how an entity must determine whether a contract qualifies for a scope exception from derivative accounting. The amendments to Topic 815-40 change the scope of contracts that are recognized as assets or liabilities. This standard is effective for interim and annual periods beginning after December 15, 2021, with early adoption permitted after December 15, 2020. Adoption of this standard can either be on a modified retrospective or full retrospective basis. The Company is currently evaluating this standard but expect no material impact on the financial statements.

3. Fair Value of Financial Instruments

The Company measures certain financial assets and liabilities at fair value. Fair value is determined based on the exit price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy:

Level 1 — Quoted prices in active markets for identical assets or liabilities;

Level 2 — Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 — Inputs that are generally unobservable and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

Financial assets measured at fair value on a recurring basis using the above input categories were as follows (in thousands):

		Fair Value at	
		December 31,	
	Pricing Category	2020	2019
Assets:			
Cash equivalents:			
Money market funds	Level 1	\$ 744	\$ 3,334
U.S. Treasury securities.	Level 1	64,997	29,957
Short-term investments:			
U.S. Treasury securities.	Level 1	68,990	39,877
Total		\$ 134,731	\$ 73,168
Liabilities:			
Other non-current liabilities:			
Derivative liability.	Level 3	\$ 70,870	\$ —
Warrant liability	Level 3	39,670	—
Total		\$ 110,540	\$ —

As of December 31, 2020 and 2019, short-term investments were primarily comprised of U.S. Treasury securities. The unrealized gain/losses related to fixed income debt securities were immaterial and primarily due to changes in interest rates, which are temporary in nature.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

3. Fair Value of Financial Instruments (cont.)

As of December 31, 2020 and 2019, the contractual maturities of the short-term investments were less than one year.

In August 2020, the Company issued Convertible Notes that contain embedded features subject to derivative accounting. Refer to Note 5, Debt, for additional information on the Convertible Notes.

The embedded derivatives are recognized as a derivative liability on the balance sheet, and are measured at fair value, subject to remeasurement at each balance sheet date. The fair value of derivative liability is measured as the difference between the estimated value of the Convertible Notes with and without such conversion features utilizing Monte Carlo simulation pricing model.

The warrants issued in connection with the Convertible Notes are classified as a liability because they can become exercisable into common stock upon a QIPO or into convertible preferred stock after five years from issuance date in the event that there is no QIPO during such period. Such warrants are measured at fair value, subject to remeasurement at each balance sheet date. The fair value of the warrant liability is measured using Monte Carlo Simulation pricing model.

The fair value of the Convertible Notes was \$365.9 million as of December 31, 2020. The carrying value of the Convertible Notes of \$106.4 million, net of \$97.1 million unamortized debt discount and issuance costs, as of December 31, 2020, was recorded in Debt, non-current on the balance sheets.

The valuation of derivative and warranty liabilities and the Convertible Notes are based on significant inputs not observable in the market, and thus represents a level 3 measure. The key inputs to the valuation model include fair value of equity, equity volatility, expected term until a liquidity event to exit, expected term until exercise, and risk-free interest rate.

A summary of the changes in the fair value of the derivative liability is as follows (in thousands):

	Amount
Derivative liability – at issuance	\$ 68,514
Change in fair value	2,356
Derivative liability – December 31, 2020	<u>\$ 70,870</u>

A summary of the changes in the fair value of the warrant liability is as follows (in thousands):

	Amount
Warrant liability – at issuance	\$ 29,037
Change in fair value	10,633
Warrant liability – December 31, 2020	<u>\$ 39,670</u>

The change in fair value of derivative and warrant liabilities is recorded in the statement of operations.

4. Balance Sheet Components

Cash and cash equivalents consisted of the following (in thousands):

	December 31,	
	2020	2019
Cash	\$ 44,978	\$ 6,949
Cash equivalents	65,741	33,291
Total cash and cash equivalents	<u>\$ 110,719</u>	<u>\$ 40,240</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

4. Balance Sheet Components (cont.)

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the balance sheets to the total of such amounts shown on the statements of cash flows.

	December 31,	
	2020	2019
Cash and cash equivalents.	\$ 110,719	\$ 40,240
Restricted cash, current portion	8,397	5,970
Restricted cash, net of current portion	4,581	7,439
Total restricted cash	12,978	13,409
Total cash and cash equivalents, and restricted cash.	<u>\$ 123,697</u>	<u>\$ 53,649</u>

Inventories consisted of the following (in thousands):

	December 31,	
	2020	2019
Raw materials	\$ 31,148	\$ 46,495
Work in progress	8,042	23,197
Finished goods	47,756	19,400
Service parts	5,384	4,950
Total inventories	<u>\$ 92,330</u>	<u>\$ 94,042</u>

The Company recorded a write-down of excess or obsolete inventories to cost of goods sold of \$3.0 million, \$4.9 million and \$4.2 million in the years ended December 31, 2020, 2019 and 2018, respectively.

Property, plant, and equipment, net, consisted of the following (in thousands):

	December 31,	
	2020	2019
Computer hardware.	\$ 4,708	\$ 3,830
Computer software	8,849	6,558
Internally used vehicles and charging systems	19,136	12,936
Leased vehicles and batteries	7,081	10,715
Leasehold improvements	10,234	8,275
Machinery and equipment	26,026	14,237
Office furniture and equipment	1,854	1,876
Tooling	21,727	17,918
Finance lease right-of-use assets.	179	—
Construction in progress	1,830	6,642
	101,624	82,987
Less: Accumulated depreciation and amortization	(48,037)	(35,472)
Total	<u>\$ 53,587</u>	<u>\$ 47,515</u>

Construction in progress was comprised of various assets that are not available for their intended use as of the balance sheet date.

Depreciation and amortization expense were \$15.5 million, \$12.6 million and \$9.3 million for the years ended December 31, 2020, 2019 and 2018, respectively.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

4. Balance Sheet Components (cont.)

Accrued liabilities consisted of the following (in thousands):

	December 31,	
	2020	2019
Accrued payroll and related expenses	\$ 6,695	\$ 2,799
Accrued sales and use tax	975	1,254
Warranty reserve	6,121	7,697
Financing obligation	3,056	850
Accrued interest	127	174
Accrued audit and accounting related expenses	428	419
Accrued charger installation costs	769	547
Other accrued expenses	1,565	895
Total	<u>\$ 19,736</u>	<u>\$ 14,635</u>

Other long-term liabilities consisted of the following (in thousands):

	December 31,	
	2020	2019
Financing obligation	\$ —	\$ 3,056
Accrued interest	—	120
Warranty reserve	12,461	7,229
Deferred rent	—	793
Finance lease liabilities, non-current	117	—
Total	<u>\$ 12,578</u>	<u>\$ 11,198</u>

In July 2016, we entered into a bus sale and lease transaction for ten Catalyst buses. These buses are leased to other parties for five years by the customer. At the end of the lease term, the fourth quarter of 2021, we have an obligation to repurchase the buses back from the customer. We make a portion of the monthly lease payments directly to the customer and also provided a guarantee to the customer on the remaining lease payments if the lessee fails to pay. We received \$6.0 million from the customer directly upon delivery in 2016. Under U.S. GAAP, this sales transaction is considered as a borrowing and the lease transaction is considered as an operating lease.

The financing obligation was \$3.1 million and \$3.9 million as of December 31, 2020 and 2019, respectively. Interest expense on the financing obligation is recognized using the effective interest method. The monthly lease payment is recognized as leasing revenue. The costs of the buses are recorded as leased vehicles in property, plant, and equipment on the balance sheets.

5. Debt

Debt, net of debt discount and issuance costs, consisted of the following (in thousands):

	December 31,	
	2020	2019
Hercules Credit Facility	\$ —	\$ 9,640
Senior Credit Facility	16,809	14,934
PPP loan	10,000	—
Convertible Notes	106,443	—
Total Debt, non-current	<u>\$ 133,252</u>	<u>\$ 24,574</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

5. Debt (cont.)

Loan and Security Agreement

The Company entered into a loan and security agreement with Hercules Capital, Inc. (“Hercules Credit Facility”) in 2015, and amendments in 2016 and 2017. In May 2019, the Company entered into an amendment to the Hercules Credit Facility to repay \$20.0 million in principal, and extend the maturity date of the remaining \$10.0 million outstanding principal to May 2021. The interest rate was composed of a cash interest rate of the greater of 10.55% or 10.55% plus the prime rate minus 5.5% and a PIK interest rate of 1.75% per annum. The loan had an interest only period through its maturity date. The \$2.3 million end-of-term charge under the Amended Hercules Credit Facility was paid on June 1, 2019. The \$0.8 million accrued PIK interest under the existing Hercules Credit Facility and \$0.2 million prepayment penalty were paid at the closing of the amendment. As of December 31, 2019, the outstanding balance under the Hercules Credit Facility was \$10.0 million, and the cash interest rate was 10.55% per annum.

In connection with entering into the Hercules Credit Facility in 2015, the Company issued to Hercules a warrant to purchase 397,932 shares of Series 4 convertible preferred stock. The Company determined the fair value of the convertible preferred stock warrant shares was \$0.3 million, which was recorded as a debt discount and a convertible preferred stock warrant liability, as discussed further in Note 8. In connection with the first amendment, the Company issued to Hercules an additional warrant to purchase 79,587 shares of Series 4 convertible preferred stock. The Company determined the fair value of the convertible preferred stock warrant was \$0.1 million, which was recorded as a debt discount and a convertible preferred stock warrant liability, as discussed further in Note 8. In connection with the Amended Hercules Credit Facility in 2019, the Company issued to Hercules a warrant to purchase 36,630 shares of common stock warrants. The Company determined the fair value of the common stock warrant was \$0.1 million, which was recorded as a debt discount and classified as equity in additional paid-in capital. The warrant is exercisable for 10 years, and will automatically exercise upon the initial public offering.

The end-of-term charge was accreted to accrued interest using the effective-interest method from the funding date to its payment due date. As of December 31, 2019, the accrued PIK interest balance was \$0.1 million.

The balance of debt issuance costs and discounts was \$0.4 million as of December 31, 2019. The debt issuance cost and debt discounts were amortized to interest expense over the terms of the Hercules Credit Facility using the effective interest method. The amortization of debt issuance cost and debt discounts to interest expense was \$0.2 million, \$0.3 million and \$0.2 million for 2020, 2019 and 2018, respectively.

The Company’s obligations under the Hercules Credit Facility were secured by a security interest and amended to a second security interest under the Amended Hercules Credit Facility on substantially all the Company’s assets except for intellectual property and other restricted property.

In August 2020, the Company made the repayment in full of its obligations of \$10.3 million under the Hercules Credit Facility, as amended, including principal and accrued interest. The Hercules Credit Facility was terminated upon payoff and the remaining unamortized debt issuance cost and debt discounts of \$0.2 million were recorded to interest expense.

Senior Credit Facility

In May 2019, the Company entered into a Loan, Guaranty and Security Agreement for a senior secured asset-based lending facility (“Senior Credit Facility”) with borrowing capacity up to \$75.0 million. The commitment under the Senior Credit Facility is available to the Company on a revolving basis through the earlier of May 2024 or 91 days prior to the stated maturity of any subordinated debt in aggregate amount of \$7.5 million or more. The maximum availability under the Senior Credit Facility is based on certain specified percentages of eligible accounts receivable and inventory, subject to certain reserves, to be determined in accordance with the Senior Credit Facility. The commitment under the Senior Credit Facility includes a \$10.0 million letter of credit sub-line. Subject to certain conditions, the commitment may be increased by \$50.0 million upon approval by the lender, and at the Company’s option, the commitment can be reduced to \$25.0 million or terminated upon at least 15 days written notice.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

5. Debt (cont.)

The Senior Credit Facility is secured by a security interest in substantially all of the Company's assets except for intellectual property and other restricted property.

Borrowings under the Senior Credit Facility bear interest at per annum rates equal to, at the Company's option, either (i) the base rate plus an applicable margin for base rate loan, or (ii) the London Interbank Offered Rate ("LIBOR") plus an applicable margin for LIBOR loan. The base rate is calculated as the greater of (a) the Lender prime rate, (b) the federal funds rate plus 0.5%, and (c) one-month LIBOR plus 1.0%. The applicable margin is calculated based on a pricing grid linked to quarterly average excess availability (as a percentage of borrowing capacity). For base rate loans, the applicable margin ranges from 0.0% to 1.5%, and for LIBOR Loans, it ranges from 1.5% to 3.0%. The Senior Credit Facility contains certain customary non-financial covenants. In addition, the Senior Credit Facility requires the Company to maintain a Fixed Charge Coverage Ratio of at least 1.00:1.00 during such times as a covenant trigger event shall exist.

As of December 31, 2020 and 2019, the outstanding balance under the Senior Credit Facility was \$17.1 million and \$15.3 million, respectively, with maturity of May 2024. The Company incurred approximately \$0.4 million debt issuance costs under this facility, and will amortize these costs to interest expense over the borrowing term. The interest rate was 3.09% and 4.89% per annum as of December 31, 2020 and 2019, respectively.

Small Business Administration Loan

In May 2020, the Company received Small Business Administration ("SBA") loan proceeds of \$10.0 million from Town Center Bank pursuant to the Paycheck Protection Program ("the PPP loan") under the "Coronavirus Aid, Relief and Economic Security (CARES) Act". The PPP loan was in the form of a note and matures on May 6, 2022. The interest rate is 1.00% per annum and payable monthly commencing in December 2020. All or a portion of the PPP loan may be forgiven by the SBA upon application with supporting documentation of expenditures in accordance with SBA requirements, which include employees being kept on the payroll for eight weeks after the date of the loan and the proceeds being used for payroll, rent, mortgage interest, or utilities.

Convertible Notes

In August 2020, the Company entered into a Note Purchase Agreement for Secured Convertible Promissory Notes ("Convertible Notes"). The Convertible Notes have an aggregate principal amount of \$200.0 million, with a cash interest of 5.0% per annum payable at each quarter end and a paid-in-kind interest of 4.5% per annum payable by increasing the principal balance at each quarter end. The Convertible Notes will mature in August 2025, and the Company may not make prepayment unless approved by the required holders of the Convertible Notes.

At or after an underwritten initial public offering in which the Company receives gross proceeds of not less than \$100 million ("QIPO"), or at the time of a merger, acquisition or other combination between the Company and a publicly-traded special purpose acquisition company ("SPAC transaction"), the holders may elect to convert the Convertible Notes into shares of common stock.

At the next bona fide equity financing following the Note Purchase Agreement, or 36 months after the date of the Note Purchase Agreement if no such equity financing shall have occurred (a "Qualified Financing"), the holders may elect to convert the Convertible Notes into shares of the most senior series of the Company's preferred stock.

The conversion price will be an amount equal to:

- i) if the conversion stock is being issued at or following a QIPO, the QIPO price per share multiplied by the Discount Coefficient (as defined in the Convertible Notes), which is initially equal to 90% and will decrease by 2.75% every 6 months following the first anniversary of the closing date of the Convertible Notes, in effect on the date of QIPO (the "QIPO Conversion Price"); or

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

5. Debt (cont.)

- ii) if the conversion stock is being issued following a Qualified Financing, 75% of the lowest per share cash purchase price of the common stock or preferred stock sold by the Company in the Qualified Financing; or
- iii) if the conversion stock is being issued following a SPAC transaction, 75% of the SPAC Transaction Price Per Share (as defined in the Note Purchase Agreement) (the “SPAC Conversion Price”).

The Convertible Notes will automatically be converted into common stock at any time after the expiration of the lock-up period of a QIPO or SPAC transaction, if the following conditions are met:

- if the QIPO price per share equals or exceeds \$6.9075, then upon the volume-weighted average price of the Company’s publicly-traded common stock over a period of 20 consecutive trading days exceeds 150% of the QIPO Conversion Price; or if the QIPO price per share is lower than \$6.9075, then upon the volume-weighted average price of the Company’s publicly-traded common stock over a period of 20 consecutive trading days exceeds 150% of an amount equal to \$6.9075 multiplied by the Discount Coefficient at the time of the QIPO.
- if the SPAC Transaction Price Per Share equals or exceeds \$6.9075, then upon the volume-weighted average price of the Company’s publicly-traded common stock over a period of 20 consecutive trading days commencing after the six month anniversary of the closing of the SPAC transaction exceeding 150% of the SPAC Conversion Price; or if the SPAC Transaction Price Per Share is lower than \$6.9075, then upon volume-weighted average price of the Company’s publicly-traded common stock over a period of 20 consecutive trading days commencing after the six month anniversary of the closing of the SPAC transaction and over which the Conversion Stock would be freely tradable exceeding 175% of an amount equal to \$6.9075 multiplied by 75%.

Each of the Convertible Notes shall rank equally without preference or priority of any kind over one another, but senior in all rights, privileges and preferences to all other shares of the Company’s capital stock and all other securities of the Company that are convertible into or exercisable for the Company’s capital stock directly or indirectly.

Prior to the maturity date or prior to the payment or conversion of the entire balance of the Convertible Notes, in the event of a liquidation or sale of the Company, the Company shall pay to the holders of Convertible Notes the greater of (i) 150% of the principal balance of the Convertible Notes or (ii) the consideration that the holders would have received had the holders elected to convert the Convertible Notes into preferred stock immediately prior to such liquidation event.

The Convertible Notes do not entitle the holders to any voting rights or other rights as a stockholder of the Company, unless and until the Convertible Notes are actually converted into shares of the Company’s capital stock in accordance with their terms.

The Note Purchase Agreement contains certain customary non-financial covenants. In addition, the Note Purchase Agreement requires the Company to maintain liquidity at quarter end of not less than the greater of (i) \$75.0 million and (ii) four times of cash burn for the three-month period then ended.

In connection with the issuance of the Convertible Notes, the Company issued warrants to the holders of Convertible Notes to purchase 5.1 million shares of Company stock at an exercise price of \$0.01 per share. The stock issuable upon exercise of the warrants shall be (1) common stock, or (2) in the event that a QIPO has not occurred within five years of the Note Purchase Agreement or in the event of a liquidation or sale of the Company, the most senior series of the Company’s convertible preferred stock (or in the event that the Company is consolidated or merges with one or more other corporations, the stock that the holder of the warrant would have been entitled to receive if holder would have exercised the warrant prior to such event). The warrants are exercisable for 7 years, and will be automatically exercised in the event of a change of control transaction or the expiration of the warrants.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

5. Debt (cont.)

The warrants are freestanding financial instruments and classified as liability due to the possibility that they can become exercisable into convertible preferred stock. The warrant liability of \$29.0 million is initially measured at fair value on its issuance date and recorded as a debt discount, and will be amortized during the term of the Convertible Notes to interest expense using the effective-interest method. The warrant liability will be remeasured on a recurring basis at each reporting period date, with the change in fair value reported in the statement of operations.

The embedded features are composed of conversion options that have the economic characteristics of a contingent early redemption feature settled in a variable number of shares of Company stock. These conversion options are bifurcated and accounted for separately from the host debt instrument. The derivative liability of \$68.5 million was initially measured at fair value on the issuance date of the Convertible Notes and recorded as a debt discount and will be amortized during the term of the Convertible Notes to interest expense using the effective-interest method. The derivative liability will be remeasured on a recurring basis at each reporting period date, with the change in fair value reported in the statement of operations.

The issuance costs of \$5.1 million were recorded as debt discount and will be amortized during the term of the Convertible Notes to interest expense using the effective interest method. The amortization expense of debt discount and issuance costs was \$5.6 million for the year ended December 31, 2020.

The Convertible Notes will mature in August 2025 or will be settled by issuing equity stock, and accordingly are classified as a non-current liability on the Company's balance sheets. As of December 31, 2020, the Convertible Notes, net of debt discount and issuance costs, consisted of the following (in thousands):

Principal	\$ 200,000
PIK interest	3,501
Total principal	203,501
Less debt discount and issuance costs	(97,058)
Total Convertible Notes	<u>\$ 106,443</u>

As of December 31, 2020, the contractual future principal repayments of the total debt were as follows (in thousands):

2022	\$ 10,000
2024	17,074
2025 ⁽¹⁾	203,501
Total	<u>\$ 230,575</u>

(1) Including PIK interest added to principal balance through December 31, 2020.

The Company was in compliance with all of the covenants contained in the Senior Credit Facility and Convertible Notes as of December 31, 2020.

6. Leases

The Company adopted the new lease accounting standard on January 1, 2020 using the modified retrospective transition method, recognizing a cumulative-effect adjustment to the balance sheet and not adjusting comparative information for prior periods. In addition, the Company elected the package of practical expedients permitted under the transition guidance, which allowed the Company not to reassess (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases, and (3) initial direct costs for any existing leases. The Company did not elect the use of hindsight practical expedients in determining the lease term for existing leases. Topic 842 also provides practical expedients for an entity's ongoing accounting. The Company has elected the short-term lease recognition exemption for all leases that qualify. As a result, for those leases with a term of less

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

6. Leases (cont.)

than 12 months, it will not recognize right-of-use assets or lease liabilities. The Company also elected the practical expedient to not separate lease and non-lease components for all its leases regardless of whether the Company is the lessee or a lessor to the lease.

The adoption resulted in a recognition of \$13.8 million of operating lease assets and \$14.3 million of operating lease liabilities on the balance sheet on January 1, 2020. The difference represents prepaid rent expense and deferred rent for leases existed on the date of adoption, which was an offset to the opening balance of operating lease assets. The adoption has no impact on the Company's operating expenses and cash flows.

As a Lessor

The net investment in leases are as follows:

	December 31,	
	2020	2019
Net investment in leases, current	\$ 398	\$ 343
Net investment in leases, non-current	3,101	3,809
Total net investment in leases	<u>\$ 3,499</u>	<u>\$ 4,152</u>

Interest income from accretion of net investment in lease is not material.

In the year ended December 31, 2020, the Company assigned one operating lease and three sales-type leases. The Company received a total of \$3.7 million in cash, and recorded \$0.9 million in product revenue for the assigned operating lease, and an aggregate loss of assignment of \$1.2 million for the sales-type leases in the other expense (income), net on the statement of operations.

Future minimum payments receivable from operating and sales-type leases as of December 31, 2020 for each of the next five years are as follows:

	Operating leases	Sales-type leases
2021	\$ 726	\$ 395
2022	105	395
2023	105	296
2024	105	135
2025	105	408
Thereafter	222	2,282
Total minimum lease payments	<u>\$ 1,368</u>	<u>\$ 3,911</u>

As a Lessee

The Company leases its office and manufacturing facilities in Burlingame, California, Greenville, South Carolina, City of Industry, California, and Rochester Hills, Michigan under operating lease agreements with various expiration dates through 2026.

In June 2018, the Company entered into an agreement to sublease its office facilities in Rochester Hills, Michigan from July 2018 to October 2023. The total sublease payments are approximately \$2.3 million for the lease term. The sublease income is recorded in the other expense (income), net on the statement of operations.

The Company had no material capital leases as of December 31, 2020.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

6. Leases (cont.)

Maturities of operating lease liabilities as of December 31, 2020 were as follows (in thousands):

2021.....	\$	3,622
2022.....		3,133
2023.....		2,300
2024.....		1,648
2025.....		1,039
Thereafter		443
Total undiscounted lease payment		12,185
Less: imputed interest		(1,141)
Total lease liabilities	\$	<u>11,044</u>

Future minimum payments for noncancellable operating leases, based on previous lease accounting standard, as of December 31, 2019 were as follows (in thousands):

2020.....	\$	3,912
2021.....		3,619
2022.....		3,128
2023.....		2,300
2024.....		1,648
Thereafter		1,482
Total minimum lease payments.....		16,089
Less proceeds from sublease rental.....		(1,853)
Net operating lease obligation.....	\$	<u>14,236</u>

Operating lease expense was \$4.0 million, \$3.4 million, and \$3.1 million for the years ended December 31, 2020, 2019 and 2018, respectively.

Short-term and variable lease expenses for the year ended December 31, 2020 were not significant.

Supplemental cash flow information related to leases were as follows (in thousands):

	Year Ended December 31, 2020
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	(3,855)

In the year ended December 31, 2020, the cash flow from financing leases and right-of-use assets obtained in exchange for lease obligations were not significant.

Operating lease right-of-use assets and liabilities consist of the following (in thousands):

	December 31, 2020
Operating leases	
Operating lease right-of-use assets	\$ 10,310
Operating lease liabilities, current	\$ 3,153
Operating lease liabilities, non-current.....	7,891
Total operating lease liabilities	<u>\$ 11,044</u>

The weighted average remaining lease term and discount rate of operating leases are 4.0 years and 4.9%, respectively, as of December 31, 2020.

As of December 31, 2020, the Company had no significant additional operating leases and finance leases that have not yet commenced.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

7. Commitments and Contingencies

Purchase Commitments

As of December 31, 2020, the Company had outstanding inventory and other purchase commitments of \$215.7 million.

Letters of Credit

As of December 31, 2020, the Company had letters of credit outstanding totaling \$0.5 million, which will expire over various dates in 2021.

Guarantees

The Company provides guarantees of lease payments for vehicles under the financing transaction discussed in Note 4, in the event the lessee does not make payments to the financing company.

The Company regularly reviews its performance risk under the arrangement, and in the event that it becomes probable that it will be required to perform under a guarantee, the fair value of probable payment will be recorded. No guarantee liability was recorded as of December 31, 2020 and 2019.

Legal Proceedings

The Company accrues contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated. From time to time in the normal course of business, various claims and litigation have been asserted or commenced. Due to uncertainties inherent in litigation and other claims, the Company can give no assurance that it will prevail in any such matters, which could subject the Company to significant liability or damages. Any claims or litigation could have an adverse effect on the Company's business, financial position, operating results, or cash flows in or following the period that claims or litigation are resolved.

As of December 31, 2020, the Company was not a party to any legal proceedings that would have a material adverse effect on its business.

8. Convertible Preferred Stock

In August and September 2019, the Company completed a private placement and issuance of a total of 10,857,762 shares of Series 8 convertible preferred stock at \$6.9075 per share for proceeds of \$74.8 million, net of issuance costs of approximately \$0.2 million. In October 2019, the Company completed an additional private placement and issuance of 1,719,145 shares of Series 8 convertible preferred stock at \$6.9075 per share for gross proceeds of \$11.9 million.

In June 2018, the Company completed the private placement and issuance of a total of 15,307,518 shares of Series 7 convertible preferred stock at \$6.526419 per share for proceeds of \$98.8 million, net of issuance costs of approximately \$1.1 million. In September 2018, the Company completed the private placement and issuance of a total of 8,442,102 additional shares of Series 7 convertible preferred stock at \$6.526419 per share for proceeds of \$53.0 million, net of issuance costs of approximately \$2.1 million.

In January 2018, the Company completed an additional private placement and issuance of 4,512,743 shares of Series 6 convertible preferred stock at \$5.539864 per share for proceeds of \$24.9 million, net of issuance costs of \$0.1 million. The \$5.0 million prepayment for the sale of Series 6 convertible preferred stock, which was recorded as a non-current liability as of December 31, 2017, was converted to equity upon closing of this transaction.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

8. Convertible Preferred Stock (cont.)

The following table summarizes convertible preferred stock authorized and issued and outstanding as of December 31, 2020 and 2019:

	Shares Authorized	Shares Issued and Outstanding	Net Carrying Value	Aggregate Liquidation Preference
			(in thousands)	
Series 1 ⁽¹⁾	27,567,694	27,476,120	\$ 79,564	\$ 75,006
Series 2	6,069,073	6,069,073	24,868	24,953
Series 3	7,617,704	7,617,704	36,096	36,475
Series 4	9,159,674	8,682,155	29,901	30,000
Series 5	28,391,526	28,391,526	138,747	142,987
Series 6	14,440,784	14,440,784	79,085	80,000
Series 7	23,749,620	23,749,620	151,770	155,000
Series 8	12,576,907	12,576,907	86,648	86,875
Total	<u>129,572,982</u>	<u>129,003,889</u>	<u>\$ 626,679</u>	<u>\$ 631,296</u>

- (1) Including Series 1 convertible preferred stock issued through exercise of warrants to purchase 197,315 shares. The proceeds from exercise of the warrants was \$0.5 million.

The rights, preferences, and privileges of the convertible preferred stock are as follows:

Dividends

The holders of convertible preferred stock are entitled to receive noncumulative dividends equal to 8% of the original issue price per share, when and if declared by the board of directors, prior and in preference to dividends on common stock. The holders of convertible preferred stock are also entitled to participate in dividends on common stock held on an as-if converted basis. No dividends on convertible preferred stock or common stock had been declared by the board of directors as of December 31, 2020.

Conversion Rights

Each share of convertible preferred stock is convertible at the option of the holder into shares of common stock at any time. The conversion rate for convertible preferred stock is equal to the quotient obtained by dividing the applicable original issue price by the applicable conversion price in effect at the time of conversion. The original issue price for the Series 1, 2, 3, 4, 5, 6, 7, and 8 convertible preferred stock is \$2.729862, \$4.11146, \$4.78821, \$3.45536, \$5.03624, \$5.539864, \$6.526419, and \$6.9075 per share, respectively, as adjusted for stock splits, stock dividends, combinations, subdivisions, recapitalizations, or similar transactions. The conversion price of the Series 1, 2, 3, 4, 5, 6, 7, and 8 convertible preferred stock is \$2.729862, \$4.01068, \$4.58348, \$3.45536, \$5.03624, \$5.539864, \$6.526419, and \$6.9075 per share, respectively, as adjusted for certain dilutive issuances, splits and combinations.

Each share of convertible preferred stock automatically converts into shares of common stock at the then-effective conversion price upon the Company's sale of its common stock in a firm commitment underwriting pursuant to a registration statement filed under the Securities Act of 1933, as amended, at an aggregate public offering price of not less than \$50.0 million. In addition, all shares of convertible preferred stock (other than the Series 7 preferred stock and Series 8 preferred stock) will automatically convert into shares of common stock upon a vote by the holders of a majority of the outstanding shares of convertible preferred stock voting together as a single class on an as-converted basis; the Series 7 preferred stock may not be converted without the vote or written consent of the holders of at least a majority of the then outstanding shares of Series 7 convertible preferred stock and the Series 8 preferred stock may not be converted without the vote or written consent of the holders of at least a majority of the then outstanding shares of Series 8 convertible preferred stock.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

8. Convertible Preferred Stock (cont.)

In the event that the initial offering price to the public (prior to any underwriting discount), under the Securities Act of 1933, as amended, at an aggregate public offering price of not less than \$50.0 million (IPO), is less than the original issuance price of the Series 8 convertible preferred stock, the conversion price of the Series 8 shall be adjusted to the higher of the IPO price or the original issuance price of the Series 7 convertible preferred stock.

Voting Rights

Holders of convertible preferred stock have voting rights equal to the number of shares of common stock into which their respective convertible preferred shares are then convertible. Holders of convertible preferred stock, as a separate class, voting on an as-converted basis, shall be entitled to elect seven directors of the Company. Holders of the common stock, as a separate class, shall be entitled to elect one director of the Company. The holders of common stock and convertible preferred stock, voting together as a single class on an as-converted basis, shall be entitled to elect the remaining number of directors of the Company.

Liquidation Preferences

In the event of a liquidation or sale of the Company, either voluntary or involuntary, distributions to the stockholders shall be made in the following manner: the holders of Series 8 preferred stock shall be entitled, before holders of other series of preferred stock and before holders of common stock, to an amount per share equal to the greater of (1) the original issue price of Series 8 preferred stock plus any declared but unpaid dividends and (2) the amount that would have been payable had all shares of Series 8 preferred stock been converted into common stock immediately prior to such event. After payment to the holders of Series 8 preferred stock, the holders of Series 7 preferred stock shall be entitled, before holders of other series of preferred stock, an amount per share equal to the greater of (1) the original issue price of Series 7 preferred stock plus any declared but unpaid dividends and (2) the amount that would have been payable had all shares of Series 7 preferred stock been converted into common stock immediately prior to such event. After payment to the holders of Series 8 and Series 7 preferred stock, the holders of Series 5 and 6 convertible preferred stock then outstanding shall be entitled, on a pari passu basis, an amount per share equal to the greater of (1) the applicable original issue price for such series of convertible preferred stock plus any declared but unpaid dividends and (2) the amount that would have been payable had all shares of such series convertible preferred stock been converted into common stock immediately prior to such event. After payment to the holders of Series 8, Series 7, and Series 5 and 6 convertible preferred stock, the holders of Series 1, 2, 3, and 4 convertible preferred stock then outstanding shall be entitled, on a pari passu basis, an amount per share equal to the greater of (1) the applicable original issue price for such series of convertible preferred stock plus any declared but unpaid dividends and (2) the amount that would have been payable had all shares of such series convertible preferred stock been converted into common stock immediately prior to such event. After payment of all preferential amounts required to be paid to the holders of convertible preferred stock, the remaining funds and assets available for distribution shall be distributed among the holders of common stock, pro rata based on the number of shares of common stock held.

Redemption

Convertible preferred stock is not redeemable by the Company or at the option of the preferred stockholders.

Convertible Preferred Stock Warrants

Warrants for Series 4 Preferred Stock

In May 2016, in connection with the first amendment to the Hercules Credit Facility, the Company issued warrants to purchase an additional 79,587 shares of Series 4 convertible preferred stock to Hercules at an exercise price of \$3.45536 per share, subject to certain adjustments. The warrants expire at the earlier of May 2023 and three years from the Company's qualified initial public offering.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

8. Convertible Preferred Stock (cont.)

During 2015, the Company issued warrants to purchase 397,932 shares of Series 4 convertible preferred stock to Hercules at an exercise price of \$3.45536 per share, subject to certain adjustments. The warrants expire in the earlier of May 2022 or three years from the Company's qualified initial public offering.

Warrants for Series 1 Preferred Stock

In each of October 2011 and March 2012, the Company issued warrants to purchase 45,787 shares of Series 1 convertible preferred stock at an exercise price of \$2.729862 per share to a bank in connection with a debt arrangement. The warrants expire in October 2021.

The warrants for Series 1 and Series 4 convertible preferred stock are recorded as a warrant liability included in other long-term liabilities on the balance sheets prior to January 1, 2018.

The Company adopted ASU No. 2017-11, *Earnings per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815)* on January 1, 2018, and reclassified its warrant liability of \$0.6 million to additional paid-in capital upon adoption. As of December 31, 2020, a total of 569,093 shares of the Series 1 and Series 4 convertible preferred stock warrants were outstanding.

9. Common Stock

As of December 31, 2020, the Company was authorized to issue 304,672,982 shares of capital stock with a par value of \$0.0001 per share. The authorized shares consisted of 175,100,000 shares of common stock and 129,572,982 shares of convertible preferred stock. There were 6,361,952 shares and 4,400,247 shares of common stock issued and outstanding as of December 31, 2020 and 2019, respectively.

The Company had reserved shares of common stock, on an as-if-converted basis, for issuance as follows:

	December 31,	
	2020	2019
Exercise of stock options to purchase common stock.	26,359,796	20,401,985
Exercise of common stock warrants to purchase common stock	5,149,716	117,630
Issuances of shares available under stock option plans.	442,891	2,362,407
Conversion of convertible preferred stock	129,496,639	129,496,639
Conversion of convertible preferred stock warrants	569,093	569,093
Total	162,018,135	152,947,754

Common Stock Warrants

In August 2020, in connection with the issuance of Convertible Notes, the Company issued warrants to purchase 5,112,086 shares of common stock to purchasers of the Convertible Notes. The warrants have an exercise price of \$0.01 per share. The stock issuable upon exercise of the warrants shall be (1) common stock, or (2) in the event that a QIPO has not occurred within five years of the Note Purchase Agreement or in the event of a liquidation or sale of the Company, the most senior series of the Company's preferred stock (or in the event that the Company consolidated or merges with one or more other corporation, the stock that the holder of the warrant would have been entitled to receive if holder would have exercised the warrant prior to such event). The warrants are exercisable for 7 years, and will be automatically exercised in the event of a change of control transaction or the expiration of the warrants. These warrants are classified as liability in the balance sheets. Refer to Note 5 for further details.

In May 2019, in connection with the 2019 Amended Hercules Credit Facility, the Company issued to Hercules a warrant to purchase 36,630 shares of common stock. The warrants have an exercise price of \$5.46 per share, which are exercisable for 10 years and will automatically exercise upon the initial public offering. See Note 5, Debt.

In the fourth quarter of 2020, 80,000 shares of the common stock warrants expired.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

10. Stock Option Plan

In 2010, the Company adopted the 2010 Equity Incentive Plan (the “Plan”). The Plan provides for the issuance of incentive stock options, non-statutory stock options, stock appreciation rights, restricted stock, and restricted stock units. Non-statutory stock options, stock appreciation rights, restricted stock, and restricted stock units may be granted to employees, directors, and consultants, but only employees may be granted incentive stock options. No stock appreciation rights, restricted stock, or restricted stock units had been issued under the Plan as of December 31, 2020.

The exercise price per share of all stock options granted under the Plan must equal at least 100% of the fair market value per share of the Company’s common stock on the date of grant as determined by the board of directors. If, at the time the Company grants an incentive stock option, the optionee owns stock representing more than 10% of the total combined voting power of all classes of stock of the Company, the exercise price per share must be at least 110% of the fair market value per share of the Company’s common stock on the date of grant and the stock options will expire five years after the date of grant. Except as noted above, stock options expire no more than ten years after the date of grant.

Generally, a terminated service provider may exercise stock options within three months of termination. Awards that expire or are cancelled without delivery of shares generally become available for re-issuance under the 2010 Plan.

Stock option awards generally vest over a four-year period, with 25% vesting after one year from date of grant and quarterly thereafter. Certain awards have shorter vesting periods.

During 2020, the board of directors approved an increase in the number of shares of common stock reserved under the 2010 Equity Incentive Plan by 6,000,000 shares to 31,994,478 shares.

The shares available for grant under the Plan were as follows:

	Year Ended December 31,		
	2020	2019	2018
Balance at the beginning of period	2,362,407	3,627,104	2,751,406
Additional shares authorized.	6,000,000	1,519,075	6,847,235
Granted	(10,281,875)	(3,359,941)	(7,312,022)
Repurchased	—	9,000	—
Cancelled/forfeited	2,362,359	567,169	1,340,485
Balance at the ending of period	<u>442,891</u>	<u>2,362,407</u>	<u>3,627,104</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

10. Stock Option Plan (cont.)

A summary of the Company's stock option activity and related information was as follows:

	Options Outstanding			
	Number of Stock Options Outstanding	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)
Balance as of December 31, 2017.	13,764,812	\$ 1.67	8.3	\$ 9,498
Granted	7,312,022	4.11		
Exercised.	(1,217,877)	1.60		
Cancelled/forfeited/expired.	(1,340,485)	2.06		
Balance as of December 31, 2018.	18,518,472	\$ 2.61	8.3	\$ 42,951
Granted	3,359,941	5.23		
Exercised.	(909,259)	1.90		
Cancelled/forfeited/expired.	(567,169)	3.50		
Balance as of December 31, 2019.	20,401,985	\$ 3.05	7.6	\$ 34,723
Granted ¹	6,531,875	4.36		
Exercised.	(1,961,705)	2.14		
Cancelled/forfeited/expired.	(2,362,359)	4.11		
Balance as of December 31, 2020 ⁽¹⁾	22,609,796	\$ 3.40	7.4	\$ 65,056
Exercisable as of December 31, 2020.	12,637,973	\$ 2.63	6.2	\$ 46,004

(1) Excluding CEO Equity Awards of 3,000,000 shares and Milestone Options of 750,000 shares, of which 562,500 shares exercisable as of December 31, 2020. Refer to section below for further details.

In March 2020, in conjunction with Mr. Allen's appointment as the President and Chief Executive Officer, the board of directors approved a grant to Mr. Allen of stock option awards with respect to 5,250,000 shares, comprised of (1) 1,500,000 shares of time-based award with an exercise price of \$4.75 per share vesting quarterly over 4 years, (2) 3,000,000 shares of time-based award consists of 4 tranches with an exercise price of \$10, \$15, \$20 and \$25 per share, respectively, and vesting quarterly over 4 years ("Equity Awards"), and (3) 750,000 shares of milestone-based award with exercise price of \$4.75 per share will vest entirely and become exercisable on the first trading day following the expiration of the lockup period of the Company's initial public offering or the consummation of a change in control of the Company ("Milestone Options"). The Milestone Options shall vest in full and become exercisable upon the consummation of a merger involving a Special Purpose Acquisition Company.

The stock-based compensation expense for Milestone Options will be recognized at the time the performance milestone becomes probable of achievement. No stock-based compensation expense related to the Milestone Options was recognized as of December 31, 2020 as the performance condition was not considered probable of achievement. The unrecognized stock-based compensation expense associated with the Milestone Options was \$2.1 million on the grant date and as of December 31, 2020.

The weighted average fair value of stock options granted, excluding the 3,000,000 shares underlying the Equity Awards with exercise price of \$10, \$15, \$20 or \$25 per share and 750,000 shares underlying the Milestone Options, was \$3.13 per share for 2020. The weighted average fair value of stock options granted was \$3.14 per share for 2019 and \$2.64 per share for 2018. Aggregate intrinsic value represents the difference between the estimated fair value of the underlying common stock and the exercise price of outstanding, in-the-money stock options. The total intrinsic value of stock options exercised was \$4.3 million for 2020, \$2.9 million for 2019 and \$2.3 million for 2018. The total estimated grant date fair value of stock options vested was \$9.9 million for 2020, \$8.3 million for 2019 and \$4.7 million for 2018. As of December 31, 2020, the total unrecognized stock-based compensation expense related to outstanding stock options was \$34.8 million, which is expected to be recognized over a weighted-average period of 2.9 years.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

10. Stock Option Plan (cont.)

Determining Fair Value of Stock Options

The Company uses the Black-Scholes option pricing model to determine the fair value of stock options. The fair value of each stock option grant is estimated on the date of the grant. The fair value of the common stock underlying the stock options has historically been determined by the board of directors. There has been no public market for the Company's common stock. Therefore, the board of directors has determined the fair value of the common stock at the time of the stock option grant by considering a number of objective and subjective factors including independent third-party valuation reports, valuations of comparable companies, sales of convertible preferred stock and common stock to unrelated third parties, operating and financial performance, lack of liquidity of capital stock and general and industry-specific economic outlook, among other factors. The fair value of the underlying common stock shall be determined by the board of directors until such time that the Company's common stock is listed on an established stock exchange or national market system.

The fair value of stock options granted is estimated on the date of grant using the following assumptions:

	Year Ended December 31,		
	2020	2019	2018
Expected term (in years)	6.1	6.1	6.0
Risk-free interest rate	0.5%	1.8%	2.8%
Expected volatility	69.1%	65.4%	71.5%
Expected dividend rate	—	—	—

Expected Term — The Company estimates the expected term consistent with the simplified method. The Company elected to use the simplified method because of its limited history of stock option exercise activity. The simplified method calculates the expected term as the average of the vesting and contractual terms of the award.

Volatility — Since the Company has no trading history by which to determine the volatility of its own common stock price, the expected volatility being used is derived from the historical stock volatility of a representative industry peer group of comparable publicly listed companies over a period approximately equal to the expected term of the stock options.

Risk-Free Interest Rate — The risk-free interest rate is based on U.S. Treasury zero coupon issues with remaining terms similar to the expected term on the options.

Expected Dividend — The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

Forfeiture — All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. Under the ASU No. 2016-09, *Compensation — Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, the Company elected to account for forfeitures when they occur.

Stock-based Compensation Expense

Stock-based compensation expense included in operating results was as follows (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Cost of goods sold.	\$ 929	\$ 826	\$ 553
Research and development	1,616	1,436	1,227
Selling, general and administrative.	7,737	6,258	3,596
Total stock-based compensation expense	<u>\$ 10,282</u>	<u>\$ 8,520</u>	<u>\$ 5,376</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

11. Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period, less the weighted-average unvested common stock subject to repurchase or forfeiture as they are not deemed to be issued for accounting purposes. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including convertible preferred stock, stock options, and warrants, to the extent they are dilutive.

The computation of basic and diluted net loss per share of common stock under the two-class method attributable to common stockholders was as follows (in thousands, except for per share data):

	Year Ended December 31,		
	2020	2019	2018
Numerator:			
Net loss	\$ (127,007)	\$ (101,552)	\$ (91,622)
Denominator:			
Weighted-average shares used in computing net loss per share of common stock, basic and diluted	4,913	4,052	2,831
Net loss per share of common stock, basic and diluted	<u>\$ (25.85)</u>	<u>\$ (25.06)</u>	<u>\$ (32.36)</u>

We applied the two-class method to calculate its basic and diluted net loss per share of common stock, as the convertible preferred stock are participating securities. The two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that otherwise would have been available to common stock holders. However, the two-class method does not impact the net loss per share of common stock as we were in a loss position for each of the periods presented and holders of convertible preferred stock do not have to participate in losses.

Since we were in a loss position for each of the periods presented, diluted net loss per share is the same as basic net loss per share for each period as the inclusion of all potential common stock shares outstanding would have been anti-dilutive. The potentially dilutive securities that were excluded from the diluted per share calculation because they would have been anti-dilutive were as follows:

	Year Ended December 31,		
	2020	2019	2018
Convertible preferred stock ⁽¹⁾	129,496,639	129,496,639	116,919,732
Warrants to purchase convertible preferred stock.	569,093	569,093	569,093
Stock options to purchase common stock.	26,359,796	20,401,985	18,518,472
Warrants to purchase common stock	5,149,716	117,630	81,000
Common stock subject to repurchase	—	—	14,000
	<u>161,575,244</u>	<u>150,585,347</u>	<u>136,102,297</u>

(1) Represents the shares of common stock that the convertible preferred stock is convertible into.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

12. Income Tax

The components of the net loss before the provision for income taxes were as follows (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Domestic	\$ (126,985)	\$ (101,552)	\$ (91,622)

The provision for income taxes consisted of the following (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Current:			
Federal	\$ —	\$ —	\$ —
State	13	—	—
Foreign	9	—	—
Total current provision	22	—	—
Deferred:	—	—	—
Federal	—	—	—
State	—	—	—
Foreign	—	—	—
Total deferred provision	—	—	—
Total provision for income taxes	<u>\$ 22</u>	<u>\$ —</u>	<u>\$ —</u>

A reconciliation of the U.S. federal statutory income tax rates to our effective tax rate is as follows (in percentages):

	Year Ended December 31,		
	2020	2019	2018
U.S. federal statutory rate	21.0%	21.0%	21.0%
State income taxes, net of federal benefit	1.7	3.4	6.1
Change in valuation allowance	(17.5)	(23.9)	(27.0)
Research and development credit	0.2	0.3	0.6
Fair market adjustment	(2.1)	—	—
Non-deductible Convertible Notes interest expense	(2.2)	—	—
Other	(1.1)	(0.8)	(0.7)
Effective income tax rate	<u>—%</u>	<u>—%</u>	<u>—%</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

12. Income Tax (cont.)

Our deferred tax assets (liabilities) are as follows (in thousands):

	December 31,	
	2020	2019
Deferred tax assets:		
Net operating loss carryforwards	\$ 113,643	\$ 96,047
Deferred revenue	6,731	4,695
Stock-based compensation	3,560	2,509
Accruals and reserves, not currently deductible for tax purposes	8,351	7,612
Research and development credit	2,761	2,458
Goodwill	1,014	1,277
Interest expense	2,097	1,576
Lease liability	2,738	—
Other	44	39
Gross deferred tax assets	140,939	116,213
Less valuation allowance	(137,437)	(115,175)
Net deferred tax assets	<u>\$ 3,502</u>	<u>\$ 1,038</u>
Deferred tax liabilities:		
Property, plant and equipment	\$ (1,008)	\$ (1,050)
ROU assets	(2,494)	—
Other	—	12
Gross deferred tax liabilities	(3,502)	(1,038)
Net deferred tax asset (liabilities)	<u>\$ —</u>	<u>\$ —</u>

The net valuation allowance increased by \$22.3 million and \$24.3 million for 2020 and 2019, respectively.

As of December 31, 2020 and 2019, the Company's net deferred tax assets and liabilities were zero. The deferred tax assets consist primarily of the federal and state net operating losses. Realization of deferred tax assets is dependent upon future taxable income, if any, the amount and timing of which are uncertain. In assessing the realizability of deferred tax assets, management determined that it is more likely than not that no deferred tax assets will be realized. Therefore, the Company has provided a full valuation allowance against these deferred tax assets.

The Company had net operating loss carryforwards as follows (in thousands):

	December 31,	
	2020	2019
Federal (Prior to 2018)	\$ 237,850	\$ 237,850
Federal (Post December 31, 2017)	216,724	145,480
State	317,801	272,029
Total	<u>\$ 772,375</u>	<u>\$ 655,359</u>

Net operating loss carryforwards are available to offset future federal and state taxable income. The federal net operating loss carryforwards generated prior to 2018 will begin to expire in 2030 and the net operating loss carryforwards generated after December 31, 2017 do not expire. The state net operating loss carryforwards will begin to expire in 2023.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

12. Income Tax (cont.)

The Company had research and development credit carryforwards as follows (in thousands):

	December 31,	
	2020	2019
Federal.	\$ 2,020	\$ 1,728
State.	1,231	1,099
Total	<u>\$ 3,251</u>	<u>\$ 2,827</u>

The research and development credit carryforwards are available to reduce future regular income taxes. The federal research and development credit carryforwards will begin to expire in 2037, while the South Carolina research and development credit carryforwards will begin to expire in 2027. California research and development credit carryforwards have no expiration date.

Utilization of the Company's net operating loss carryforwards and research tax credit carryforwards may be subject to substantial annual limitations due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. The annual limitation could result in the expiration of the net operating loss carryforwards and research tax credit carryforwards before utilization.

The Company's policy is to recognize interest or penalties related to income tax matters in income tax expense. As of December 31, 2020 and 2019, the Company had no accrued interest or penalties. The unrecognized tax benefits may change during the next year for items that arise in the ordinary course of business. In the event that any unrecognized tax benefits are recognized, the effective tax rate will not be affected.

A reconciliation of the beginning and ending amount of unrecognized tax benefits for 2020, 2019 and 2018 was as follows (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Beginning balance.	\$ 707	\$ 527	\$ 165
Increase – tax positions in current period.	106	180	316
Increase – tax positions in prior periods.	—	—	46
Ending balance	<u>\$ 813</u>	<u>\$ 707</u>	<u>\$ 527</u>

The Company files tax returns in the United States and certain states. Due to the losses being carried forward, the tax years from 2011 forward remain open to examination.

In March 2020, the "Coronavirus Aid, Relief and Economic Security (CARES) Act" was signed into law. The CARES Act includes provisions relating to refundable payroll tax credits, deferment of the employer portion of certain payroll taxes, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations and technical corrections to tax depreciation methods for qualified improvement property. These provisions are not expected to have a material effect on the Company's financial statements.

13. 401(k) Plan

The Company sponsors a 401(k) defined contribution plan covering all eligible employees and provides matching contribution for the first 4% of their salaries. The matching contribution costs incurred were \$1.9 million, \$1.7 million, and \$1.2 million for the years ended December 31, 2020, 2019 and 2018, respectively.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

14. Subsequent Events

On January 11, 2021, the Company entered into an Agreement and Plan of Merger (“Merger Agreement”) with ArcLight Clean Transition Corp., a publicly traded special purpose acquisition company (“SPAC”) and Cayman Islands exempted company (“ArcLight”) and Phoenix Merger Sub, Inc., a Delaware corporation and a wholly-owned subsidiary of ArcLight (“Phoenix Merger Sub”).

At the closing, ArcLight will become a Delaware corporation, and Phoenix Merger Sub will merge with and into Proterra, with Proterra as the surviving company and continuing as a wholly-owned subsidiary of ArcLight. ArcLight’s name will be changed to Proterra Inc (“New Proterra”).

Upon closing of the merger,

- Proterra’s outstanding convertible preferred stock of 129,003,889 shares will convert into 129,496,639 shares of common stock. Each share of Proterra common stock (including shares issuable upon conversion of Proterra convertible preferred stock) will be converted into the right to receive 0.8925 shares of New Proterra Common Stock, as a result of applying the Exchange Ratio;
- each Proterra option will be converted into an option to purchase shares of New Proterra Common Stock by multiplying the number of underlying shares by the exchange ratio, rounded down to the nearest whole share; the exercise price of each converted option will be determined by dividing the per share exercise price of the respective Proterra options by the Exchange Ratio, rounded up to the nearest whole cent;
- each Proterra warrant to purchase common stock and convertible preferred stock will be converted into a warrant to purchase shares of New Proterra Common Stock by multiplying the number of underlying shares by the Exchange Ratio, rounded down to the nearest whole share; the exercise price of each converted warrant will be determined by dividing the per share exercise price of the respective Proterra warrant by the Exchange Ratio, rounded up to the nearest whole cent;
- each outstanding Convertible Note that was not optionally converted immediately prior to the consummation of the merger will remain outstanding and become convertible into shares of New Proterra Common Stock in accordance with the terms of such Convertible Notes.

In the event that the closing sale price of New Proterra common stock exceeds certain price thresholds for 20 out of any 30 consecutive trading days or in any transaction resulting in a change in control with a valuation of the New Proterra Common Stock exceeds certain price thresholds during the first five years following the closing of the merger, up to an additional 22,809,500 shares of New Proterra Common Stock may be issued to holders of Proterra convertible preferred stock, common stock, warrants, vested options and Convertible Notes as of immediately prior to the closing of the merger.

In connection with the merger, ArcLight entered into subscription agreements with certain investors (“PIPE Investors”) to purchase an aggregate of 41.5 million shares of New Proterra common stock, immediately following the closing of merger, at a purchase price of \$10.00 per share, for aggregate gross proceeds of \$415.0 million (“PIPE Financing”).

In connection with the execution of the Merger Agreement, ArcLight entered into the Sponsor Letter Agreement with the ArcLight Sponsor providing that 10% of the New Proterra Common Stock received by Sponsor upon consummation of the merger in exchange for its outstanding shares of ArcLight class B ordinary shares, excluding 140,000 shares owned by ArcLight board of directors, will be subject to vesting and forfeiture.

ArcLight public shareholders have rights to redeem their shares for cash upon the closing of the merger. The Merger Agreement includes as a condition to close the merger that, at the closing of the merger, ArcLight will have a minimum of \$350.0 million of funds, net of any unpaid liabilities.

We have evaluated subsequent events through April 7, 2021.



Schedule Five

Proterra Inc does not intend to utilize Subcontractors for the Pinellas Suncoast Transit Authority's RFP 21-980369.



PROTERRA

Pinellas Suncoast Transit Authority

2. Three Most Recent Audited Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Proterra Inc:

Opinion on the Financial Statements

We have audited the accompanying balance sheets of Proterra Inc (the Company) as of December 31, 2020 and 2019, the related statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2020, and the related notes (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2020, in conformity with U.S. generally accepted accounting principles.

Change in Accounting Principle

As discussed in note 2 to the financial statements, the Company changed its method of accounting for leases as of January 1, 2020 due to the adoption of Accounting Standards Codification Topic 842, *Leases*.

Basis for Opinion

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 are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 2012.

Santa Clara, California
April 7, 2021

PROTERRA INC
BALANCE SHEETS
(in thousands, except share and per share data)

	December 31,	
	2020	2019
Assets:		
Cash and cash equivalents	\$ 110,719	\$ 40,240
Accounts receivable, net	51,716	44,500
Short-term investments	68,990	39,877
Inventory	92,330	94,042
Prepaid expenses and other current assets	7,455	6,684
Deferred cost of goods sold	2,037	1,240
Restricted cash, current	8,397	5,970
Total current assets	341,644	232,553
Property, plant, and equipment, net	53,587	47,515
Operating lease right-of-use assets	10,310	—
Restricted cash, non-current	4,581	7,439
Other assets	4,789	6,366
Total assets	<u>\$ 414,911</u>	<u>\$ 293,873</u>
Liabilities and Stockholders' Equity:		
Accounts payable	\$ 25,074	\$ 37,865
Accrued liabilities	19,736	14,635
Deferred revenue, current	16,015	10,358
Operating lease liabilities, current	3,153	—
Debt, current	—	—
Total current liabilities	63,978	62,858
Debt, non-current	133,252	24,574
Derivative liability	70,870	—
Warrant liability	39,670	—
Deferred revenue, non-current	12,206	8,264
Operating lease liabilities, non-current	7,891	—
Other long-term liabilities	12,578	11,198
Total liabilities	340,445	106,894
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Convertible preferred stock, \$0.0001 par value; 129,572,982 shares authorized and 129,003,889 shares issued and outstanding as of December 31, 2020 and 2019; liquidation preference \$631.3 million as of December 31, 2020 and 2019	13	13
Common stock, \$0.0001 par value; 175,100,000 shares authorized and 6,361,952 shares issued and outstanding as of December 31, 2020; 170,000,000 shares authorized and 4,400,247 shares issued and outstanding as of December 31, 2019	1	—
Additional paid-in capital	682,671	668,178
Accumulated deficit	(608,219)	(481,212)
Total stockholders' equity	74,466	186,979
Total liabilities and stockholders' equity	<u>\$ 414,911</u>	<u>\$ 293,873</u>

See accompanying notes to financial statements.

PROTERRA INC
STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Year Ended December 31,		
	2020	2019	2018
Product revenue.	\$ 190,411	\$ 172,295	\$ 119,314
Parts and other service revenue.	6,532	8,989	3,896
Total revenue.	196,943	181,284	123,210
Product cost of goods sold	181,987	173,428	130,660
Parts and other service cost of goods sold	7,417	9,467	3,767
Total cost of goods sold	189,404	182,895	134,427
Gross profit (loss)	7,539	(1,611)	(11,217)
Research and development	36,233	35,477	31,504
Selling, general and administrative.	67,139	56,132	46,343
Asset impairment charge.	121	6,440	—
Total operating expenses.	103,493	98,049	77,847
Loss from operations.	(95,954)	(99,660)	(89,064)
Interest expense, net	15,413	2,704	3,476
Loss on valuation of derivative and warrant liabilities	12,989	—	—
Other expense (income), net	2,629	(812)	(918)
Loss before income taxes	(126,985)	(101,552)	(91,622)
Provision for income taxes	22	—	—
Net loss	\$ (127,007)	\$ (101,552)	\$ (91,622)
Net loss per share of common stock, basic and diluted	\$ (25.85)	\$ (25.06)	\$ (32.36)
Shares used in computing net loss per share of common stock, basic and diluted	4,913	4,052	2,831

See accompanying notes to financial statements.

PROTERRA INC
STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)

	Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
Balance, December 31, 2017 . . .	88,165	\$ 9	2,282	\$ —	\$ 386,541	\$ (288,038)	\$ 98,512
Adoption of accounting standards	—	—	—	—	587	—	587
Issuance of stock, net of costs . . .	28,262	2	1,218	—	178,625	—	178,627
Stock-based compensation	—	—	—	—	5,376	—	5,376
Net loss	—	—	—	—	—	(91,622)	(91,622)
Balance, December 31, 2018 . . .	116,427	11	3,500	—	571,129	(379,660)	191,480
Issuance of stock, net of costs . . .	12,577	2	900	—	88,388	—	88,390
Issuance of warrants	—	—	—	—	141	—	141
Stock-based compensation	—	—	—	—	8,520	—	8,520
Net loss	—	—	—	—	—	(101,552)	(101,552)
Balance, December 31, 2019 . . .	129,004	13	4,400	—	668,178	(481,212)	186,979
Issuance of stock, net of costs . . .	—	—	1,962	1	4,211	—	4,212
Stock-based compensation	—	—	—	—	10,282	—	10,282
Net loss	—	—	—	—	—	(127,007)	(127,007)
Balance, December 31, 2020 . . .	<u>129,004</u>	<u>\$ 13</u>	<u>6,362</u>	<u>\$ 1</u>	<u>\$ 682,671</u>	<u>\$ (608,219)</u>	<u>\$ 74,466</u>

See accompanying notes to financial statements.

PROTERRA INC
STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2020	2019	2018
Cash flows from operating activities:			
Net loss	\$ (127,007)	\$ (101,552)	\$ (91,622)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	15,536	12,643	9,254
Loss on disposal of fixed assets	143	527	793
Asset impairment charge	121	6,440	—
Stock-based compensation	10,282	8,520	5,376
Amortization of debt discount and issuance costs	6,045	306	247
Accretion of debt end of term charge and PIK interest	3,501	604	1,196
Loss on valuation of derivative and warrant liabilities	12,989	—	—
Others	(153)	(284)	(335)
Changes in operating assets and liabilities:			
Accounts receivable	(7,216)	(9,005)	(23,196)
Inventory	2,182	(15,692)	(23,642)
Prepaid expenses and other current assets	(1,043)	563	(5,002)
Deferred cost of goods sold	(797)	4,207	(3,356)
Operating lease right-of-use assets and liabilities	87	—	—
Other assets	1,575	(4,746)	(718)
Accounts payable and accrued liabilities	(4,090)	(1,025)	12,545
Deferred revenue, current and non-current	9,599	132	11,780
Other non-current liabilities	2,176	1,068	3,001
Net cash used in operating activities	(76,070)	(97,294)	(103,679)
Cash flows from investing activities:			
Purchase of investments	(108,960)	(71,817)	(34,152)
Proceeds from maturities of investments	80,000	50,400	16,200
Purchase of property and equipment	(25,565)	(13,810)	(16,698)
Net cash used in investing activities	(54,525)	(35,227)	(34,650)
Cash flows from financing activities:			
Proceeds from debt, net of issuance costs	219,471	21,362	—
Repayment of debt	(22,787)	(26,708)	—
Repayment of finance obligation	(484)	(452)	(452)
Proceeds from government grants	275	522	1,507
Proceeds from exercise of stock options	4,168	1,726	1,916
Proceeds from issuance of stock, net of issuance costs	—	86,746	173,659
Net cash provided by financing activities	200,643	83,196	176,630
Net increase (decrease) in cash and cash equivalents, and restricted cash	70,048	(49,325)	38,301
Cash and cash equivalents, and restricted cash at the beginning of period	53,649	102,974	64,673
Cash and cash equivalents, and restricted cash at the end of period	\$ 123,697	\$ 53,649	\$ 102,974
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$ 5,827	\$ 4,881	\$ 2,648
Cash paid for income taxes	9	—	—
Non-cash investing and financing activity:			
Issuance of warrants in connection with debt borrowing	\$ —	\$ 141	\$ —
Assets acquired through accounts payable and accrued liabilities	659	4,017	1,146
Non-cash transfer of vehicles from inventory to internal use	—	967	—
Non-cash transfer of leased assets to inventory	635	—	—

See accompanying notes to financial statements.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization and Description of Business

Proterra Inc (“Proterra” or the “Company”) is a leading developer and producer of electric vehicle technology for commercial application. Proterra designs, develops, manufactures, and sells electric transit buses as an original equipment manufacturer for North American public transit agencies, airports, universities, and other commercial transit fleets. It also designs, develops, manufactures, sells, and integrates proprietary battery systems and electrification solutions for global commercial vehicle manufacturers. Additionally, Proterra provides fleet-scale, high-power charging solutions for our customers. Proterra was originally formed in June 2004 as a Colorado limited liability company and converted to a Delaware corporation in February 2010. The Company operates from its headquarters and battery production facility in Burlingame, California. The Company also has manufacturing and product development facilities in Greenville, South Carolina and City of Industry, California.

The Company has incurred net losses and negative cash flows from operations since inception. As of December 31, 2020, the Company has an accumulated deficit of \$608.2 million, and \$179.7 million of cash and cash equivalents and short-term investments. The Company has funded operations primarily through a combination of equity and debt financing. Management believes that the Company’s currently available resources will be sufficient to fund its cash requirements for at least the next twelve months. However, there can be no assurance that future financings will be successfully completed or completed on terms acceptable to the Company. These financial statements do not include any adjustments that may result from the outcome of this uncertainty.

Basis of Presentation

The Company prepared the financial statements in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”).

The Company has not experienced any significant impact to estimates or assumptions as a result of the COVID-19 pandemic. We will continue to monitor impacts of the pandemic on an ongoing basis. While the COVID-19 pandemic has not had a material adverse impact on our financial condition and results of operations to date, the future impact of the COVID-19 pandemic on our operational and financial performance will depend on certain developments, including the duration and spread of the pandemic, impact on our customers and effect on our suppliers, all of which are uncertain and cannot be predicted.

Segments

The Company operates in the United States and started to expand its business to the European Union in 2018 and Canada in 2019. The revenue generated outside of the United States was not material for the years ended December 31, 2018 and 2019. The revenue generated outside of the United States was about 28% of total revenue or \$55.9 million for the year ended December 31, 2020, which was primarily generated from Canada.

The Company’s chief operating decision maker is its Chief Executive Officer (CEO), who reviews financial information presented at the entity level. Accordingly, the Company has determined that it has a single reportable segment.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires the use of estimates and judgments that affect the reported amounts in the financial statements and accompanying notes. U.S. GAAP requires the Company to make estimates and judgments in several areas including, but not limited to, those related to revenue recognition, collectability of accounts receivable, valuation of inventories, valuation of Convertible Notes (See Note 3), warranty liability, contingent liabilities, stock-based compensation expense, useful lives of property, plant, and equipment, recoverability of assets, residual value of leased assets, and the valuation of deferred tax assets. These estimates are based on historical facts and various other assumptions that the Company believes are reasonable. Actual results could differ materially from those estimates.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

Foreign Currency Transactions

The U.S. dollar is the Company's functional currency. Monetary assets and liabilities denominated in currencies other than the U.S. dollar are remeasured to the U.S. dollar at period end, and transaction gains and losses are recorded in other expense (income), net in the statements of operations. Net gains or losses resulting from foreign exchange transactions were not material for the years ended December 31, 2018 and 2019. The net losses resulting from foreign exchange transactions were \$1.1 million for the year ended December 31, 2020.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Accounts Receivable and Allowance for Credit Losses

Accounts receivable are recorded at the invoiced amount and do not bear interest. The Company determines the allowance for credit losses based on historical write-off experience, an analysis of the aging of outstanding receivables, customer payment patterns and expectations of changes in macroeconomic conditions that may affect the collectability of outstanding receivables. The allowance for credit losses was not material as of December 31, 2020 and 2019.

Short-Term Investments

The Company's primary objectives for investment activities are to preserve principal, provide liquidity, and maximize income without significantly increasing risk. The Company classifies its short-term investments as available-for-sale at the time of purchase because it is intended that these investments are available for current operations. Investments with maturities of one year or less from the balance sheet date are classified as short-term investments.

Investments are reported at fair value and are subject to periodic impairment review. Unrealized gains and losses related to changes in the fair value of these securities are recognized in accumulated other comprehensive loss. The ultimate value realized on these securities is subject to market price volatility until they are sold. Realized gains or losses from short-term investments are recorded in other expense (income), net.

As of December 31, 2020 and 2019, short-term investments were \$69.0 million and \$39.9 million, respectively.

Restricted Cash

The Company maintains certain cash amounts restricted as to withdrawal or use. The restricted cash is primarily collateral for performance bonds issued to certain customers. The collateral is provided in the form of a cash deposit to either support the bond directly or to collateralize a letter of credit that supports the performance bonds. As of December 31, 2020 and 2019, restricted cash was \$13.0 million and \$13.4 million, respectively.

Credit Risk and Concentration

Our financial instruments that are potentially subject to concentrations of credit risk consist primarily of cash, cash equivalents, restricted cash, short-term investments, and accounts receivable. Cash and cash equivalents and short-term investments are maintained primarily at two financial institutions, and deposits exceed federally insured limits. Risks associated with cash and cash equivalents, and short-term investments are mitigated by banking with creditworthy financial institutions. The Company has not experienced any losses on its deposits of cash and cash equivalents or its short-term investments.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

Cash equivalents consist of short-term money market funds, corporate debt securities, and debt securities issued by the U.S. Treasury, which are deposited with reputable financial institutions. The Company's cash management and investment policy limits investment instruments to investment-grade securities with the objective to preserve capital and to maintain liquidity until the funds can be used in business operations.

Accounts receivable are typically unsecured and are generally derived from revenue earned from transit agencies, universities and airports in North America and global commercial vehicle manufacturers in both North America and the European Union. The Company periodically evaluates the collectability of its accounts receivable and provides an allowance for potential credit losses as necessary.

Given the large order value for customers and the relatively low number of customers, revenue and accounts receivable have typically been concentrated with a limited number of customers.

	Revenue			Accounts Receivable	
	Year Ended December 31,			December 31,	
	2020	2019	2018	2020	2019
Number of customers accounted for 10% or more*	1	—	3	2	4

* One customer accounted for 21% of total revenue for year ended December 31, 2020 and 33% of the accounts receivable, net as of December 31, 2020. No other individual customer accounted for more than 20% of total revenue for years ended December 31, 2020, 2019 and 2018, or accounts receivable, net as of December 31, 2020 and 2019.

Single source suppliers provide the Company with a number of components that are required for manufacturing of our current products. In other instances, although there may be multiple suppliers available, many of the components are purchased from a single source. If these single source suppliers fail to meet the Company's requirements on a timely basis at competitive prices, the Company could suffer manufacturing delays, a possible loss of revenue, or incur higher cost of sales, any of which could adversely impact the Company's operating results.

Fair Value of Financial Instruments

The carrying value of the Company's financial instruments, including cash and cash equivalents, accounts receivable, short-term investments, accounts payable, and accrued and other current liabilities, approximates fair value due to the short period of time to maturity, receipt, or payment. The carrying amount of the Company's debt, except for Convertible Notes, approximates its fair value as the stated interest rates approximate market rates currently available to the Company.

In August 2020, the Company issued Convertible Notes that contain embedded features subject to derivative accounting. These embedded features are composed of conversion options that have the economic characteristics of a contingent early redemption feature settled in a variable number of shares of the Company's stock. These conversion options are bifurcated and accounted for as a derivative liability separately from the host debt instrument. Embedded derivatives are recognized as a derivative liability on the balance sheet. The derivative liability is measured at fair value and subject to remeasurement at each balance sheet date.

The warrants issued in connection with the Convertible Notes are classified as a liability because they can become exercisable into common stock upon a Qualified Initial Public Offering ("QIPO") or into convertible preferred stock after 5 years from issuance date in the event that there is no QIPO during such period. Such warrants are measured at fair value, subject to remeasurement at each balance sheet date.

Inventories

Inventories are recorded at the lower of cost and net realizable value using the first-in, first-out method. Inventory costs consist primarily of the cost of materials, manufacturing support costs, including labor and factory overhead associated with such production, and shipping costs. The costs of vehicles, charger equipment or prototype

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

products delivered to customers that have not yet met revenue recognition criteria are also included in inventories. We assess the valuation of inventory and periodically record a provision to adjust inventory to its estimated net realizable value, including when we determine inventory to be obsolete or in excess of anticipated demand. Once inventory has been written-off or written-down, it creates a new cost basis for the inventory that is not subsequently written-up.

Deferred Cost of Goods Sold

Deferred cost of goods sold primarily includes incurred costs for charging system installations that have not met revenue recognition criteria.

Property, Plant, and Equipment

Property, plant, and equipment, including leasehold improvements, are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets, as follows:

Property, Plant, and Equipment	Estimated Useful Life
Computer hardware	3 years
Computer software	3 to 5 years
Internally used vehicles and charging systems	over the shorter of their estimated useful lives or 5 years
Machinery and equipment	5 to 12 years
Office furniture and equipment	5 years
Tooling	5 years
Leasehold improvements	over the shorter of their estimated useful lives or the terms of the related leases
Leased batteries	over the shorter of the terms of the related leases or 12 years
Leased vehicles and charging systems	over the shorter of the terms of the related leases or 5 years

In the fourth quarter of 2019, we completed a review of the estimated useful lives of vehicles and charging equipment used for demonstration purposes. Based on this review, we revised the estimated useful lives of demo vehicles from 12 years to five years effective on November 1, 2019, after considering the condition of assets and our long-term strategy for operating such assets. We believe this change in estimate is appropriate, as it is based on actual experience and the expectations for the ongoing productive use of these assets. The impact to depreciation expense caused by this change in estimate is not material to selling, general and administrative expense on the statement of operations for the year ended December 31, 2019 or future periods.

If the estimated useful life of an asset is less than the stated number of years in our capitalization policy, the depreciation expense will be recorded over the shorter period.

Upon the retirement or sale of property, plant, and equipment, the cost and associated accumulated depreciation are removed from the balance sheet, and the resulting gain or loss is reflected on the statement of operations. Maintenance and repair expenditures are expensed as incurred while major improvements that increase the functionality, output, or expected life of an asset are capitalized and depreciated ratably over the identified useful life.

Impairment of Long-Lived Assets

The Company evaluates the recoverability of property, plant, and equipment and right-of-use assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of these assets is measured by a comparison of the carrying amounts to the future undiscounted cash flows the assets are expected to generate. If such review indicates that the carrying amount of long-lived assets is not recoverable, the carrying amount of such assets is reduced to fair value.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

In addition to the recoverability assessment, the Company periodically reviews the remaining estimated useful lives of property, plant, and equipment. If the estimated useful life assumption for any asset is reduced, the remaining net book value is depreciated over the revised estimated useful life.

The Company reviews long-lived assets for impairment at the lowest level for which separate cash flows can be identified. During the fourth quarter of 2019, due to the introduction of new products and related technology advancements, we determined that an impairment analysis of certain assets leased to customers was required to be performed. The estimated undiscounted future cash flows generated by these assets were less than their carrying amounts. The carrying amounts of the assets were reduced to fair value, which resulted in an impairment charge of \$6.4 million recorded in the statement of operations for the year ended December 31, 2019.

No impairment charge was recognized in 2018. We recorded \$0.1 million impairment charge associated with a facility lease for the year ended December 31, 2020.

Deferred Revenue

Deferred revenue consists of billings or payments received in advance of revenue recognition that are recognized as revenue once the revenue recognition criteria are met. In some instances, progress billings are issued upon meeting certain milestones stated in the contracts. Accordingly, the deferred revenue balance does not represent the total contract value of non-cancelable arrangements. Invoices are typically due within 30 to 40 days.

Deferred revenue was \$28.2 million and \$18.6 million as of December 31, 2020 and 2019, respectively. For the year ended December 31, 2020, \$16.5 million revenue was recognized from the deferred revenue balance as of December 31, 2019. The reduction in deferred revenue was offset by new billings for products and extended warranty services for which revenue had not been recognized as of December 31, 2020. The current portion of deferred revenue represents the amount that is expected to be recognized as revenue within one year from the balance sheet date.

Revenue Recognition

We derive revenue primarily from the sale of vehicles and charging systems, the installation of charging systems, the sale of battery systems and powertrain components to other vehicle manufacturers, as well as the sale of spare parts and other services provided to customers. Product revenue consists of revenue earned from vehicles and charging systems, battery systems and powertrain components, installation of charging systems, and revenue from leased vehicles, charging systems, and batteries under operating leases. Leasing revenue recognized over time was approximately \$2.3 million, \$3.8 million and \$3.0 million for the years ended December 31, 2020, 2019 and 2018, respectively. Parts and other service revenue includes revenue earned from spare parts, the design and development of battery systems and drive systems for other vehicle manufacturers, and extended warranties.

Goods and services that are promised in our contracts include vehicles, charging systems, battery systems and powertrain components to other vehicle manufacturers, installation of charging systems, spare parts, and extended warranty. We assess the products and services promised in contracts at contract inception, and identify performance obligations for each promise to transfer to the customer a product or service that is distinct. If a product or service is separately identifiable from other items in the bundled arrangement and a customer can benefit from the product or service on its own or with other resources that are readily available to the customer, then such product or service is considered distinct. Customer contracts typically have multiple performance obligations. Generally, our goods and services are considered separate performance obligations. Depending on the contractual arrangement, the charging systems and related installation services if purchased by customer are typically considered as one performance obligation, as they represent inputs of a combined integrated output which benefits the customer. Development services are typically sold on a stand-alone basis and are not bundled with other goods or services.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

The transaction price of the contract is allocated to each performance obligation in a manner depicting the amount of consideration to which the Company expects to be entitled in exchange for transferring the goods or services to the customer (the “allocation objective”). If the allocation objective is met at contractual prices, no further allocations are made. Otherwise, the Company allocates the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis.

To determine the standalone selling price of its promised products or services, we conduct an analysis to determine whether its products or services have an observable standalone selling price. In determining the observable standalone selling price, the Company requires that a substantial majority of the standalone selling prices for a product or service fall within a reasonably narrow range. If there is no directly observable standalone selling price for a particular product or service, then we estimate a standalone selling price by using the estimated cost plus margin or by reviewing external and internal market factors including, but not limited to, pricing practices including historical discounting, major service groups, and the geographies in which we offer products and services.

We recognize revenue when or as it satisfies a performance obligation by transferring control of a product or service to a customer.

Revenue from product sales is recognized when control of the underlying performance obligations is transferred to the customer. Revenue from vehicles and charging systems, and installation of charging systems is typically recognized upon acceptance by the customer. Under certain contract arrangements, the control of the performance obligations related to the charging systems is transferred over time, and the associated revenue is recognized over the installation period using an input measure based on costs incurred to date relative to total estimated costs to completion. Spare parts revenue is recognized upon shipment. Extended warranty revenue is recognized over the life of the extended warranty using the time elapsed method. Development service contracts typically include the delivery of prototype products to customers. The performance obligation associated with the development of prototype products as well as battery systems and powertrain components to other vehicle manufacturers, is satisfied at a point in time, typically upon shipping.

Revenue derived from performance obligations satisfied over time from charging systems and installation was \$6.0 million, \$7.2 million and \$0.6 million in the years ended December 31, 2020, 2019, and 2018, respectively. Extended warranty revenue is not material to date.

Typically, the Company does not have contract assets, as rights to consideration in exchange for goods or services that have transferred to a customer are not conditional on anything other than the passage of time. In certain cases, there is a condition that requires a contract asset to be recognized. As of December 31, 2020 and 2019, the contract assets balance was \$2.8 million and \$0.6 million, respectively. The contract assets are expected to be billed within the next twelve months and are recorded in the prepaid expenses and other current assets on the balance sheets.

As of December 31, 2020, the amount of remaining performance obligations that have not been recognized as revenue was \$229.4 million, of which 67% was expected to be recognized as revenue over the next 12 months and the remainder thereafter. This amount excludes the value of remaining performance obligations for contracts with an original expected length of one year or less.

Lease Arrangements

The Company offers customers leasing alternatives outside of the standard sales contracts for vehicles, charging equipment and batteries used in the vehicles. The leasing arrangements are typically bundled together with the sales contracts. We assessed the nature of the bundled arrangements under the revenue accounting standard. For arrangements that contain a lease, we determined the classification of the lease in accordance with Topic 840, Leases, prior to the adoption of Topic 842, Leases, on January 1, 2020. A lease arrangement that transfers substantially all of the benefits and risks incident to ownership of the products is classified as a sales-type lease based on the criteria established by the accounting standard; otherwise the lease is classified as an operating lease.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

For sales-type leases, product revenue is recognized upon customer acceptance of the underlying leased assets. The current portion of net investment in sales-type leases is recorded in Accounts Receivable, and the non-current portion is recorded in Other Assets on the Company's balance sheets. The discounted unguaranteed residual value of underlying leased assets is not material to the net investment in lease balance.

For operating leases, the leasing revenue is recognized on a straight-line basis over the lease term, which is commenced upon customer acceptance.

We monitor the performance of customers who leased batteries and are subject to ongoing payments. No allowance was recorded for the receivables under the leasing arrangements.

We adopted the new lease accounting standard, Topic 842, Leases, on January 1, 2020. We determine whether an arrangement is or contains a lease at inception. Short-term leases with a term of less than 12 months will not be recognized in the right-of-use assets or lease liabilities. The lease and non-lease components are not separated for all leases regardless of whether the Company is the lessee or a lessor to the lease. Refer to Note 6, Leases, for additional information.

Cost of Goods Sold

Cost of goods sold includes direct material and labor costs, manufacturing overhead including depreciation expense, freight costs, and reserves for estimated warranty expenses. Cost of goods sold also includes charges to write-down the carrying value of inventory when it exceeds its estimated net realizable value and to provide for on-hand inventory that is either obsolete or in excess of forecasted demand. Costs of development services are expensed as incurred. Costs of development services incurred in periods prior to the finalization of an agreement are recorded as research and development expense. Once an agreement is finalized, these costs are recorded in cost of goods sold.

Sales and Other Taxes

Taxes assessed by various government entities, such as sales, use, and value added taxes, collected at the time of sale are excluded from revenue.

Shipping Costs

Amounts billed to customers related to shipping and handling are classified as revenue, and the related shipping and handling costs are included in cost of goods sold.

Research and Development Costs

Research and development costs are expensed as incurred. Research and development expense consists primarily of payroll and benefits of those employees engaged in research, design, and development activities, costs related to prototype parts and design tools, license expenses related to intellectual property, supplies and services, depreciation, and other occupancy costs.

Advertising Expenses

Advertising costs are expensed as incurred. Advertising expenses were \$0.6 million, \$0.9 million, and \$0.8 million for the year ended December 31, 2020, 2019 and 2018, respectively.

Product Warranties

The Company provides a limited warranty to customers on vehicles, charging systems, and battery systems. The limited warranty ranges from one to 12 years depending on the components. Separately, the Company also periodically performs field service actions related to product service campaigns. Pursuant to these warranties and

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

field service actions, we will repair, replace, or adjust the parts on the products that are defective in factory-supplied materials or workmanship. A warranty reserve for the products sold is recorded at the point of revenue recognition, which includes the best estimate of the projected costs to repair or replace items under the limited warranty and field service actions. These estimates are based on actual claims incurred to date and an estimate of the nature, frequency and costs of future claims. These estimates are inherently uncertain given the relatively short history of sales. Changes to the historical or projected warranty experience may cause material changes to the warranty reserve in the future. The warranty reserve does not include projected warranty costs associated with the vehicles under operating leases, as the costs to repair these warranty claims are expensed as incurred. The portion of the warranty reserve expected to be incurred within the next 12 months is included within accrued liabilities while the remaining balance is included within other long-term liabilities on the balance sheets.

Warranty expense is recorded as a component of cost of goods sold. Accrued warranty activity consisted of the following (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Warranty reserve – beginning of period	\$ 14,926	\$ 10,602	\$ 2,581
Warranty costs incurred	(4,214)	(6,031)	(2,653)
Net changes in liability for pre-existing warranties, including expirations.	(3,392)	(840)	—
Provision for warranty	11,262	11,195	10,674
Warranty reserve – end of period	<u>\$ 18,582</u>	<u>\$ 14,926</u>	<u>\$ 10,602</u>

Stock-Based Compensation

The Company uses the fair value method for recording stock-based compensation expense. Stock-based compensation expense for stock options is estimated at the grant date based on each stock option's fair value as calculated using the Black-Scholes option pricing model. The stock-based compensation expense for stock option grants is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The Company adjusts these reserves when facts and circumstances change, such as the closing of a tax audit or the refinement of an estimate. The provision for income taxes includes the effects of any reserves that are considered appropriate.

Accrued interest and penalties related to unrecognized tax benefits are classified as income tax expense.

Government Incentives

The Company receives incentives from the federal and state government agencies in the form of grants. Incentives are recorded in the financial statements in accordance with their purposes, either as a reduction of expense or a reduction of the cost of the capital investment. The benefit of these incentives is recorded when performance is complete and all conditions as specified in the agreement are fulfilled.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (cont.)

California and certain other states provide incentives to accelerate the purchase of cleaner, more efficient buses in the form of point-of-sale discounts to vehicle purchasers. These incentives are included in the customer contract value, and recognized as revenue once all revenue recognition criteria are met.

Other Comprehensive Income (Loss)

The Company did not have other comprehensive income (loss) for the years ended December 31, 2020, 2019 and 2018, respectively.

2. Adoption of New Accounting Standards

Topic 842, *Leases*. This standard provides guidance on the recognition, measurement, presentation, and disclosure of leases. The new standard supersedes the present U.S. GAAP standard on leases and requires substantially all leases to be reported on the balance sheet as right-of-use assets and lease obligations. The Company elected to adopt the new lease accounting standard on January 1, 2020 using the optional transition method, recognizing a cumulative-effect adjustment to the balance sheet and not adjusting comparative information for prior periods. Refer to Note 6, *Leases*, for additional information.

ASU No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This standard requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. The Company adopted this standard on January 1, 2020, and it had no material impact on the financial statements.

ASU No. 2018-13, *Changes to Disclosure Requirements for Fair Value Measurement (Topic 820)*. This standard improves the effectiveness of disclosure requirements for recurring and nonrecurring fair value measurements. This standard removes, modifies, and adds certain disclosure requirements. The Company adopted this standard on January 1, 2020, and it had no material impact on the financial statements.

ASU No. 2018-15, *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. This standard aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract requiring the capitalization of implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The Company adopted this standard on January 1, 2020, and it had no material impact on the financial statements.

ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The amendments in this standard provide optional guidance for a limited time to ease the potential burden in accounting for reference rate reform. The new guidance provides optional expedients and exceptions for applying U.S. GAAP to contracts, hedging relationships and other transactions affected by reference rate reform if certain criteria are met. The amendments apply only to contracts and hedging relationships that reference the London Interbank Offered Rate (LIBOR) or another reference rate expected to be discontinued due to reference rate reform. These amendments are effective from March 2020 through December 31, 2022. The amendments have no material impact on the financial statements.

Recent Accounting Pronouncements Not Yet Adopted

ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. This standard simplifies the accounting for income taxes, eliminates certain exceptions within Topic 740, *Income Taxes*, and clarifies certain aspects of the current guidance to promote consistency among reporting entities. The Company will adopt this standard on January 1, 2021, and expect no material impact on the financial statements.

ASU No. 2020-06, *Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*. This standard simplifies the accounting for convertible instruments by removing certain separation models in ASC 470-20, *Debt — Debt with Conversion and Other Options*. This standard updates the guidance on certain embedded

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

2. Adoption of New Accounting Standards (cont.)

conversion features that are not required to be accounted for as derivatives under Topic 815, *Derivatives and Hedging*, or that do not result in substantial premiums accounted for as paid-in capital, such that those features are no longer required to be separated from the host contract. The convertible debt instruments will be accounted for as a single liability measured at amortized cost. This will also result in the interest expense recognized for convertible debt instruments to be typically closer to the coupon interest rate when applying the guidance in Topic 835, *Interest*. Further, this standard made amendments to the EPS guidance in Topic 260 for convertible instruments, the most significant impact of which is requiring the use of the if-converted method for diluted earnings per share calculation, and no longer allowing the net share settlement method. This standard also made revisions to Topic 815-40, which provides guidance on how an entity must determine whether a contract qualifies for a scope exception from derivative accounting. The amendments to Topic 815-40 change the scope of contracts that are recognized as assets or liabilities. This standard is effective for interim and annual periods beginning after December 15, 2021, with early adoption permitted after December 15, 2020. Adoption of this standard can either be on a modified retrospective or full retrospective basis. The Company is currently evaluating this standard but expect no material impact on the financial statements.

3. Fair Value of Financial Instruments

The Company measures certain financial assets and liabilities at fair value. Fair value is determined based on the exit price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy:

Level 1 — Quoted prices in active markets for identical assets or liabilities;

Level 2 — Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 — Inputs that are generally unobservable and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

Financial assets measured at fair value on a recurring basis using the above input categories were as follows (in thousands):

		Fair Value at	
	Pricing Category	December 31,	
		2020	2019
Assets:			
Cash equivalents:			
Money market funds	Level 1	\$ 744	\$ 3,334
U.S. Treasury securities.	Level 1	64,997	29,957
Short-term investments:			
U.S. Treasury securities.	Level 1	68,990	39,877
Total		<u>\$ 134,731</u>	<u>\$ 73,168</u>
Liabilities:			
Other non-current liabilities:			
Derivative liability.	Level 3	\$ 70,870	\$ —
Warrant liability	Level 3	39,670	—
Total		<u>\$ 110,540</u>	<u>\$ —</u>

As of December 31, 2020 and 2019, short-term investments were primarily comprised of U.S. Treasury securities. The unrealized gain/losses related to fixed income debt securities were immaterial and primarily due to changes in interest rates, which are temporary in nature.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

3. Fair Value of Financial Instruments (cont.)

As of December 31, 2020 and 2019, the contractual maturities of the short-term investments were less than one year.

In August 2020, the Company issued Convertible Notes that contain embedded features subject to derivative accounting. Refer to Note 5, Debt, for additional information on the Convertible Notes.

The embedded derivatives are recognized as a derivative liability on the balance sheet, and are measured at fair value, subject to remeasurement at each balance sheet date. The fair value of derivative liability is measured as the difference between the estimated value of the Convertible Notes with and without such conversion features utilizing Monte Carlo simulation pricing model.

The warrants issued in connection with the Convertible Notes are classified as a liability because they can become exercisable into common stock upon a QIPO or into convertible preferred stock after five years from issuance date in the event that there is no QIPO during such period. Such warrants are measured at fair value, subject to remeasurement at each balance sheet date. The fair value of the warrant liability is measured using Monte Carlo Simulation pricing model.

The fair value of the Convertible Notes was \$365.9 million as of December 31, 2020. The carrying value of the Convertible Notes of \$106.4 million, net of \$97.1 million unamortized debt discount and issuance costs, as of December 31, 2020, was recorded in Debt, non-current on the balance sheets.

The valuation of derivative and warranty liabilities and the Convertible Notes are based on significant inputs not observable in the market, and thus represents a level 3 measure. The key inputs to the valuation model include fair value of equity, equity volatility, expected term until a liquidity event to exit, expected term until exercise, and risk-free interest rate.

A summary of the changes in the fair value of the derivative liability is as follows (in thousands):

	Amount
Derivative liability – at issuance	\$ 68,514
Change in fair value	2,356
Derivative liability – December 31, 2020	<u>\$ 70,870</u>

A summary of the changes in the fair value of the warrant liability is as follows (in thousands):

	Amount
Warrant liability – at issuance	\$ 29,037
Change in fair value	10,633
Warrant liability – December 31, 2020	<u>\$ 39,670</u>

The change in fair value of derivative and warrant liabilities is recorded in the statement of operations.

4. Balance Sheet Components

Cash and cash equivalents consisted of the following (in thousands):

	December 31,	
	2020	2019
Cash	\$ 44,978	\$ 6,949
Cash equivalents	65,741	33,291
Total cash and cash equivalents	<u>\$ 110,719</u>	<u>\$ 40,240</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

4. Balance Sheet Components (cont.)

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the balance sheets to the total of such amounts shown on the statements of cash flows.

	December 31,	
	2020	2019
Cash and cash equivalents.	\$ 110,719	\$ 40,240
Restricted cash, current portion	8,397	5,970
Restricted cash, net of current portion	4,581	7,439
Total restricted cash	12,978	13,409
Total cash and cash equivalents, and restricted cash.	<u>\$ 123,697</u>	<u>\$ 53,649</u>

Inventories consisted of the following (in thousands):

	December 31,	
	2020	2019
Raw materials	\$ 31,148	\$ 46,495
Work in progress	8,042	23,197
Finished goods	47,756	19,400
Service parts	5,384	4,950
Total inventories	<u>\$ 92,330</u>	<u>\$ 94,042</u>

The Company recorded a write-down of excess or obsolete inventories to cost of goods sold of \$3.0 million, \$4.9 million and \$4.2 million in the years ended December 31, 2020, 2019 and 2018, respectively.

Property, plant, and equipment, net, consisted of the following (in thousands):

	December 31,	
	2020	2019
Computer hardware.	\$ 4,708	\$ 3,830
Computer software	8,849	6,558
Internally used vehicles and charging systems	19,136	12,936
Leased vehicles and batteries	7,081	10,715
Leasehold improvements	10,234	8,275
Machinery and equipment	26,026	14,237
Office furniture and equipment	1,854	1,876
Tooling	21,727	17,918
Finance lease right-of-use assets.	179	—
Construction in progress	1,830	6,642
	101,624	82,987
Less: Accumulated depreciation and amortization	(48,037)	(35,472)
Total	<u>\$ 53,587</u>	<u>\$ 47,515</u>

Construction in progress was comprised of various assets that are not available for their intended use as of the balance sheet date.

Depreciation and amortization expense were \$15.5 million, \$12.6 million and \$9.3 million for the years ended December 31, 2020, 2019 and 2018, respectively.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

4. Balance Sheet Components (cont.)

Accrued liabilities consisted of the following (in thousands):

	December 31,	
	2020	2019
Accrued payroll and related expenses	\$ 6,695	\$ 2,799
Accrued sales and use tax	975	1,254
Warranty reserve	6,121	7,697
Financing obligation	3,056	850
Accrued interest	127	174
Accrued audit and accounting related expenses	428	419
Accrued charger installation costs	769	547
Other accrued expenses	1,565	895
Total	<u>\$ 19,736</u>	<u>\$ 14,635</u>

Other long-term liabilities consisted of the following (in thousands):

	December 31,	
	2020	2019
Financing obligation	\$ —	\$ 3,056
Accrued interest	—	120
Warranty reserve	12,461	7,229
Deferred rent	—	793
Finance lease liabilities, non-current	117	—
Total	<u>\$ 12,578</u>	<u>\$ 11,198</u>

In July 2016, we entered into a bus sale and lease transaction for ten Catalyst buses. These buses are leased to other parties for five years by the customer. At the end of the lease term, the fourth quarter of 2021, we have an obligation to repurchase the buses back from the customer. We make a portion of the monthly lease payments directly to the customer and also provided a guarantee to the customer on the remaining lease payments if the lessee fails to pay. We received \$6.0 million from the customer directly upon delivery in 2016. Under U.S. GAAP, this sales transaction is considered as a borrowing and the lease transaction is considered as an operating lease.

The financing obligation was \$3.1 million and \$3.9 million as of December 31, 2020 and 2019, respectively. Interest expense on the financing obligation is recognized using the effective interest method. The monthly lease payment is recognized as leasing revenue. The costs of the buses are recorded as leased vehicles in property, plant, and equipment on the balance sheets.

5. Debt

Debt, net of debt discount and issuance costs, consisted of the following (in thousands):

	December 31,	
	2020	2019
Hercules Credit Facility	\$ —	\$ 9,640
Senior Credit Facility	16,809	14,934
PPP loan	10,000	—
Convertible Notes	106,443	—
Total Debt, non-current	<u>\$ 133,252</u>	<u>\$ 24,574</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

5. Debt (cont.)

Loan and Security Agreement

The Company entered into a loan and security agreement with Hercules Capital, Inc. (“Hercules Credit Facility”) in 2015, and amendments in 2016 and 2017. In May 2019, the Company entered into an amendment to the Hercules Credit Facility to repay \$20.0 million in principal, and extend the maturity date of the remaining \$10.0 million outstanding principal to May 2021. The interest rate was composed of a cash interest rate of the greater of 10.55% or 10.55% plus the prime rate minus 5.5% and a PIK interest rate of 1.75% per annum. The loan had an interest only period through its maturity date. The \$2.3 million end-of-term charge under the Amended Hercules Credit Facility was paid on June 1, 2019. The \$0.8 million accrued PIK interest under the existing Hercules Credit Facility and \$0.2 million prepayment penalty were paid at the closing of the amendment. As of December 31, 2019, the outstanding balance under the Hercules Credit Facility was \$10.0 million, and the cash interest rate was 10.55% per annum.

In connection with entering into the Hercules Credit Facility in 2015, the Company issued to Hercules a warrant to purchase 397,932 shares of Series 4 convertible preferred stock. The Company determined the fair value of the convertible preferred stock warrant shares was \$0.3 million, which was recorded as a debt discount and a convertible preferred stock warrant liability, as discussed further in Note 8. In connection with the first amendment, the Company issued to Hercules an additional warrant to purchase 79,587 shares of Series 4 convertible preferred stock. The Company determined the fair value of the convertible preferred stock warrant was \$0.1 million, which was recorded as a debt discount and a convertible preferred stock warrant liability, as discussed further in Note 8. In connection with the Amended Hercules Credit Facility in 2019, the Company issued to Hercules a warrant to purchase 36,630 shares of common stock warrants. The Company determined the fair value of the common stock warrant was \$0.1 million, which was recorded as a debt discount and classified as equity in additional paid-in capital. The warrant is exercisable for 10 years, and will automatically exercise upon the initial public offering.

The end-of-term charge was accreted to accrued interest using the effective-interest method from the funding date to its payment due date. As of December 31, 2019, the accrued PIK interest balance was \$0.1 million.

The balance of debt issuance costs and discounts was \$0.4 million as of December 31, 2019. The debt issuance cost and debt discounts were amortized to interest expense over the terms of the Hercules Credit Facility using the effective interest method. The amortization of debt issuance cost and debt discounts to interest expense was \$0.2 million, \$0.3 million and \$0.2 million for 2020, 2019 and 2018, respectively.

The Company’s obligations under the Hercules Credit Facility were secured by a security interest and amended to a second security interest under the Amended Hercules Credit Facility on substantially all the Company’s assets except for intellectual property and other restricted property.

In August 2020, the Company made the repayment in full of its obligations of \$10.3 million under the Hercules Credit Facility, as amended, including principal and accrued interest. The Hercules Credit Facility was terminated upon payoff and the remaining unamortized debt issuance cost and debt discounts of \$0.2 million were recorded to interest expense.

Senior Credit Facility

In May 2019, the Company entered into a Loan, Guaranty and Security Agreement for a senior secured asset-based lending facility (“Senior Credit Facility”) with borrowing capacity up to \$75.0 million. The commitment under the Senior Credit Facility is available to the Company on a revolving basis through the earlier of May 2024 or 91 days prior to the stated maturity of any subordinated debt in aggregate amount of \$7.5 million or more. The maximum availability under the Senior Credit Facility is based on certain specified percentages of eligible accounts receivable and inventory, subject to certain reserves, to be determined in accordance with the Senior Credit Facility. The commitment under the Senior Credit Facility includes a \$10.0 million letter of credit sub-line. Subject to certain conditions, the commitment may be increased by \$50.0 million upon approval by the lender, and at the Company’s option, the commitment can be reduced to \$25.0 million or terminated upon at least 15 days written notice.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

5. Debt (cont.)

The Senior Credit Facility is secured by a security interest in substantially all of the Company's assets except for intellectual property and other restricted property.

Borrowings under the Senior Credit Facility bear interest at per annum rates equal to, at the Company's option, either (i) the base rate plus an applicable margin for base rate loan, or (ii) the London Interbank Offered Rate ("LIBOR") plus an applicable margin for LIBOR loan. The base rate is calculated as the greater of (a) the Lender prime rate, (b) the federal funds rate plus 0.5%, and (c) one-month LIBOR plus 1.0%. The applicable margin is calculated based on a pricing grid linked to quarterly average excess availability (as a percentage of borrowing capacity). For base rate loans, the applicable margin ranges from 0.0% to 1.5%, and for LIBOR Loans, it ranges from 1.5% to 3.0%. The Senior Credit Facility contains certain customary non-financial covenants. In addition, the Senior Credit Facility requires the Company to maintain a Fixed Charge Coverage Ratio of at least 1.00:1.00 during such times as a covenant trigger event shall exist.

As of December 31, 2020 and 2019, the outstanding balance under the Senior Credit Facility was \$17.1 million and \$15.3 million, respectively, with maturity of May 2024. The Company incurred approximately \$0.4 million debt issuance costs under this facility, and will amortize these costs to interest expense over the borrowing term. The interest rate was 3.09% and 4.89% per annum as of December 31, 2020 and 2019, respectively.

Small Business Administration Loan

In May 2020, the Company received Small Business Administration ("SBA") loan proceeds of \$10.0 million from Town Center Bank pursuant to the Paycheck Protection Program ("the PPP loan") under the "Coronavirus Aid, Relief and Economic Security (CARES) Act". The PPP loan was in the form of a note and matures on May 6, 2022. The interest rate is 1.00% per annum and payable monthly commencing in December 2020. All or a portion of the PPP loan may be forgiven by the SBA upon application with supporting documentation of expenditures in accordance with SBA requirements, which include employees being kept on the payroll for eight weeks after the date of the loan and the proceeds being used for payroll, rent, mortgage interest, or utilities.

Convertible Notes

In August 2020, the Company entered into a Note Purchase Agreement for Secured Convertible Promissory Notes ("Convertible Notes"). The Convertible Notes have an aggregate principal amount of \$200.0 million, with a cash interest of 5.0% per annum payable at each quarter end and a paid-in-kind interest of 4.5% per annum payable by increasing the principal balance at each quarter end. The Convertible Notes will mature in August 2025, and the Company may not make prepayment unless approved by the required holders of the Convertible Notes.

At or after an underwritten initial public offering in which the Company receives gross proceeds of not less than \$100 million ("QIPO"), or at the time of a merger, acquisition or other combination between the Company and a publicly-traded special purpose acquisition company ("SPAC transaction"), the holders may elect to convert the Convertible Notes into shares of common stock.

At the next bona fide equity financing following the Note Purchase Agreement, or 36 months after the date of the Note Purchase Agreement if no such equity financing shall have occurred (a "Qualified Financing"), the holders may elect to convert the Convertible Notes into shares of the most senior series of the Company's preferred stock.

The conversion price will be an amount equal to:

- i) if the conversion stock is being issued at or following a QIPO, the QIPO price per share multiplied by the Discount Coefficient (as defined in the Convertible Notes), which is initially equal to 90% and will decrease by 2.75% every 6 months following the first anniversary of the closing date of the Convertible Notes, in effect on the date of QIPO (the "QIPO Conversion Price"); or

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

5. Debt (cont.)

- ii) if the conversion stock is being issued following a Qualified Financing, 75% of the lowest per share cash purchase price of the common stock or preferred stock sold by the Company in the Qualified Financing; or
- iii) if the conversion stock is being issued following a SPAC transaction, 75% of the SPAC Transaction Price Per Share (as defined in the Note Purchase Agreement) (the “SPAC Conversion Price”).

The Convertible Notes will automatically be converted into common stock at any time after the expiration of the lock-up period of a QIPO or SPAC transaction, if the following conditions are met:

- if the QIPO price per share equals or exceeds \$6.9075, then upon the volume-weighted average price of the Company’s publicly-traded common stock over a period of 20 consecutive trading days exceeds 150% of the QIPO Conversion Price; or if the QIPO price per share is lower than \$6.9075, then upon the volume-weighted average price of the Company’s publicly-traded common stock over a period of 20 consecutive trading days exceeds 150% of an amount equal to \$6.9075 multiplied by the Discount Coefficient at the time of the QIPO.
- if the SPAC Transaction Price Per Share equals or exceeds \$6.9075, then upon the volume-weighted average price of the Company’s publicly-traded common stock over a period of 20 consecutive trading days commencing after the six month anniversary of the closing of the SPAC transaction exceeding 150% of the SPAC Conversion Price; or if the SPAC Transaction Price Per Share is lower than \$6.9075, then upon volume-weighted average price of the Company’s publicly-traded common stock over a period of 20 consecutive trading days commencing after the six month anniversary of the closing of the SPAC transaction and over which the Conversion Stock would be freely tradable exceeding 175% of an amount equal to \$6.9075 multiplied by 75%.

Each of the Convertible Notes shall rank equally without preference or priority of any kind over one another, but senior in all rights, privileges and preferences to all other shares of the Company’s capital stock and all other securities of the Company that are convertible into or exercisable for the Company’s capital stock directly or indirectly.

Prior to the maturity date or prior to the payment or conversion of the entire balance of the Convertible Notes, in the event of a liquidation or sale of the Company, the Company shall pay to the holders of Convertible Notes the greater of (i) 150% of the principal balance of the Convertible Notes or (ii) the consideration that the holders would have received had the holders elected to convert the Convertible Notes into preferred stock immediately prior to such liquidation event.

The Convertible Notes do not entitle the holders to any voting rights or other rights as a stockholder of the Company, unless and until the Convertible Notes are actually converted into shares of the Company’s capital stock in accordance with their terms.

The Note Purchase Agreement contains certain customary non-financial covenants. In addition, the Note Purchase Agreement requires the Company to maintain liquidity at quarter end of not less than the greater of (i) \$75.0 million and (ii) four times of cash burn for the three-month period then ended.

In connection with the issuance of the Convertible Notes, the Company issued warrants to the holders of Convertible Notes to purchase 5.1 million shares of Company stock at an exercise price of \$0.01 per share. The stock issuable upon exercise of the warrants shall be (1) common stock, or (2) in the event that a QIPO has not occurred within five years of the Note Purchase Agreement or in the event of a liquidation or sale of the Company, the most senior series of the Company’s convertible preferred stock (or in the event that the Company is consolidated or merges with one or more other corporations, the stock that the holder of the warrant would have been entitled to receive if holder would have exercised the warrant prior to such event). The warrants are exercisable for 7 years, and will be automatically exercised in the event of a change of control transaction or the expiration of the warrants.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

5. Debt (cont.)

The warrants are freestanding financial instruments and classified as liability due to the possibility that they can become exercisable into convertible preferred stock. The warrant liability of \$29.0 million is initially measured at fair value on its issuance date and recorded as a debt discount, and will be amortized during the term of the Convertible Notes to interest expense using the effective-interest method. The warrant liability will be remeasured on a recurring basis at each reporting period date, with the change in fair value reported in the statement of operations.

The embedded features are composed of conversion options that have the economic characteristics of a contingent early redemption feature settled in a variable number of shares of Company stock. These conversion options are bifurcated and accounted for separately from the host debt instrument. The derivative liability of \$68.5 million was initially measured at fair value on the issuance date of the Convertible Notes and recorded as a debt discount and will be amortized during the term of the Convertible Notes to interest expense using the effective-interest method. The derivative liability will be remeasured on a recurring basis at each reporting period date, with the change in fair value reported in the statement of operations.

The issuance costs of \$5.1 million were recorded as debt discount and will be amortized during the term of the Convertible Notes to interest expense using the effective interest method. The amortization expense of debt discount and issuance costs was \$5.6 million for the year ended December 31, 2020.

The Convertible Notes will mature in August 2025 or will be settled by issuing equity stock, and accordingly are classified as a non-current liability on the Company's balance sheets. As of December 31, 2020, the Convertible Notes, net of debt discount and issuance costs, consisted of the following (in thousands):

Principal	\$ 200,000
PIK interest	3,501
Total principal	203,501
Less debt discount and issuance costs	(97,058)
Total Convertible Notes	<u>\$ 106,443</u>

As of December 31, 2020, the contractual future principal repayments of the total debt were as follows (in thousands):

2022	\$ 10,000
2024	17,074
2025 ⁽¹⁾	203,501
Total	<u>\$ 230,575</u>

(1) Including PIK interest added to principal balance through December 31, 2020.

The Company was in compliance with all of the covenants contained in the Senior Credit Facility and Convertible Notes as of December 31, 2020.

6. Leases

The Company adopted the new lease accounting standard on January 1, 2020 using the modified retrospective transition method, recognizing a cumulative-effect adjustment to the balance sheet and not adjusting comparative information for prior periods. In addition, the Company elected the package of practical expedients permitted under the transition guidance, which allowed the Company not to reassess (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases, and (3) initial direct costs for any existing leases. The Company did not elect the use of hindsight practical expedients in determining the lease term for existing leases. Topic 842 also provides practical expedients for an entity's ongoing accounting. The Company has elected the short-term lease recognition exemption for all leases that qualify. As a result, for those leases with a term of less

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

6. Leases (cont.)

than 12 months, it will not recognize right-of-use assets or lease liabilities. The Company also elected the practical expedient to not separate lease and non-lease components for all its leases regardless of whether the Company is the lessee or a lessor to the lease.

The adoption resulted in a recognition of \$13.8 million of operating lease assets and \$14.3 million of operating lease liabilities on the balance sheet on January 1, 2020. The difference represents prepaid rent expense and deferred rent for leases existed on the date of adoption, which was an offset to the opening balance of operating lease assets. The adoption has no impact on the Company's operating expenses and cash flows.

As a Lessor

The net investment in leases are as follows:

	December 31,	
	2020	2019
Net investment in leases, current	\$ 398	\$ 343
Net investment in leases, non-current	3,101	3,809
Total net investment in leases	<u>\$ 3,499</u>	<u>\$ 4,152</u>

Interest income from accretion of net investment in lease is not material.

In the year ended December 31, 2020, the Company assigned one operating lease and three sales-type leases. The Company received a total of \$3.7 million in cash, and recorded \$0.9 million in product revenue for the assigned operating lease, and an aggregate loss of assignment of \$1.2 million for the sales-type leases in the other expense (income), net on the statement of operations.

Future minimum payments receivable from operating and sales-type leases as of December 31, 2020 for each of the next five years are as follows:

	Operating leases	Sales-type leases
2021	\$ 726	\$ 395
2022	105	395
2023	105	296
2024	105	135
2025	105	408
Thereafter	222	2,282
Total minimum lease payments	<u>\$ 1,368</u>	<u>\$ 3,911</u>

As a Lessee

The Company leases its office and manufacturing facilities in Burlingame, California, Greenville, South Carolina, City of Industry, California, and Rochester Hills, Michigan under operating lease agreements with various expiration dates through 2026.

In June 2018, the Company entered into an agreement to sublease its office facilities in Rochester Hills, Michigan from July 2018 to October 2023. The total sublease payments are approximately \$2.3 million for the lease term. The sublease income is recorded in the other expense (income), net on the statement of operations.

The Company had no material capital leases as of December 31, 2020.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

6. Leases (cont.)

Maturities of operating lease liabilities as of December 31, 2020 were as follows (in thousands):

2021.....	\$	3,622
2022.....		3,133
2023.....		2,300
2024.....		1,648
2025.....		1,039
Thereafter		443
Total undiscounted lease payment		12,185
Less: imputed interest		(1,141)
Total lease liabilities	\$	<u>11,044</u>

Future minimum payments for noncancellable operating leases, based on previous lease accounting standard, as of December 31, 2019 were as follows (in thousands):

2020.....	\$	3,912
2021.....		3,619
2022.....		3,128
2023.....		2,300
2024.....		1,648
Thereafter		1,482
Total minimum lease payments.....		16,089
Less proceeds from sublease rental.....		(1,853)
Net operating lease obligation.....	\$	<u>14,236</u>

Operating lease expense was \$4.0 million, \$3.4 million, and \$3.1 million for the years ended December 31, 2020, 2019 and 2018, respectively.

Short-term and variable lease expenses for the year ended December 31, 2020 were not significant.

Supplemental cash flow information related to leases were as follows (in thousands):

	Year Ended December 31, 2020
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	(3,855)

In the year ended December 31, 2020, the cash flow from financing leases and right-of-use assets obtained in exchange for lease obligations were not significant.

Operating lease right-of-use assets and liabilities consist of the following (in thousands):

	December 31, 2020
Operating leases	
Operating lease right-of-use assets	\$ 10,310
Operating lease liabilities, current	\$ 3,153
Operating lease liabilities, non-current.....	7,891
Total operating lease liabilities	<u>\$ 11,044</u>

The weighted average remaining lease term and discount rate of operating leases are 4.0 years and 4.9%, respectively, as of December 31, 2020.

As of December 31, 2020, the Company had no significant additional operating leases and finance leases that have not yet commenced.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

7. Commitments and Contingencies

Purchase Commitments

As of December 31, 2020, the Company had outstanding inventory and other purchase commitments of \$215.7 million.

Letters of Credit

As of December 31, 2020, the Company had letters of credit outstanding totaling \$0.5 million, which will expire over various dates in 2021.

Guarantees

The Company provides guarantees of lease payments for vehicles under the financing transaction discussed in Note 4, in the event the lessee does not make payments to the financing company.

The Company regularly reviews its performance risk under the arrangement, and in the event that it becomes probable that it will be required to perform under a guarantee, the fair value of probable payment will be recorded. No guarantee liability was recorded as of December 31, 2020 and 2019.

Legal Proceedings

The Company accrues contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated. From time to time in the normal course of business, various claims and litigation have been asserted or commenced. Due to uncertainties inherent in litigation and other claims, the Company can give no assurance that it will prevail in any such matters, which could subject the Company to significant liability or damages. Any claims or litigation could have an adverse effect on the Company's business, financial position, operating results, or cash flows in or following the period that claims or litigation are resolved.

As of December 31, 2020, the Company was not a party to any legal proceedings that would have a material adverse effect on its business.

8. Convertible Preferred Stock

In August and September 2019, the Company completed a private placement and issuance of a total of 10,857,762 shares of Series 8 convertible preferred stock at \$6.9075 per share for proceeds of \$74.8 million, net of issuance costs of approximately \$0.2 million. In October 2019, the Company completed an additional private placement and issuance of 1,719,145 shares of Series 8 convertible preferred stock at \$6.9075 per share for gross proceeds of \$11.9 million.

In June 2018, the Company completed the private placement and issuance of a total of 15,307,518 shares of Series 7 convertible preferred stock at \$6.526419 per share for proceeds of \$98.8 million, net of issuance costs of approximately \$1.1 million. In September 2018, the Company completed the private placement and issuance of a total of 8,442,102 additional shares of Series 7 convertible preferred stock at \$6.526419 per share for proceeds of \$53.0 million, net of issuance costs of approximately \$2.1 million.

In January 2018, the Company completed an additional private placement and issuance of 4,512,743 shares of Series 6 convertible preferred stock at \$5.539864 per share for proceeds of \$24.9 million, net of issuance costs of \$0.1 million. The \$5.0 million prepayment for the sale of Series 6 convertible preferred stock, which was recorded as a non-current liability as of December 31, 2017, was converted to equity upon closing of this transaction.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

8. Convertible Preferred Stock (cont.)

The following table summarizes convertible preferred stock authorized and issued and outstanding as of December 31, 2020 and 2019:

	Shares Authorized	Shares Issued and Outstanding	Net Carrying Value	Aggregate Liquidation Preference
			(in thousands)	
Series 1 ⁽¹⁾	27,567,694	27,476,120	\$ 79,564	\$ 75,006
Series 2	6,069,073	6,069,073	24,868	24,953
Series 3	7,617,704	7,617,704	36,096	36,475
Series 4	9,159,674	8,682,155	29,901	30,000
Series 5	28,391,526	28,391,526	138,747	142,987
Series 6	14,440,784	14,440,784	79,085	80,000
Series 7	23,749,620	23,749,620	151,770	155,000
Series 8	12,576,907	12,576,907	86,648	86,875
Total	<u>129,572,982</u>	<u>129,003,889</u>	<u>\$ 626,679</u>	<u>\$ 631,296</u>

- (1) Including Series 1 convertible preferred stock issued through exercise of warrants to purchase 197,315 shares. The proceeds from exercise of the warrants was \$0.5 million.

The rights, preferences, and privileges of the convertible preferred stock are as follows:

Dividends

The holders of convertible preferred stock are entitled to receive noncumulative dividends equal to 8% of the original issue price per share, when and if declared by the board of directors, prior and in preference to dividends on common stock. The holders of convertible preferred stock are also entitled to participate in dividends on common stock held on an as-if converted basis. No dividends on convertible preferred stock or common stock had been declared by the board of directors as of December 31, 2020.

Conversion Rights

Each share of convertible preferred stock is convertible at the option of the holder into shares of common stock at any time. The conversion rate for convertible preferred stock is equal to the quotient obtained by dividing the applicable original issue price by the applicable conversion price in effect at the time of conversion. The original issue price for the Series 1, 2, 3, 4, 5, 6, 7, and 8 convertible preferred stock is \$2.729862, \$4.11146, \$4.78821, \$3.45536, \$5.03624, \$5.539864, \$6.526419, and \$6.9075 per share, respectively, as adjusted for stock splits, stock dividends, combinations, subdivisions, recapitalizations, or similar transactions. The conversion price of the Series 1, 2, 3, 4, 5, 6, 7, and 8 convertible preferred stock is \$2.729862, \$4.01068, \$4.58348, \$3.45536, \$5.03624, \$5.539864, \$6.526419, and \$6.9075 per share, respectively, as adjusted for certain dilutive issuances, splits and combinations.

Each share of convertible preferred stock automatically converts into shares of common stock at the then-effective conversion price upon the Company's sale of its common stock in a firm commitment underwriting pursuant to a registration statement filed under the Securities Act of 1933, as amended, at an aggregate public offering price of not less than \$50.0 million. In addition, all shares of convertible preferred stock (other than the Series 7 preferred stock and Series 8 preferred stock) will automatically convert into shares of common stock upon a vote by the holders of a majority of the outstanding shares of convertible preferred stock voting together as a single class on an as-converted basis; the Series 7 preferred stock may not be converted without the vote or written consent of the holders of at least a majority of the then outstanding shares of Series 7 convertible preferred stock and the Series 8 preferred stock may not be converted without the vote or written consent of the holders of at least a majority of the then outstanding shares of Series 8 convertible preferred stock.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

8. Convertible Preferred Stock (cont.)

In the event that the initial offering price to the public (prior to any underwriting discount), under the Securities Act of 1933, as amended, at an aggregate public offering price of not less than \$50.0 million (IPO), is less than the original issuance price of the Series 8 convertible preferred stock, the conversion price of the Series 8 shall be adjusted to the higher of the IPO price or the original issuance price of the Series 7 convertible preferred stock.

Voting Rights

Holders of convertible preferred stock have voting rights equal to the number of shares of common stock into which their respective convertible preferred shares are then convertible. Holders of convertible preferred stock, as a separate class, voting on an as-converted basis, shall be entitled to elect seven directors of the Company. Holders of the common stock, as a separate class, shall be entitled to elect one director of the Company. The holders of common stock and convertible preferred stock, voting together as a single class on an as-converted basis, shall be entitled to elect the remaining number of directors of the Company.

Liquidation Preferences

In the event of a liquidation or sale of the Company, either voluntary or involuntary, distributions to the stockholders shall be made in the following manner: the holders of Series 8 preferred stock shall be entitled, before holders of other series of preferred stock and before holders of common stock, to an amount per share equal to the greater of (1) the original issue price of Series 8 preferred stock plus any declared but unpaid dividends and (2) the amount that would have been payable had all shares of Series 8 preferred stock been converted into common stock immediately prior to such event. After payment to the holders of Series 8 preferred stock, the holders of Series 7 preferred stock shall be entitled, before holders of other series of preferred stock, an amount per share equal to the greater of (1) the original issue price of Series 7 preferred stock plus any declared but unpaid dividends and (2) the amount that would have been payable had all shares of Series 7 preferred stock been converted into common stock immediately prior to such event. After payment to the holders of Series 8 and Series 7 preferred stock, the holders of Series 5 and 6 convertible preferred stock then outstanding shall be entitled, on a pari passu basis, an amount per share equal to the greater of (1) the applicable original issue price for such series of convertible preferred stock plus any declared but unpaid dividends and (2) the amount that would have been payable had all shares of such series convertible preferred stock been converted into common stock immediately prior to such event. After payment to the holders of Series 8, Series 7, and Series 5 and 6 convertible preferred stock, the holders of Series 1, 2, 3, and 4 convertible preferred stock then outstanding shall be entitled, on a pari passu basis, an amount per share equal to the greater of (1) the applicable original issue price for such series of convertible preferred stock plus any declared but unpaid dividends and (2) the amount that would have been payable had all shares of such series convertible preferred stock been converted into common stock immediately prior to such event. After payment of all preferential amounts required to be paid to the holders of convertible preferred stock, the remaining funds and assets available for distribution shall be distributed among the holders of common stock, pro rata based on the number of shares of common stock held.

Redemption

Convertible preferred stock is not redeemable by the Company or at the option of the preferred stockholders.

Convertible Preferred Stock Warrants

Warrants for Series 4 Preferred Stock

In May 2016, in connection with the first amendment to the Hercules Credit Facility, the Company issued warrants to purchase an additional 79,587 shares of Series 4 convertible preferred stock to Hercules at an exercise price of \$3.45536 per share, subject to certain adjustments. The warrants expire at the earlier of May 2023 and three years from the Company's qualified initial public offering.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

8. Convertible Preferred Stock (cont.)

During 2015, the Company issued warrants to purchase 397,932 shares of Series 4 convertible preferred stock to Hercules at an exercise price of \$3.45536 per share, subject to certain adjustments. The warrants expire in the earlier of May 2022 or three years from the Company's qualified initial public offering.

Warrants for Series 1 Preferred Stock

In each of October 2011 and March 2012, the Company issued warrants to purchase 45,787 shares of Series 1 convertible preferred stock at an exercise price of \$2.729862 per share to a bank in connection with a debt arrangement. The warrants expire in October 2021.

The warrants for Series 1 and Series 4 convertible preferred stock are recorded as a warrant liability included in other long-term liabilities on the balance sheets prior to January 1, 2018.

The Company adopted ASU No. 2017-11, *Earnings per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815)* on January 1, 2018, and reclassified its warrant liability of \$0.6 million to additional paid-in capital upon adoption. As of December 31, 2020, a total of 569,093 shares of the Series 1 and Series 4 convertible preferred stock warrants were outstanding.

9. Common Stock

As of December 31, 2020, the Company was authorized to issue 304,672,982 shares of capital stock with a par value of \$0.0001 per share. The authorized shares consisted of 175,100,000 shares of common stock and 129,572,982 shares of convertible preferred stock. There were 6,361,952 shares and 4,400,247 shares of common stock issued and outstanding as of December 31, 2020 and 2019, respectively.

The Company had reserved shares of common stock, on an as-if-converted basis, for issuance as follows:

	December 31,	
	2020	2019
Exercise of stock options to purchase common stock.	26,359,796	20,401,985
Exercise of common stock warrants to purchase common stock	5,149,716	117,630
Issuances of shares available under stock option plans.	442,891	2,362,407
Conversion of convertible preferred stock	129,496,639	129,496,639
Conversion of convertible preferred stock warrants	569,093	569,093
Total	162,018,135	152,947,754

Common Stock Warrants

In August 2020, in connection with the issuance of Convertible Notes, the Company issued warrants to purchase 5,112,086 shares of common stock to purchasers of the Convertible Notes. The warrants have an exercise price of \$0.01 per share. The stock issuable upon exercise of the warrants shall be (1) common stock, or (2) in the event that a QIPO has not occurred within five years of the Note Purchase Agreement or in the event of a liquidation or sale of the Company, the most senior series of the Company's preferred stock (or in the event that the Company consolidated or merges with one or more other corporation, the stock that the holder of the warrant would have been entitled to receive if holder would have exercised the warrant prior to such event). The warrants are exercisable for 7 years, and will be automatically exercised in the event of a change of control transaction or the expiration of the warrants. These warrants are classified as liability in the balance sheets. Refer to Note 5 for further details.

In May 2019, in connection with the 2019 Amended Hercules Credit Facility, the Company issued to Hercules a warrant to purchase 36,630 shares of common stock. The warrants have an exercise price of \$5.46 per share, which are exercisable for 10 years and will automatically exercise upon the initial public offering. See Note 5, Debt.

In the fourth quarter of 2020, 80,000 shares of the common stock warrants expired.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

10. Stock Option Plan

In 2010, the Company adopted the 2010 Equity Incentive Plan (the “Plan”). The Plan provides for the issuance of incentive stock options, non-statutory stock options, stock appreciation rights, restricted stock, and restricted stock units. Non-statutory stock options, stock appreciation rights, restricted stock, and restricted stock units may be granted to employees, directors, and consultants, but only employees may be granted incentive stock options. No stock appreciation rights, restricted stock, or restricted stock units had been issued under the Plan as of December 31, 2020.

The exercise price per share of all stock options granted under the Plan must equal at least 100% of the fair market value per share of the Company’s common stock on the date of grant as determined by the board of directors. If, at the time the Company grants an incentive stock option, the optionee owns stock representing more than 10% of the total combined voting power of all classes of stock of the Company, the exercise price per share must be at least 110% of the fair market value per share of the Company’s common stock on the date of grant and the stock options will expire five years after the date of grant. Except as noted above, stock options expire no more than ten years after the date of grant.

Generally, a terminated service provider may exercise stock options within three months of termination. Awards that expire or are cancelled without delivery of shares generally become available for re-issuance under the 2010 Plan.

Stock option awards generally vest over a four-year period, with 25% vesting after one year from date of grant and quarterly thereafter. Certain awards have shorter vesting periods.

During 2020, the board of directors approved an increase in the number of shares of common stock reserved under the 2010 Equity Incentive Plan by 6,000,000 shares to 31,994,478 shares.

The shares available for grant under the Plan were as follows:

	Year Ended December 31,		
	2020	2019	2018
Balance at the beginning of period	2,362,407	3,627,104	2,751,406
Additional shares authorized.	6,000,000	1,519,075	6,847,235
Granted	(10,281,875)	(3,359,941)	(7,312,022)
Repurchased	—	9,000	—
Cancelled/forfeited	2,362,359	567,169	1,340,485
Balance at the ending of period	<u>442,891</u>	<u>2,362,407</u>	<u>3,627,104</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

10. Stock Option Plan (cont.)

A summary of the Company's stock option activity and related information was as follows:

	Options Outstanding			
	Number of Stock Options Outstanding	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)
Balance as of December 31, 2017.	13,764,812	\$ 1.67	8.3	\$ 9,498
Granted	7,312,022	4.11		
Exercised.	(1,217,877)	1.60		
Cancelled/forfeited/expired.	(1,340,485)	2.06		
Balance as of December 31, 2018.	18,518,472	\$ 2.61	8.3	\$ 42,951
Granted	3,359,941	5.23		
Exercised.	(909,259)	1.90		
Cancelled/forfeited/expired.	(567,169)	3.50		
Balance as of December 31, 2019.	20,401,985	\$ 3.05	7.6	\$ 34,723
Granted ¹	6,531,875	4.36		
Exercised.	(1,961,705)	2.14		
Cancelled/forfeited/expired.	(2,362,359)	4.11		
Balance as of December 31, 2020 ⁽¹⁾	22,609,796	\$ 3.40	7.4	\$ 65,056
Exercisable as of December 31, 2020.	12,637,973	\$ 2.63	6.2	\$ 46,004

(1) Excluding CEO Equity Awards of 3,000,000 shares and Milestone Options of 750,000 shares, of which 562,500 shares exercisable as of December 31, 2020. Refer to section below for further details.

In March 2020, in conjunction with Mr. Allen's appointment as the President and Chief Executive Officer, the board of directors approved a grant to Mr. Allen of stock option awards with respect to 5,250,000 shares, comprised of (1) 1,500,000 shares of time-based award with an exercise price of \$4.75 per share vesting quarterly over 4 years, (2) 3,000,000 shares of time-based award consists of 4 tranches with an exercise price of \$10, \$15, \$20 and \$25 per share, respectively, and vesting quarterly over 4 years ("Equity Awards"), and (3) 750,000 shares of milestone-based award with exercise price of \$4.75 per share will vest entirely and become exercisable on the first trading day following the expiration of the lockup period of the Company's initial public offering or the consummation of a change in control of the Company ("Milestone Options"). The Milestone Options shall vest in full and become exercisable upon the consummation of a merger involving a Special Purpose Acquisition Company.

The stock-based compensation expense for Milestone Options will be recognized at the time the performance milestone becomes probable of achievement. No stock-based compensation expense related to the Milestone Options was recognized as of December 31, 2020 as the performance condition was not considered probable of achievement. The unrecognized stock-based compensation expense associated with the Milestone Options was \$2.1 million on the grant date and as of December 31, 2020.

The weighted average fair value of stock options granted, excluding the 3,000,000 shares underlying the Equity Awards with exercise price of \$10, \$15, \$20 or \$25 per share and 750,000 shares underlying the Milestone Options, was \$3.13 per share for 2020. The weighted average fair value of stock options granted was \$3.14 per share for 2019 and \$2.64 per share for 2018. Aggregate intrinsic value represents the difference between the estimated fair value of the underlying common stock and the exercise price of outstanding, in-the-money stock options. The total intrinsic value of stock options exercised was \$4.3 million for 2020, \$2.9 million for 2019 and \$2.3 million for 2018. The total estimated grant date fair value of stock options vested was \$9.9 million for 2020, \$8.3 million for 2019 and \$4.7 million for 2018. As of December 31, 2020, the total unrecognized stock-based compensation expense related to outstanding stock options was \$34.8 million, which is expected to be recognized over a weighted-average period of 2.9 years.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

10. Stock Option Plan (cont.)

Determining Fair Value of Stock Options

The Company uses the Black-Scholes option pricing model to determine the fair value of stock options. The fair value of each stock option grant is estimated on the date of the grant. The fair value of the common stock underlying the stock options has historically been determined by the board of directors. There has been no public market for the Company's common stock. Therefore, the board of directors has determined the fair value of the common stock at the time of the stock option grant by considering a number of objective and subjective factors including independent third-party valuation reports, valuations of comparable companies, sales of convertible preferred stock and common stock to unrelated third parties, operating and financial performance, lack of liquidity of capital stock and general and industry-specific economic outlook, among other factors. The fair value of the underlying common stock shall be determined by the board of directors until such time that the Company's common stock is listed on an established stock exchange or national market system.

The fair value of stock options granted is estimated on the date of grant using the following assumptions:

	Year Ended December 31,		
	2020	2019	2018
Expected term (in years)	6.1	6.1	6.0
Risk-free interest rate	0.5%	1.8%	2.8%
Expected volatility	69.1%	65.4%	71.5%
Expected dividend rate	—	—	—

Expected Term — The Company estimates the expected term consistent with the simplified method. The Company elected to use the simplified method because of its limited history of stock option exercise activity. The simplified method calculates the expected term as the average of the vesting and contractual terms of the award.

Volatility — Since the Company has no trading history by which to determine the volatility of its own common stock price, the expected volatility being used is derived from the historical stock volatility of a representative industry peer group of comparable publicly listed companies over a period approximately equal to the expected term of the stock options.

Risk-Free Interest Rate — The risk-free interest rate is based on U.S. Treasury zero coupon issues with remaining terms similar to the expected term on the options.

Expected Dividend — The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

Forfeiture — All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. Under the ASU No. 2016-09, *Compensation — Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, the Company elected to account for forfeitures when they occur.

Stock-based Compensation Expense

Stock-based compensation expense included in operating results was as follows (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Cost of goods sold.	\$ 929	\$ 826	\$ 553
Research and development	1,616	1,436	1,227
Selling, general and administrative.	7,737	6,258	3,596
Total stock-based compensation expense	<u>\$ 10,282</u>	<u>\$ 8,520</u>	<u>\$ 5,376</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

11. Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period, less the weighted-average unvested common stock subject to repurchase or forfeiture as they are not deemed to be issued for accounting purposes. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including convertible preferred stock, stock options, and warrants, to the extent they are dilutive.

The computation of basic and diluted net loss per share of common stock under the two-class method attributable to common stockholders was as follows (in thousands, except for per share data):

	Year Ended December 31,		
	2020	2019	2018
Numerator:			
Net loss	\$ (127,007)	\$ (101,552)	\$ (91,622)
Denominator:			
Weighted-average shares used in computing net loss per share of common stock, basic and diluted	4,913	4,052	2,831
Net loss per share of common stock, basic and diluted	<u>\$ (25.85)</u>	<u>\$ (25.06)</u>	<u>\$ (32.36)</u>

We applied the two-class method to calculate its basic and diluted net loss per share of common stock, as the convertible preferred stock are participating securities. The two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that otherwise would have been available to common stock holders. However, the two-class method does not impact the net loss per share of common stock as we were in a loss position for each of the periods presented and holders of convertible preferred stock do not have to participate in losses.

Since we were in a loss position for each of the periods presented, diluted net loss per share is the same as basic net loss per share for each period as the inclusion of all potential common stock shares outstanding would have been anti-dilutive. The potentially dilutive securities that were excluded from the diluted per share calculation because they would have been anti-dilutive were as follows:

	Year Ended December 31,		
	2020	2019	2018
Convertible preferred stock ⁽¹⁾	129,496,639	129,496,639	116,919,732
Warrants to purchase convertible preferred stock.	569,093	569,093	569,093
Stock options to purchase common stock.	26,359,796	20,401,985	18,518,472
Warrants to purchase common stock	5,149,716	117,630	81,000
Common stock subject to repurchase	—	—	14,000
	<u>161,575,244</u>	<u>150,585,347</u>	<u>136,102,297</u>

(1) Represents the shares of common stock that the convertible preferred stock is convertible into.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

12. Income Tax

The components of the net loss before the provision for income taxes were as follows (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Domestic	\$ (126,985)	\$ (101,552)	\$ (91,622)

The provision for income taxes consisted of the following (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Current:			
Federal	\$ —	\$ —	\$ —
State	13	—	—
Foreign	9	—	—
Total current provision	22	—	—
Deferred:	—	—	—
Federal	—	—	—
State	—	—	—
Foreign	—	—	—
Total deferred provision	—	—	—
Total provision for income taxes	<u>\$ 22</u>	<u>\$ —</u>	<u>\$ —</u>

A reconciliation of the U.S. federal statutory income tax rates to our effective tax rate is as follows (in percentages):

	Year Ended December 31,		
	2020	2019	2018
U.S. federal statutory rate	21.0%	21.0%	21.0%
State income taxes, net of federal benefit	1.7	3.4	6.1
Change in valuation allowance	(17.5)	(23.9)	(27.0)
Research and development credit	0.2	0.3	0.6
Fair market adjustment	(2.1)	—	—
Non-deductible Convertible Notes interest expense	(2.2)	—	—
Other	(1.1)	(0.8)	(0.7)
Effective income tax rate	<u>—%</u>	<u>—%</u>	<u>—%</u>

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

12. Income Tax (cont.)

Our deferred tax assets (liabilities) are as follows (in thousands):

	December 31,	
	2020	2019
Deferred tax assets:		
Net operating loss carryforwards	\$ 113,643	\$ 96,047
Deferred revenue	6,731	4,695
Stock-based compensation	3,560	2,509
Accruals and reserves, not currently deductible for tax purposes	8,351	7,612
Research and development credit	2,761	2,458
Goodwill	1,014	1,277
Interest expense	2,097	1,576
Lease liability	2,738	—
Other	44	39
Gross deferred tax assets	140,939	116,213
Less valuation allowance	(137,437)	(115,175)
Net deferred tax assets	<u>\$ 3,502</u>	<u>\$ 1,038</u>
Deferred tax liabilities:		
Property, plant and equipment	\$ (1,008)	\$ (1,050)
ROU assets	(2,494)	—
Other	—	12
Gross deferred tax liabilities	(3,502)	(1,038)
Net deferred tax asset (liabilities)	<u>\$ —</u>	<u>\$ —</u>

The net valuation allowance increased by \$22.3 million and \$24.3 million for 2020 and 2019, respectively.

As of December 31, 2020 and 2019, the Company's net deferred tax assets and liabilities were zero. The deferred tax assets consist primarily of the federal and state net operating losses. Realization of deferred tax assets is dependent upon future taxable income, if any, the amount and timing of which are uncertain. In assessing the realizability of deferred tax assets, management determined that it is more likely than not that no deferred tax assets will be realized. Therefore, the Company has provided a full valuation allowance against these deferred tax assets.

The Company had net operating loss carryforwards as follows (in thousands):

	December 31,	
	2020	2019
Federal (Prior to 2018)	\$ 237,850	\$ 237,850
Federal (Post December 31, 2017)	216,724	145,480
State	317,801	272,029
Total	<u>\$ 772,375</u>	<u>\$ 655,359</u>

Net operating loss carryforwards are available to offset future federal and state taxable income. The federal net operating loss carryforwards generated prior to 2018 will begin to expire in 2030 and the net operating loss carryforwards generated after December 31, 2017 do not expire. The state net operating loss carryforwards will begin to expire in 2023.

PROTERRA INC.
NOTES TO FINANCIAL STATEMENTS

12. Income Tax (cont.)

The Company had research and development credit carryforwards as follows (in thousands):

	December 31,	
	2020	2019
Federal.	\$ 2,020	\$ 1,728
State.	1,231	1,099
Total	<u>\$ 3,251</u>	<u>\$ 2,827</u>

The research and development credit carryforwards are available to reduce future regular income taxes. The federal research and development credit carryforwards will begin to expire in 2037, while the South Carolina research and development credit carryforwards will begin to expire in 2027. California research and development credit carryforwards have no expiration date.

Utilization of the Company's net operating loss carryforwards and research tax credit carryforwards may be subject to substantial annual limitations due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. The annual limitation could result in the expiration of the net operating loss carryforwards and research tax credit carryforwards before utilization.

The Company's policy is to recognize interest or penalties related to income tax matters in income tax expense. As of December 31, 2020 and 2019, the Company had no accrued interest or penalties. The unrecognized tax benefits may change during the next year for items that arise in the ordinary course of business. In the event that any unrecognized tax benefits are recognized, the effective tax rate will not be affected.

A reconciliation of the beginning and ending amount of unrecognized tax benefits for 2020, 2019 and 2018 was as follows (in thousands):

	Year Ended December 31,		
	2020	2019	2018
Beginning balance.	\$ 707	\$ 527	\$ 165
Increase – tax positions in current period.	106	180	316
Increase – tax positions in prior periods.	—	—	46
Ending balance	<u>\$ 813</u>	<u>\$ 707</u>	<u>\$ 527</u>

The Company files tax returns in the United States and certain states. Due to the losses being carried forward, the tax years from 2011 forward remain open to examination.

In March 2020, the "Coronavirus Aid, Relief and Economic Security (CARES) Act" was signed into law. The CARES Act includes provisions relating to refundable payroll tax credits, deferment of the employer portion of certain payroll taxes, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations and technical corrections to tax depreciation methods for qualified improvement property. These provisions are not expected to have a material effect on the Company's financial statements.

13. 401(k) Plan

The Company sponsors a 401(k) defined contribution plan covering all eligible employees and provides matching contribution for the first 4% of their salaries. The matching contribution costs incurred were \$1.9 million, \$1.7 million, and \$1.2 million for the years ended December 31, 2020, 2019 and 2018, respectively.

PROTERRA INC.
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14. Subsequent Events

On January 11, 2021, the Company entered into an Agreement and Plan of Merger (“Merger Agreement”) with ArcLight Clean Transition Corp., a publicly traded special purpose acquisition company (“SPAC”) and Cayman Islands exempted company (“ArcLight”) and Phoenix Merger Sub, Inc., a Delaware corporation and a wholly-owned subsidiary of ArcLight (“Phoenix Merger Sub”).

At the closing, ArcLight will become a Delaware corporation, and Phoenix Merger Sub will merge with and into Proterra, with Proterra as the surviving company and continuing as a wholly-owned subsidiary of ArcLight. ArcLight’s name will be changed to Proterra Inc (“New Proterra”).

Upon closing of the merger,

- Proterra’s outstanding convertible preferred stock of 129,003,889 shares will convert into 129,496,639 shares of common stock. Each share of Proterra common stock (including shares issuable upon conversion of Proterra convertible preferred stock) will be converted into the right to receive 0.8925 shares of New Proterra Common Stock, as a result of applying the Exchange Ratio;
- each Proterra option will be converted into an option to purchase shares of New Proterra Common Stock by multiplying the number of underlying shares by the exchange ratio, rounded down to the nearest whole share; the exercise price of each converted option will be determined by dividing the per share exercise price of the respective Proterra options by the Exchange Ratio, rounded up to the nearest whole cent;
- each Proterra warrant to purchase common stock and convertible preferred stock will be converted into a warrant to purchase shares of New Proterra Common Stock by multiplying the number of underlying shares by the Exchange Ratio, rounded down to the nearest whole share; the exercise price of each converted warrant will be determined by dividing the per share exercise price of the respective Proterra warrant by the Exchange Ratio, rounded up to the nearest whole cent;
- each outstanding Convertible Note that was not optionally converted immediately prior to the consummation of the merger will remain outstanding and become convertible into shares of New Proterra Common Stock in accordance with the terms of such Convertible Notes.

In the event that the closing sale price of New Proterra common stock exceeds certain price thresholds for 20 out of any 30 consecutive trading days or in any transaction resulting in a change in control with a valuation of the New Proterra Common Stock exceeds certain price thresholds during the first five years following the closing of the merger, up to an additional 22,809,500 shares of New Proterra Common Stock may be issued to holders of Proterra convertible preferred stock, common stock, warrants, vested options and Convertible Notes as of immediately prior to the closing of the merger.

In connection with the merger, ArcLight entered into subscription agreements with certain investors (“PIPE Investors”) to purchase an aggregate of 41.5 million shares of New Proterra common stock, immediately following the closing of merger, at a purchase price of \$10.00 per share, for aggregate gross proceeds of \$415.0 million (“PIPE Financing”).

In connection with the execution of the Merger Agreement, ArcLight entered into the Sponsor Letter Agreement with the ArcLight Sponsor providing that 10% of the New Proterra Common Stock received by Sponsor upon consummation of the merger in exchange for its outstanding shares of ArcLight class B ordinary shares, excluding 140,000 shares owned by ArcLight board of directors, will be subject to vesting and forfeiture.

ArcLight public shareholders have rights to redeem their shares for cash upon the closing of the merger. The Merger Agreement includes as a condition to close the merger that, at the closing of the merger, ArcLight will have a minimum of \$350.0 million of funds, net of any unpaid liabilities.

We have evaluated subsequent events through April 7, 2021.