
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2022

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 001-38839

Shift Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

82-5325852

(IRS Employer Identification No.)

290 Division Street, Suite 400, San Francisco, California 94103-4893

(Address of principal executive offices)

Registrant's telephone number, including area code: (855) 575-6739
Securities registered pursuant to Section 12(b) of the Exchange Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|--|-------------------|---|
| Class A common stock, par value \$0.0001 per share | SFT | Nasdaq Capital Market |

Securities registered pursuant to Section 12(g) of the Exchange Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|-------------------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer | <input checked="" type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> | Smaller reporting company | <input type="checkbox"/> |
| Emerging growth company | <input checked="" type="checkbox"/> | | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of May 9, 2022 the registrant had 82,679,131 shares of common stock outstanding.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Statements contained in this Quarterly Report on Form 10-Q that reflect our current views with respect to future events and financial performance, business strategies, and expectations for our business constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Our forward-looking statements include, but are not limited to, statements regarding our or our management’s expectations, hopes, beliefs, intentions or strategies regarding the future. In addition, any statements that refer to projections, forecasts or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. The words “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “might,” “plan,” “possible,” “potential,” “predict,” “project,” “should,” “would,” “will,” “approximately,” “shall,” the negative of any of these and any similar expressions may identify forward-looking statements, but the absence of these words does not mean that a statement is not forward-looking.

Some factors that could cause actual results to differ include, but are not limited to:

- general business and economic conditions and risks related to the larger automotive ecosystem;
- competition, and the ability of the Company to grow and manage growth profitably;
- our history of losses and ability to achieve or maintain profitability in the future;
- our ability to sustain our current rate of growth;
- our ability to establish our software as a platform to be used by automotive dealers;
- risks relating to our inspection, reconditioning and storage hubs;
- impacts of COVID-19 and other pandemics;
- our reliance on third-party carriers for transportation;
- our current geographic concentration where we provide reconditioning services and store inventory;
- cyber-attacks or other privacy or data security incidents;
- the impact of copycat websites;
- failure to adequately protect our intellectual property, technology and confidential information;
- our reliance on third-party service providers to provide financing;
- the impact of federal and state laws related to financial services on our third-party service providers;
- the impact of federal, state and local laws on our ability to obtain and maintain necessary dealer and financing licenses in the states in which we do business;
- risks that impact the quality of our customer experience, our reputation, or our brand;
- changes and ambiguity in the prices of new and used vehicles;
- our ability to correctly appraise and price vehicles;
- access to desirable vehicle inventory;
- our ability to expeditiously sell inventory;
- our ability to expand product offerings;
- changes in applicable laws and regulations and our ability to comply with applicable laws and regulations;
- access to additional debt and equity capital;

- changes in technology and consumer acceptance of such changes;
- our reliance on internet search engines, vehicle listing sites and social networking sites to help drive traffic to our website;
- any restrictions on the sending of emails or messages or an inability to timely deliver such communications;
- seasonal and other fluctuations in our quarterly results of operations;
- competition in the markets in which we operate;
- changes in the auto industry and conditions affecting automotive manufacturers;
- natural disasters, adverse weather events and other catastrophic events;
- our dependence on key personnel;
- our ability to rapidly hire and retain qualified personnel necessary to grow our business as anticipated;
- increases in labor costs;
- our reliance on third-party technology and information systems;
- our use of open-source software;
- claims asserting that our employees, consultants or advisors have wrongfully used or disclosed alleged trade secrets of their current or former employers;
- significant disruptions in service on our platform;
- impairment charges;
- changes in interest rates;
- volatility in the price of our common stock;
- issuances of our common stock and future sales of our common stock;
- our ability to establish and maintain effective internal control over financial reporting; and
- other economic, business and/or competitive factors, risks and uncertainties, including those described in “Item 1A. Risk Factors.”

We do not undertake, and expressly disclaim, any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws. We caution you not to place undue reliance on the forward-looking statements, which speak only as of the date of this filing.

Part I - Financial Information

ITEM 1. FINANCIAL STATEMENTS

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(in thousands, except share and per share amounts)
(unaudited)

| | As of March 31, 2022 | As of December 31, 2021 |
|---|-------------------------|----------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 94,883 | \$ 182,616 |
| Accounts receivable, net of allowance for doubtful accounts of \$280 and \$304 | 19,954 | 20,084 |
| Inventory | 160,327 | 122,743 |
| Prepaid expenses and other current assets | 7,948 | 7,392 |
| Total current assets | 283,112 | 332,835 |
| Property and equipment, net | 9,473 | 7,940 |
| Operating lease right-of-use assets | 26,216 | — |
| Capitalized website and internal use software costs, net | 10,519 | 9,262 |
| Restricted cash, non-current | 11,900 | 11,725 |
| Deferred borrowing costs | 487 | 564 |
| Other non-current assets | 3,189 | 3,414 |
| Total assets | \$ 344,896 | \$ 365,740 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 15,166 | \$ 15,175 |
| Accrued expenses and other current liabilities | 35,599 | 43,944 |
| Current maturities of operating lease liabilities | 4,491 | — |
| Flooring line of credit | 100,005 | 83,252 |
| Total current liabilities | 155,261 | 142,371 |
| Convertible notes, net | 144,623 | 144,335 |
| Non-current operating lease liabilities | 22,738 | — |
| Other non-current liabilities | 1,657 | 3,762 |
| Total liabilities | 324,279 | 290,468 |
| Commitments and contingencies (Note 10) | | |
| Stockholders' equity: | | |
| Preferred stock – par value \$0.0001 per share; 1,000,000 shares authorized at March 31, 2022 and December 31, 2021, respectively | — | — |
| Common stock – par value \$0.0001 per share; 500,000,000 shares authorized at March 31, 2022 and December 31, 2021, respectively; 82,679,131 and 81,369,311 shares issued and outstanding at March 31, 2022 and December 31, 2021, respectively | 8 | 8 |
| Additional paid-in capital | 518,368 | 515,975 |
| Accumulated deficit | (497,759) | (440,711) |
| Total stockholders' equity | 20,617 | 75,272 |
| Total liabilities and stockholders' equity | \$ 344,896 | \$ 365,740 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations and Comprehensive Loss
(in thousands, except share and per share amounts)
(unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|--------------------|
| | 2022 | 2021 |
| Revenue | | |
| Ecommerce revenue, net | \$ 183,081 | \$ 88,954 |
| Other revenue, net | 8,712 | 4,019 |
| Wholesale vehicle revenue | 27,787 | 13,031 |
| Total revenue | <u>219,580</u> | <u>106,004</u> |
| Cost of sales | <u>208,792</u> | <u>98,638</u> |
| Gross profit | 10,788 | 7,366 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 63,537 | 50,234 |
| Depreciation and amortization | 1,680 | 1,101 |
| Total operating expenses | <u>65,217</u> | <u>51,335</u> |
| Loss from operations | (54,429) | (43,969) |
| Change in fair value of financial instruments | — | 2,153 |
| Interest and other expense, net | (2,578) | (939) |
| Net loss before income taxes | <u>(57,007)</u> | <u>(42,755)</u> |
| Provision for income taxes | 41 | — |
| Net loss and comprehensive loss attributable to common stockholders | <u>\$ (57,048)</u> | <u>\$ (42,755)</u> |
| Net loss and comprehensive loss per share attributable to common stockholders, basic and diluted | <u>\$ (0.70)</u> | <u>\$ (0.55)</u> |
| Weighted-average number of shares outstanding used to compute net loss per share attributable to common stockholders, basic and diluted | <u>81,825,252</u> | <u>77,909,110</u> |

The accompanying notes are an integral part of these condensed consolidated financial statements.

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Stockholders' Equity
(in thousands, except share and per share amounts)
(unaudited)

| | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Total Stockholders' Equity |
|--|--------------|--------|----------------------------------|------------------------|----------------------------------|
| | Shares | Amount | | | |
| Balance at December 31, 2021 | 81,369,311 | \$ 8 | \$ 515,975 | \$ (440,711) | \$ 75,272 |
| Issuance of common stock under stock-based compensation plans, net of shares exchanged for withholding tax | 1,300,295 | — | (2,162) | — | (2,162) |
| Issuance of common stock upon exercise of vested options | 12,309 | — | 3 | — | 3 |
| Repurchase of shares related to early exercised options | (2,784) | — | — | — | — |
| Vesting of early exercised options | — | — | 35 | — | 35 |
| Stock-based compensation | — | — | 4,517 | — | 4,517 |
| Net loss and comprehensive loss | — | — | — | (57,048) | (57,048) |
| Balance at March 31, 2022 | 82,679,131 | \$ 8 | \$ 518,368 | \$ (497,759) | \$ 20,617 |

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Stockholders' Equity
(in thousands, except share and per share amounts)
(unaudited)

| | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Total Stockholders' Equity |
|--|-------------------|-------------|----------------------------------|------------------------|----------------------------------|
| | Shares | Amount | | | |
| Balance at December 31, 2020 | 83,904,182 | \$ 8 | \$ 511,617 | \$ (274,443) | \$ 237,182 |
| Warrant Exchange | 125,160 | — | (497) | — | (497) |
| Issuance of common stock upon exercise of vested options | 107,645 | — | 200 | — | 200 |
| Vesting of early exercised options | — | — | 132 | — | 132 |
| Repurchase of shares related to early exercised options | — | — | 1 | — | 1 |
| Stock-based compensation | — | — | 8,375 | — | 8,375 |
| Net loss and comprehensive loss | — | — | — | (42,755) | (42,755) |
| Balance at March 31, 2021 | <u>84,136,987</u> | <u>\$ 8</u> | <u>\$ 519,828</u> | <u>\$ (317,198)</u> | <u>\$ 202,638</u> |

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|-------------|
| | 2022 | 2021 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | \$ (57,048) | \$ (42,755) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 2,019 | 1,173 |
| Stock-based compensation expense | 4,192 | 8,203 |
| Change in fair value of financial instruments | — | (2,153) |
| Amortization of operating lease right-of-use assets | 2,162 | — |
| Contra-revenue associated with milestones | 159 | 159 |
| Amortization of debt discounts | 365 | — |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 130 | (12,782) |
| Inventory | (37,762) | (25,167) |
| Prepaid expenses and other current assets | (2,179) | (4,129) |
| Other non-current assets | (27) | 296 |
| Accounts payable | (543) | 1,760 |
| Accrued expenses and other current liabilities | (6,243) | 3,005 |
| Operating lease liabilities | (1,925) | — |
| Other non-current liabilities | (1,670) | 915 |
| Net cash, cash equivalents, and restricted cash used in operating activities | (98,370) | (71,475) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of property and equipment | (1,444) | (1,135) |
| Capitalized website internal-use software costs | (2,328) | (1,353) |
| Net cash, cash equivalents, and restricted cash used in investing activities | (3,772) | (2,488) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from flooring line of credit facility | 126,903 | 57,096 |
| Repayment of flooring line of credit facility | (110,150) | (39,661) |
| Exchange of warrants for cash | — | (497) |
| Proceeds from stock option exercises, including from early exercised options | 3 | 200 |
| Payment of tax withheld for common stock issued under stock-based compensation plans | (2,162) | — |
| Repurchase of shares related to early exercised options | (10) | (1) |
| Net cash, cash equivalents, and restricted cash provided by financing activities | 14,584 | 17,137 |
| Net decrease in cash, cash equivalents and restricted cash | (87,558) | (56,826) |
| Cash, cash equivalents and restricted cash, beginning of period | 194,341 | 235,541 |
| Cash, cash equivalents and restricted cash, end of period | \$ 106,783 | \$ 178,715 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|--------|
| | 2022 | 2021 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid for interest | \$ 496 | \$ 176 |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES | | |
| Capital expenditures in accounts payable | \$ 534 | \$ — |
| Vesting of exercised options | 35 | 132 |
| Stock-based compensation capitalized to internal-use software | 325 | 172 |
| Establishment of operating lease right of use assets and lease liabilities | | |
| Operating lease right of use assets | 27,855 | — |
| Operating lease liabilities | 28,631 | — |
| Other Assets | 1,716 | — |
| Other Liabilities | 2,492 | — |

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. DESCRIPTION OF THE BUSINESS AND ACCOUNTING POLICIES

Shift Technologies, Inc., which, together with its subsidiaries we refer to as Shift, we, us, our, SFT, or the Company, conducts its business through its wholly owned subsidiaries Shift Platform, Inc., Shift Operations, LLC, and their subsidiaries. Shift Platform, Inc., formerly known as Shift Technologies, Inc. (“Legacy Shift”) was incorporated in the State of Delaware on December 9, 2013.

On October 13, 2020, Insurance Acquisition Corp. (“IAC”), an entity listed on the Nasdaq Capital Market under the trade symbol “INSU”, acquired Shift Platform, Inc., formerly known as Shift Technologies, Inc. (“Legacy Shift”), by the merger of IAC Merger Sub, Inc., a direct wholly owned subsidiary of IAC, with and into Legacy Shift, with Legacy Shift continuing as the surviving entity and a wholly owned subsidiary of IAC (the “Merger”). The public company resulting from the merger was renamed Shift Technologies, Inc.

The Company is headquartered in San Francisco, California and operates hubs to purchase, recondition and/or sell vehicles in major cities in California, Oregon, Washington, and Texas. Shift operates an innovative platform to make car purchases, car sales and ownership simple. Shift’s innovative platform, which includes proprietary pricing technology, provides consumers with a digital purchase and selling experience, and includes offerings throughout the sales cycle, including vehicle pickup and delivery at a customer’s location.

The Company currently is organized into two reportable segments: Retail and Wholesale. The Retail segment represents retail sales of used vehicles through the Company’s ecommerce platform and fees earned on sales of value-added products associated with those vehicles sales such as vehicle service contracts, guaranteed asset protection waiver coverage, prepaid maintenance plans, and appearance protection plans. The Wholesale segment represents sales of used vehicles through wholesale auctions or directly to a wholesaler (“DTW”).

COVID-19

In March 2020, the World Health Organization declared the outbreak of the novel coronavirus disease (“COVID-19”) as a pandemic. The Company saw a slowing of vehicle sales immediately following the shelter in place ordinances in March; however, within five weeks, weekly sales volume rebounded nearly to pre-COVID-19 volumes. The Company has adjusted certain aspects of its operations to protect its employees and customers while still meeting customers’ needs for vital technology, including implementing contactless purchase and delivery processes and applying long-term antimicrobial surface and air protection systems for its entire inventory.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), was signed into law in response to the COVID-19 pandemic. The CARES Act includes several significant income tax relief provisions as well as the deferral of the employer portion of the social security payroll tax. The income tax benefits include a favorable increase in the interest expense limitation under section 163(j), allowing a five-year net operating loss (“NOL”) carryback provision for certain NOLs, and increasing the amount of NOLs corporations may use to offset income for taxable years beginning before 2021. The Company has evaluated the income tax impacts of the CARES Act and does not expect that the income tax relief provisions of the CARES Act will significantly impact the Company, since it has had taxable losses since inception. In addition, the Company has adopted the deferral of the employer portion of the social security payroll tax. The deferral was effective from the enactment date through December 31, 2020. As of March 31, 2022, the Company had repaid \$0.6 million of the \$1.3 million originally deferred. As required, the remaining deferred amount will be paid by December 31, 2022.

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(unaudited)

Basis of Presentation

Our unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Intercompany accounts and transactions have been eliminated. In the opinion of management, the interim condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, necessary for fair financial statement presentation.

The interim condensed consolidated balance sheets as of March 31, 2022 and December 31, 2021, the interim condensed consolidated statements of operations and comprehensive loss for the three months ended March 31, 2022 and 2021, condensed consolidated statements of stockholders' equity for the three months ended March 31, 2022 and 2021, and condensed consolidated statements of cash flows for the three months ended March 31, 2022 and 2021, and amounts relating to the interim periods included in the accompanying notes to the interim condensed consolidated financial statements are unaudited. The unaudited interim financial statements have been prepared on the same basis as the audited consolidated financial statements contained in the Company's most recent Annual Report on Form 10-K, and in management's opinion, reflect all adjustments, which are normal and recurring in nature, necessary for the fair financial statement presentation of the Company's condensed consolidated balance sheet as of March 31, 2022, and its results of operations for the three months ended March 31, 2022 and 2021 and cash flows for the three months ended March 31, 2022 and 2021. The results for the three months ended March 31, 2022 are not necessarily indicative of the results expected for the fiscal year or any other periods. These interim financial statements should be read in conjunction with the Company's consolidated financial statements and related notes for the fiscal year ended December 31, 2021 included in our Annual Report on Form 10-K filed with the United States Securities and Exchange Commission ("SEC") on March 16, 2022.

Liquidity and Management's Plan

For the three months ended March 31, 2022 and 2021, the Company generated negative cash flows from operations of approximately \$98.4 million and \$71.5 million, respectively, and generated net losses of approximately \$57.0 million and \$42.8 million, respectively. As of March 31, 2022, the Company had unrestricted cash and cash equivalents of \$94.9 million and total working capital of \$127.9 million. Since inception, the Company has had negative cash flows and losses from operations which it has funded primarily through issuances of common and preferred stock and through a reverse recapitalization via its merger with Insurance Acquisition Corp. in October 2020. The Company has historically funded vehicle inventory purchases through its vehicle floorplan facilities (see Note 5 - Borrowings). As further discussed in Note 14 - Subsequent Events, the Company has entered into an "At the Market" (ATM) facility that allows it to raise capital via the sale of its Class A Common Stock. The Company is also actively engaged in other efforts to raise debt or equity capital.

The Company's plan is to raise additional capital through the ATM and other capital-raising efforts to provide net proceeds which the Company believes will be sufficient to provide the liquidity necessary to satisfy its obligations over the next twelve months. The Company's ability to raise capital from the ATM facility may be constrained by the price of and demand for the Company's Class A Common Stock. There can be no assurance that net proceeds from the ATM will be sufficient, or that the Company will be able to complete its other planned capital raising efforts and raise sufficient additional capital that will provide it with sufficient liquidity to satisfy its obligations over the next twelve months.

In accordance with Accounting Standards Update No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (Subtopic 205-40), the Company has evaluated whether there are conditions and events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the condensed consolidated financial statements are issued or available to be issued. Management determined as a result of this evaluation the Company's losses and negative cash flows from operations since inception, combined with its current cash and working capital position, raise substantial doubt about the Company's ability to continue as a going concern.

The condensed consolidated financial statements have been prepared on a basis that assumes the Company will continue as a going concern which contemplates the realization of assets and satisfaction of liabilities and commitments in the ordinary course of business. Accordingly, the accompanying condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(unaudited)

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates and assumptions, including those related to the valuation of vehicle inventory, capitalized website and internal-use software development costs, fair value of common stock, financial instruments, convertible debt, stock-based compensation and income taxes.

The COVID-19 pandemic has adversely impacted the global economy, as well as the Company's operations, and the extent and duration of the impacts remain unclear. The Company's future estimates, including, but not limited to, the inventory valuations, and fair value measurements, may be impacted and continue to evolve as conditions change as a result of the COVID-19 pandemic.

Management bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from those estimates.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability.

The authoritative guidance on fair value measurements establishes a three-tier fair value hierarchy for disclosure of fair value measurements as follows:

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

Level 2 — Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires management to make judgments and consider factors specific to the asset or liability. As of March 31, 2022 and December 31, 2021, the Company had no assets or liabilities measured at fair value.

On October 13, 2020, Insurance Acquisition Corp. ("IAC"), an entity listed on the Nasdaq Capital Market under the trade symbol "INSU", acquired Legacy Shift by the merger of IAC Merger Sub, Inc., a direct wholly owned subsidiary of IAC, with and into Legacy Shift, with Legacy Shift continuing as the surviving entity and a wholly owned subsidiary of IAC (the "Merger"). The public company resulting from the merger was renamed Shift Technologies, Inc.

In connection with the closing of the Merger, 6,000,218 shares of the Company's common stock (the "Escrow Shares") were deposited into an escrow account, with each former Legacy Shift stockholder listed as beneficiary in proportion to their percentage ownership of Legacy Shift common shares immediately prior to the Merger. The Escrow Shares will be released to the beneficiaries if the following conditions are achieved following October 13, 2020, the date of the closing of the Merger:

- i. if at any time during the 12 months following the closing, the closing share price of the Company's common stock is greater than \$12.00 over any 20 trading days within any 30 trading day period, 50% of the Escrow Shares will be released; and
- ii. if at any time during the 30 months following the closing, the closing share price of the Company's common stock is greater than \$15.00 over any 20 trading days within any 30 trading day period, 50% of the Escrow Shares will be released.

SHIFT TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(unaudited)

- iii. If, during the 30 months following the closing, there is a change of control (as defined in the Merger Agreement) that will result in the holders of the Company's common stock receiving a per share price equal to or in excess of \$10 per share (as equitably adjusted for stock splits, stock dividends, special cash dividends, reorganizations, combinations, recapitalizations and similar transactions affecting the common stock after the date of the Merger), then all remaining Escrow Shares shall be released to the Legacy Shift stockholders effective as of immediately prior to the consummation of such change of control.

The Escrow Shares are legally outstanding and the beneficiaries retain all voting, dividend and distribution rights applicable to the Company's common stock while the shares are in escrow. If the conditions for the release of the Escrow Shares are not met, the shares and any dividends or distributions arising therefrom shall be returned to the Company. The Escrow Shares are not considered outstanding for accounting purposes, and as such are excluded from the calculation of basic net loss per share (see Note 12).

The Escrow Shares meet the accounting definition of a derivative financial instrument. Prior to the cancellation of the first tranche on October 13, 2021, as the number of Escrow Shares that would have ultimately been released was partially dependent on variables (namely, the occurrence of a change in control) that are not valuation inputs to a "fixed for fixed" option or forward contract, the Escrow Shares were not considered to be indexed to the Company's common stock and were therefore classified as a liability. The Company's obligation to release the Escrow Shares upon achievement of the milestones was initially recorded to financial instruments liability on the condensed consolidated balance sheets at fair value as of the date of the Merger. Subsequent changes in the fair value of the liability were recorded to change in fair value of financial instruments on the condensed consolidated statements of operations and comprehensive loss.

The Escrow Shares were remeasured on a recurring basis using Level 3 inputs. The fair value of the Escrow Shares was determined using a Monte Carlo valuation model, which requires significant estimates including the expected volatility of our common stock. The expected annual volatility of our common stock was estimated to be 67.60% as of March 31, 2021, based on the historical volatility of comparable publicly traded companies.

The table below illustrates the changes in the fair value of the Company's Level 3 financial instruments liability:

| <i>(in thousands)</i> | 2021 |
|--|------------------|
| Balance as of January 1, | \$ 25,230 |
| Remeasurement of Escrow Shares liability | (2,153) |
| Balance as of March 31, | <u>\$ 23,077</u> |

As of the first anniversary of the Merger on October 13, 2021, the first tranche of 3,000,109 Escrow Shares had failed to satisfy the \$12.00 stock performance hurdle. As a result, the shares were returned to the Company for cancellation.

Following the return of the first tranche of the Escrow Shares to the Company on October 13, 2021, the Escrow Shares met the "fixed for fixed" option or forward contract criteria for equity classification. As such, changes in fair value of the Escrow Shares through October 13, 2021 were recorded in change in fair value of financial instruments on the condensed consolidated statements of operations and comprehensive loss. The fair value of the shares on October 13, 2021 of \$6.3 million, measured using the Monte Carlo valuation model, was reclassified to additional paid-in capital on the condensed consolidated balance sheets.

During the three months ended March 31, 2021, the Company recognized a gain related to the change in fair value of the Escrow Shares of \$2.2 million, which is included in change in fair value of financial instruments on the condensed consolidated statements of operations and comprehensive loss.

Recently Issued Accounting Standards

In June 2016, the FASB issued ASU 2016-13, *Financial instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, and subsequent related ASUs, which amends the guidance on the impairment of financial instruments by requiring measurement and recognition of expected credit losses for financial assets held. This ASU is effective for public and private companies' fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2019, and December 15, 2022, respectively. The Company expects to adopt ASU 2016-13 under the private company transition guidance beginning January 1, 2023, and is currently evaluating the impact on the Company's condensed consolidated financial statements.

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Recently Adopted Accounting Standards

In February 2016, the FASB issued, ASU 2016-02, Leases (Topic 842), which amends the accounting guidance on leases. The new standard requires a lessee to recognize right-of-use assets and lease obligations on the balance sheet for most lease agreements. Leases are classified as either operating or finance, with classification affecting the pattern of expense recognition in the statement of operations. The FASB also subsequently issued amendments to the standard to provide additional practical expedients and an additional transition method option.

The Company adopted Topic 842 as of January 1, 2022 using the modified retrospective approach with a cumulative-effect adjustment to opening retained earnings (accumulated deficit) with no restatement of comparative periods. Upon adoption, the Company recognized \$28.6 million of operating lease liabilities and \$27.9 million of operating lease right-of-use assets. The adoption of Topic 842 did not result in a cumulative effect adjustment to accumulated deficit.

Topic 842 provides various optional practical expedients for transition. The Company elected to utilize the package of practical expedients for transition which permitted the Company to not reassess its prior conclusions regarding whether a contract is or contains a lease, lease classification and initial direct costs.

Topic 842 also provides optional practical expedients for an entity's ongoing lease accounting. The Company elected the short-term lease recognition exemption for all leases that qualify and the practical expedient to not separate lease and non-lease components of leases.

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes* ("ASU 2019-12"). ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and also clarifies and amends existing guidance to improve consistent application. The Company adopted ASU 2019-12 on January 1, 2022. There was no impact to the Company's condensed consolidated financial statements.

2. PROPERTY AND EQUIPMENT, NET

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

| | As of March 31, 2022 | As of December 31, 2021 |
|--------------------------------|-------------------------|----------------------------|
| Equipment | \$ 10,717 | \$ 8,753 |
| Furniture and fixtures | 326 | 252 |
| Leasehold improvements | 1,372 | 1,258 |
| Total property and equipment | 12,415 | 10,263 |
| Less: accumulated depreciation | (2,942) | (2,323) |
| Property and equipment, net | <u>\$ 9,473</u> | <u>\$ 7,940</u> |

Depreciation expense related to property and equipment was \$0.6 million and \$0.3 million for the three months ended March 31, 2022 and 2021, respectively. Depreciation expense related to reconditioning facilities of \$0.3 million and \$0.1 million, respectively, is included in cost of sales with the remainder included in depreciation and amortization in the condensed consolidated statements of operations and comprehensive loss.

3. CAPITALIZED WEBSITE AND INTERNAL-USE SOFTWARE COSTS, NET

Capitalized website and internal use software costs, net consists of the following (in thousands):

| | As of March 31, 2022 | As of December 31, 2021 |
|---|-------------------------|----------------------------|
| Capitalized website domain costs – nonamortizable | \$ 385 | \$ 385 |
| Capitalized website and internal-use software development costs – amortizable | 27,029 | 24,433 |
| Less: accumulated amortization | (16,895) | (15,556) |
| Capitalized website and internal-use software development costs, net | <u>\$ 10,519</u> | <u>\$ 9,262</u> |

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Amortization of capitalized software development costs is included in depreciation and amortization in the condensed consolidated statements of operations and comprehensive loss. Amortization of capitalized software development costs amounted to \$1.4 million and \$0.9 million for the three months ended March 31, 2022 and 2021, respectively.

4. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following (in thousands):

| | As of March 31, 2022 | As of December 31, 2021 |
|---|-------------------------|----------------------------|
| Liability for vehicles acquired under OEM program | \$ 3,166 | \$ 3,550 |
| Accrued payroll related costs | 8,149 | 15,890 |
| Provision for DMV refunds | 1,121 | 1,170 |
| Accrued sales taxes | 9,467 | 13,787 |
| Common stock subject to repurchase liability, current | 125 | 142 |
| Interest payable | 2,692 | 910 |
| Provision for sales returns and cancellations | 4,588 | 3,302 |
| Other accrued expenses | 6,291 | 5,193 |
| Total accrued expenses and other current liabilities | <u>\$ 35,599</u> | <u>\$ 43,944</u> |

In November 2019, the Company entered into an arrangement with an original equipment manufacturer (“OEM”) to sell vehicles sourced locally through the trade-in program of the OEM on the Company’s platform. Under the terms of the arrangement, the Company has the option to provisionally accept any trade-ins based on information provided by the OEM. The Company transports any accepted vehicles to one of its inspection, reconditioning and storage centers where Shift inspects the vehicle and makes a final purchasing decision regarding the vehicle. Any rejected vehicles are sent to wholesale auction facilities at Shift’s expense, at which point Shift has no further obligations to the automaker for the rejected vehicle. The Company records inventory received under the arrangement with the OEM equal to the amount of the liability due to the OEM to acquire such vehicles. The liability due to the OEM provider for such acquired vehicles is equal to the OEM’s original acquisition price. The final price paid to the OEM upon sale of the vehicle includes an additional amount equal to 50% of the excess of the sales price over the original acquisition price.

Provision for sales returns and cancellations in the table above as of December 31, 2021 has been disaggregated to be shown separately from other accrued expenses to conform to the presentation as of March 31, 2022.

5. BORROWINGS

Convertible Notes

On May 27, 2021, the Company completed a private offering of its 4.75% Convertible Senior Notes due 2026 (the “Notes”). The aggregate principal amount of the Notes sold in the offering was \$150.0 million. The Notes are the Company’s senior unsecured obligations and will rank equally in right of payment with the Company’s future senior unsecured indebtedness, senior in right of payment to the Company’s future indebtedness that is expressly subordinated to the Notes and effectively subordinated to the Company’s future secured indebtedness, to the extent of the value of the collateral securing that indebtedness.

The Notes accrue interest payable semi-annually in arrears at a rate of 4.75% per year. The Notes will mature on May 15, 2026, unless earlier converted, redeemed or repurchased by the Company.

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The Notes are convertible into shares of the Company's Class A common stock at an initial conversion rate of 118.6556 shares of the Company's Class A common stock per \$1,000 principal amount of Notes (which is equivalent to an initial conversion price of approximately \$8.43 per share of the Company's Class A common stock). The initial conversion price represents a premium of approximately 27.50% over the last reported sale price of the Company's Class A common stock on May 24, 2021, which was \$6.61 per share. The conversion rate will be subject to adjustment upon the occurrence of certain events prior to the maturity date. The Company will increase the conversion rate on a sliding scale to up to a maximum of 151.2859 per \$1,000 principal amount for a holder who elects to convert its notes in connection with certain corporate events or the Company's delivery of a notice of redemption, as the case may be, in certain circumstances.

Noteholders may convert their notes at their option only in the following circumstances:

1. during any calendar quarter commencing after the calendar quarter ending on June 30, 2021, if the last reported sale price per share of our Class A common stock exceeds 130% of the conversion price for each of at least 20 trading days during the 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter;
2. during the 5 consecutive business days immediately after any 10 consecutive trading day period (such 10 consecutive trading day period, the "measurement period") in which the trading price per \$1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price per share of our Class A common stock on such trading day and the conversion rate on such trading day;
3. upon the occurrence of certain corporate events or distributions on our Class A common stock;
4. if we call such notes for redemption; and
5. at any time from, and including, November 15, 2025 until the close of business on the second scheduled trading day immediately before the maturity date.

Conversions of the Notes will be settled in cash, shares of the Company's Class A common stock or a combination thereof, at the Company's election.

The Notes will be redeemable, in whole or in part (subject to a partial redemption limitation), at the Company's option at any time, and from time to time, on or after May 20, 2024 and on or before the 40th scheduled trading day immediately before the Maturity Date, at a cash redemption price equal to the principal amount of the Notes to be redeemed, plus accrued and unpaid interest, if any, to, but excluding, the redemption date, but only if (i) the last reported sale price per share of the Company's Class A common stock exceeds 130% of the conversion price on (1) each of at least 20 trading days, whether or not consecutive, during the 30 consecutive trading days ending on, and including, the trading day immediately before the date the Company sends the related redemption notice; and (2) the trading day immediately before the date the Company sends such notice; and (ii) a registration statement covering the resale of the shares of the Company's Class A common stock, if any, issuable upon conversion of the Notes in connection with such optional redemption is effective and available for use and is expected, as of the date the redemption notice is sent, to remain effective and available during the period from, and including the date the redemption notice is sent to, and including, the business day immediately before the related redemption date, unless the Company elects cash settlement in respect of the conversions in connection with such optional redemption.

In addition, calling any Note for redemption will constitute a make-whole fundamental change with respect to that Note, in which case the conversion rate applicable to the conversion of that Note will be increased in certain circumstances if it is converted after it is called for redemption and on or prior to the business day immediately before the related redemption date. If the Company elects to redeem less than all of the outstanding Notes, at least \$50.0 million aggregate principal amount of Notes must be outstanding and not subject to redemption as of the date the Company sends the related redemption notice.

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Unamortized deferred borrowing costs at March 31, 2022 were \$5.4 million, and are included as a reduction to convertible notes, net on the condensed consolidated balance sheets. For the three months ended March 31, 2022, the Company recorded \$2.1 million of contractual interest expense and \$0.3 million of deferred borrowing cost amortization to interest and other expense, net on the condensed consolidated statements of operations and comprehensive loss. The effective interest rate of the Notes is 5.73%.

The fair value of the Notes (Level 1) at March 31, 2022 was \$85.9 million.

The Company used a portion of the net proceeds from the sale of the notes to pay the cost of the capped call transactions (see Note 6 - Stockholders' Equity), and is using the remaining proceeds for working capital and general corporate purposes.

Ally Flooring Line of Credit

On December 9, 2021, the Company entered into a \$100.0 million flooring line of credit facility with Ally Bank to finance its used vehicle inventory (the "Ally FLOC"), which is secured by substantially all of the Company's assets. Borrowings under the Ally FLOC bear interest at the Prime Rate (as defined in the agreement) plus 1.50%. For the three months ended March 31, 2022, the weighted average interest rate on borrowings outstanding under the Ally FLOC was 4.75%. As of March 31, 2022, the Company had an outstanding balance under the facility of \$100.0 million and no unused capacity. As of December 31, 2021, the Company had an outstanding balance under the facility of \$83.3 million and \$16.7 million in unused capacity.

Under the Ally FLOC, repayment of amounts drawn for the purchase of a vehicle should generally be made as soon as practicable after selling or otherwise disposing of the vehicles. Outstanding balances related to vehicles held in inventory for more than 180 days require monthly principal payments equal to 10% of the original principal amount of that vehicle until the remaining outstanding balance is 50% (or less) of the original principal balance. Prepayments may be made without incurring a premium or penalty. Additionally, the Company is permitted to make prepayments to the lender to be held as principal payments and subsequently reborrow such amounts.

The Ally FLOC requires the Company to maintain unrestricted cash and cash equivalents of not less than 20% of the total credit line, and to maintain an additional restricted cash balance equal to 10% of the total credit line. Additionally, the Ally FLOC requires the company to maintain at least 10% equity in the Company's total inventory balance. As of March 31, 2022, the Company was in compliance with all covenants related to the Ally FLOC.

Additionally, the Company is required to pay an availability fee each calendar quarter if the average outstanding balance for such quarter is less than 50% of the average total credit line for such quarter. The Company was required to pay an upfront commitment fee upon execution of the Ally FLOC.

US Bank Flooring Line of Credit

On October 11, 2018, the Company entered into a flooring line of credit facility ("FLOC") with U.S. Bank National Association ("US Bank"), with the proceeds from such arrangement available to finance the purchase of vehicles. The FLOC initially allowed for a \$30.0 million commitment of advances, whereby the Company may borrow, prepay, repay and reborrow the advances. Advances were able to be prepaid in part or in full at any time without charge, penalty or premium. Advances under the facility accrued interest at LIBOR plus 2.00%. The obligations under the facility were secured by substantially all of the Company's inventory, both currently owned or acquired thereafter. Repayment of obligations under the facility were guaranteed by Lithia. Refer to Note 8 - Related Party Transactions for further details regarding the guarantee of the flooring line of credit, the commercial agreement and the warrants.

Subsequent amendments extended the expiration date to October 11, 2021 and increased the amount available under the FLOC to \$50.0 million. The amendments also required the Company to pay a fee of 0.40% per annum on unused availability under the FLOC, and reduced the Liquidity Covenant to one times the three-month cash burn amount.

The FLOC was subject to customary subjective acceleration clauses, effective upon a material adverse change in the Company's business or financial condition, or a material impairment in the Company's ability to repay the borrowing.

The FLOC expired on October 11, 2021 and was repaid in full.

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6. STOCKHOLDERS' EQUITY

Capped Call Transactions

On May 27, 2021, in connection with the issuance of the Notes (see Note 5 - Borrowings), the Company consummated privately negotiated capped call transactions (the "Capped Call Transactions") with certain of the initial purchasers, their respective affiliates and other counterparties (the "Capped Call Counterparties"). The Capped Call Transactions initially cover, subject to anti-dilution adjustments substantially similar to those applicable to the Notes, the number of the Company's Class A common shares underlying the Notes. The Capped Call Transactions are expected generally to reduce the potential dilution to holders of the Company's Class A common stock upon conversion of the Notes and/or offset the potential cash payments that the Company could be required to make in excess of the principal amount of any converted Notes upon conversion thereof, with such reduction and/or offset subject to a cap. The Capped Call Transactions are settled from time to time upon the conversion of the Notes, with a final expiration date of May 15, 2026. The Capped Call Transactions are settled in the same proportion of cash and stock as the converted Notes. The proportion of cash and stock used to settle the Notes is at the discretion of the Company.

The cap price of the Capped Call Transactions was initially approximately \$14.8725 per share, which represents a premium of approximately 125% above the last reported sale price per share of Class A common stock on NASDAQ on May 24, 2021, and is subject to certain adjustments under the terms of the Capped Call Transactions.

The Capped Call Transactions are separate transactions entered into by the Company with the Capped Call Counterparties, are not part of the terms of the Notes and will not change any holder's rights under the Notes. Holders of the Notes will not have any rights with respect to the Capped Call Transactions.

The Company used approximately \$28.4 million of the net proceeds from the offering of the Notes to pay the cost of the Capped Call Transactions. The Capped Call Transactions do not meet the criteria for separate accounting as a derivative as they are indexed to the Company's stock. The premiums paid for the Capped Call Transactions have been included as a net reduction to additional paid-in capital on the condensed consolidated balance sheets.

The settlement amount of the Capped Call Transactions at March 31, 2022 was zero. The settlement amount shall be greater than zero if the volume weighted average price ("VWAP") of the Company's Class A common stock is above \$8.43 at any time over the 40 consecutive trading days immediately prior to settlement.

7. STOCK-BASED COMPENSATION PLANS

The Company's 2014 Stock Option Plan (the "2014 Plan") provides for the grant of restricted stock awards and incentive and non-qualified options and to purchase common stock to officers, employees, directors, and consultants. Options granted to employees and non-employees generally vest ratably over four to five years, with a maximum contractual term of ten years. Outstanding awards under the 2014 Plan continue to be subject to the terms and conditions of the 2014 Plan. The number of shares authorized for issuance under the 2014 Plan was reduced to the number of shares subject to awards outstanding under the 2014 Plan immediately after the Merger. As a result, no further awards will be made under the 2014 Plan. Shares reserved for awards that are subsequently expired or forfeited will no longer be returned to the pool of shares authorized for issuance under the 2014 Plan.

Each Legacy Shift option from the 2014 Plan that was outstanding immediately prior to the Merger, whether vested or unvested, was converted into an option to purchase a number of shares of post-Merger common stock (each such option, a "Converted Option") equal to the product (rounded down to the nearest whole number) of (i) the number of shares of Legacy Shift common stock subject to such Legacy Shift option immediately prior to the Merger and (ii) the equity award exchange ratio. The per share exercise price for each share of post-Merger common stock issuable upon exercise of the Converted Option is equal to the exercise price per Legacy Shift share of each Legacy Shift option immediately before the Merger, with certain adjustments necessary to preserve ISO classification of awards for income tax purposes. The mechanism of conversion resulted in the fair value of each Converted Option award equaling the fair value of the corresponding Legacy Shift option award immediately prior to the consummation of the Merger. Except as specifically provided in the Merger Agreement, following the Merger, each Converted Option continues to be governed by the same terms and conditions (including vesting and exercisability terms) as were applicable to the corresponding former Legacy Shift option immediately prior to the consummation of the Merger. All stock option activity was retroactively restated to reflect the Converted Options. No stock options were granted during the three months ended March 31, 2022.

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At the Company's special meeting of stockholders held on October 13, 2020, the stockholders approved the 2020 Omnibus Equity Compensation Plan (the "2020 Plan"). The 2020 Plan provides for the grant of incentive and non-qualified stock option, restricted stock units ("RSUs"), restricted share awards, stock appreciation awards, and cash-based awards to employees, directors, and consultants of the Company. Awards under the 2020 Plan expire no more than ten years from the date of grant. The 2020 Plan became effective immediately upon the closing of the Merger.

Activity related to employee and non-employee stock options issued under the 2014 Plan is set forth below:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value (000's) |
|----------------------------------|---------------------|---------------------------------------|---|---|
| As of December 31, 2021 | 1,597,793 | \$ 1.59 | 7.47 | \$ 3,574 |
| Granted | — | — | | |
| Exercised | (12,309) | 0.22 | | |
| Forfeited | (17,035) | 3.30 | | |
| Cancelled (expired) | (5,421) | 4.33 | | |
| As of March 31, 2022 | 1,563,028 | \$ 1.57 | 4.75 | \$ 2,133 |
| Exercisable as of March 31, 2022 | 1,563,028 | \$ 1.57 | 4.75 | \$ 2,133 |

Activity related to employee and non-employee RSU awards issued under the 2020 Plan is set forth below:

| | Number of Shares | Weighted Average Grant Date Fair Value | Weighted Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value (000's) |
|----------------------------------|---------------------|---|---|---|
| Unvested as of December 31, 2021 | 9,733,977 | \$ 6.14 | 2.21 | \$ 33,193 |
| Granted | 778,962 | 3.11 | | |
| Vested | (672,620) | 8.28 | | |
| Forfeited | (2,368,207) | 6.05 | | |
| Unvested as of March 31, 2022 | 7,472,112 | \$ 5.66 | 1.48 | \$ 16,439 |
| Vested and unreleased | 9,514 | | | |
| Outstanding as of March 31, 2022 | 7,481,626 | | | |

Unvested RSUs as of March 31, 2022 include 1,216,990 RSUs that vest if the closing price of the Company's common stock exceeds thresholds ranging from \$23 to \$28 during the two year period following the second anniversary of the later of the closing of the Merger or the grantee's date of hire. The grant date fair values of awards with market-based vesting conditions were determined using a Monte Carlo valuation model, which requires significant estimates including the expected volatility of our common stock.

Stock-Based Compensation Expense

For the three months ended March 31, 2022 and 2021, the Company recorded stock-based compensation expense to selling, general and administrative expenses on the condensed consolidated statements of operations and comprehensive loss of \$4.2 million and \$8.2 million, respectively. In addition, the Company capitalized stock-based compensation costs for the three months ended March 31, 2022 and 2021 of \$0.3 million and \$0.2 million, respectively, to capitalized website and internal use software costs, net.

As of March 31, 2022, there was \$34.3 million of unrecognized stock-based compensation expense that is expected to be recognized over a weighted-average period of 2.64 years.

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Common Stock Subject to Repurchase Related to Early Exercised Options

The Company typically allows employees to exercise options prior to vesting. Upon termination of service of an employee, the Company has the right to repurchase at the original purchase price any non-vested but issued common shares. Such an exercise is not substantive for accounting purposes. The consideration received for an exercise of an option is considered to be a deposit of the exercise price, and the related dollar amount is recorded as a liability. The liability is reclassified to additional paid in capital as the award vests.

As of March 31, 2022 and December 31, 2021, the Company has recorded a liability of \$0.2 million and \$0.2 million relating to 48,009 and 59,639 options that were exercised but not vested, respectively.

8. RELATED PARTY TRANSACTIONS

Sales with Related Party

The Company operates a one-sided marketplace (“OSM”) program whereby the Company acquires cars from various sources in Oxnard, California and sells them directly and solely to Lithia. The Company invoices Lithia based on the purchase price of the car plus an agreed upon margin. During the three months ended March 31, 2022 and 2021, the Company recognized approximately \$4.7 million and \$2.3 million, respectively, of sales from the OSM agreement with Lithia.

Accounts Receivable from Related Party

As of March 31, 2022 and December 31, 2021, the Company had \$3.7 million and \$2.1 million in outstanding accounts receivable from Lithia, which is comprised of \$3.7 million and \$2.0 million, respectively, in vehicle sales and \$3 thousand and \$77 thousand, respectively, in commissions based on the number of loan contracts booked with US bank. The Company operates under Lithia’s master agreement with US Bank where the collections pass through Lithia.

Warrant and Commercial Agreements

In September 2018, the Company entered into a warrant agreement (the “Warrant Agreement”) and a commercial agreement for Milestone 1 with Lithia and granted Lithia a warrant to purchase 86,661,588 shares of Legacy Shift common stock at an exercise price of \$0.01 per share (the “Warrant Shares”). The Warrant Shares were scheduled to vest and become exercisable in six separate tranches of 14,443,598 shares each. Vesting and exercisability was dependent upon the achievement of the Milestones, as defined below. While the Warrant Agreement establishes general vesting terms for each of the six Milestones, each of the six Milestones contains substantive service or performance requirements, and were non-binding as neither the Company nor Lithia were obligated to perform until the commercial agreement associated with each Milestone was executed. All Warrant Shares became vested prior to the Vesting Termination Date and were exercised prior to the Merger.

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In connection with the negotiations related to Milestone 5, Lithia facilitated an agreement with Automotive Warranty Services (“AWS”) to sell and market AWS’s service plans, whereby the Company receives commission rates from AWS of comparable terms to those received by Lithia. In substance the Company paid Lithia, in the form of Warrant Shares, to make an upfront payment to Company’s customers on behalf of the Company as the Company achieved favorable pricing from AWS. The benefits of this agreement were guaranteed by Lithia for an initial term of five years commencing on the signing date of the agreement. Such arrangement was the first of a number of agreements to be entered into under the terms of Milestone 5, see further discussion below. The estimated fair value of the in substance upfront payment to AWS was \$2.8 million with an offsetting entry recorded to additional paid-in capital, representing a capital transaction with a related party.

Milestone 5 was met in October 2019 and the Company recorded the warrants to additional paid-in capital based on a fair value of \$4.3 million. Milestone 5 was achieved after a mutual signed agreement was entered into evidencing that Lithia provided commercially best efforts to help the Company secure and maintain access to four finance and insurance products on par with a typical Lithia store. The fair value of the in substance upfront payment, other than the \$2.8 million for AWS discussed above, was \$0.4 million and was recorded to other non-current assets on the condensed consolidated balance sheets. The combined asset recorded of \$3.2 million is subject to amortization over a five-year period expected period of benefit. During the three months ended March 31, 2022 and 2021, the Company amortized \$0.2 million and \$0.2 million, respectively of the asset as a reduction to finance and insurance sales, which is recorded within other revenue, net on the condensed consolidated statements of operations and comprehensive loss. As of March 31, 2022 and December 31, 2021, the remaining asset, net of amortization, was \$1.1 million and \$1.2 million, respectively.

Lease Agreements

On November 1, 2018 and July 10, 2019, pursuant to Milestone 3 and 4, the Company and Lithia, entered into license and services agreements that govern the Company’s access to and utilization of reconditioning, offices and parking spaces at the Concord and Portland facilities of Lithia, respectively. Both agreements expired on October 12, 2021. During the three months ended March 31, 2021, total costs related to these agreements was \$50 thousand. The lease costs were expensed to selling, general and administrative expenses on the condensed consolidated statements of operations and comprehensive loss.

Flooring Line of Credit Guarantee

In February 2019, the Company entered into a guarantee agreement with Lithia. The interest rate was 1.50% per annum based on a daily outstanding flooring line of credit and was payable monthly to Lithia. For the three months ended March 31, 2021, the Company recorded \$31 thousand of interest and \$0.8 million of deferred borrowing cost amortization to interest and other expense, net on the condensed consolidated statements of operations and comprehensive loss. The guarantee expired conterminously with the FLOC on October 11, 2021.

Accounts Payable Due to Related Party

As of March 31, 2022 and December 31, 2021 payables and accruals to Lithia consisted of other miscellaneous expenses of \$0.1 million and \$0.2 million, respectively.

9. LEASES

The Company is a tenant under various operating leases with third parties, including leases of office facilities and vehicle inspection, reconditioning and storage locations.

The Company assesses whether each lease is an operating or finance lease at the lease commencement date. The Company does not have any material leases, individually or in the aggregate, classified as a finance leasing arrangement.

The Company’s real estate leases often require it to make payments for maintenance in addition to rent as well as payments for real estate taxes and insurance. Maintenance, real estate taxes, and insurance payments are generally variable costs which are based on actual expenses incurred by the lessor. Therefore, these amounts are not included in the consideration of the contract when determining the right-of-use asset and lease liability but are reflected as variable lease expenses in the period incurred.

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Leases with an initial term of 12 months or less are not recorded on the Company's condensed consolidated balance sheets and expense for these leases are recognized on a straight-line basis over the lease term.

As the rate implicit in the lease is generally not readily determinable for the Company's operating leases, the discount rates used to determine the present value of the Company's lease liabilities are based on the Company's incremental borrowing rate at the lease commencement date and commensurate with the remaining lease term. The incremental borrowing rate for a lease is the rate of interest the Company would have to pay to borrow on a collateralized basis over a similar term for an amount equal to the lease payments in a similar economic environment. The Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments.

The Company's lease costs and activity for the three months ended March 31, 2022 were as follows (in thousands):

| | Three Months Ended March 31, 2022 |
|---|--|
| Lease cost | |
| Operating lease cost | \$ 2,162 |
| Short-term lease cost | 832 |
| Variable lease cost | 185 |
| Total lease cost | \$ 3,179 |
| Cash paid for amounts included in the measurement of operating lease liabilities | |
| Operating cash flows from operating leases | \$ 1,925 |
| Weighted average remaining lease term - operating leases (in years) | 5.14 |
| Weighted average discount rate - operating leases | 7.30% |

Operating leases liabilities by maturity date from March 31, 2022 were as follows (in thousands):

| Year ended December 31, | Operating Leases |
|-------------------------------------|-------------------------|
| 2022 | \$ 4,215 |
| 2023 | 8,111 |
| 2024 | 5,041 |
| 2025 | 4,349 |
| 2026 | 4,191 |
| Thereafter | 7,937 |
| Total minimum lease payments | 33,844 |
| Less: Imputed interest | 6,615 |
| Total lease liabilities | \$ 27,229 |

As of March 31, 2022, the total minimum lease payments presented above excludes approximately \$45.3 million of minimum lease payments for leases of vehicle storage and reconditioning facilities executed but not yet commenced.

Rent expense for operating leases during the three months ended March 31, 2021 was \$1.8 million.

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10. COMMITMENTS AND CONTINGENCIES

Litigation

The Company may be subject to legal proceedings and claims that arise in the ordinary course of business. Other than the matter discussed below, Management is not currently aware of any matters that will have a material effect on the financial position, results of operations, or cash flows of the Company.

On May 7, 2021, we were named in a lawsuit filed in the U.S. District Court for the Southern District of New York (Stifel, Nicolaus & Company, Inc. v. Shift Technologies, Inc. 21-cv-04135) by a former financial advisor, Stifel, Nicolaus & Company, Inc. (“Stifel”), claiming that we are required to pay the former financial advisor certain compensation as a result of the Merger. In addition, the complaint seeks punitive damages as a result of alleged unjust enrichment for the amount of the benefits allegedly conferred on Shift by Stifel. The Company believes it has meritorious defenses against the claim, and the probable incurred losses related to the claim are immaterial as of March 31, 2022. Based on such information as is available to us, the range of additional reasonably possible losses related to the claim does not exceed \$4.0 million, excluding any punitive damages which the Company cannot currently estimate. The Company believes the claim is without merit and intends to defend itself vigorously; however, there can be no assurances that the Company will be successful in its defense.

11. SEGMENT INFORMATION

The Company currently is organized into two reportable segments: Retail and Wholesale. The Retail segment represents retail sales of used vehicles through the Company’s ecommerce platform and fees earned on sales of value-added products associated with those vehicles sales such as vehicle service contracts, guaranteed asset protection waiver coverage, prepaid maintenance plans, and appearance protection plans. The Wholesale segment represents sales of used vehicles through wholesale auctions or directly to a wholesaler (“DTW”).

No operating segments have been aggregated to form the reportable segments. The Company determined its operating segments based on how the chief operating decision maker (“CODM”) or decision-making group reviews the Company’s operating results in assessing performance and allocating resources. The CODM is the Chief Executive Officer. The CODM reviews revenue and gross profit for each of the reportable segments. Gross profit is defined as revenue less cost of sales incurred by the segment. The CODM does not evaluate operating segments using asset information as these are managed on an enterprise wide group basis. Accordingly, the Company does not report segment asset information. During the three months ended March 31, 2022 and 2021, the Company did not have sales to customers outside the United States. As of March 31, 2022 and December 31, 2021, the Company did not have any assets located outside of the United States.

Information about the Company’s reportable segments are as follows (in thousands):

| | Three Months Ended March 31, 2022 | | |
|---------------------------------|--|------------------|---------------------|
| | Retail | Wholesale | Consolidated |
| Revenue from external customers | \$ 191,793 | \$ 27,787 | \$ 219,580 |
| Segment gross profit (loss) | 10,926 | (138) | 10,788 |
| | Three Months Ended March 31, 2021 | | |
| | Retail | Wholesale | Consolidated |
| Revenue from external customers | \$ 92,973 | \$ 13,031 | \$ 106,004 |
| Segment gross profit | 7,236 | 130 | 7,366 |

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The reconciliation between reportable segment gross profit to net loss and comprehensive loss attributable to common stockholders is as follows (in thousands):

| | Three Months Ended March 31, | |
|---|---|-------------|
| | 2022 | 2021 |
| Segment gross profit | \$ 10,788 | \$ 7,366 |
| Selling, general and administrative expenses | (63,537) | (50,234) |
| Depreciation and amortization | (1,680) | (1,101) |
| Change in fair value of financial instruments | — | 2,153 |
| Interest and other expense, net | (2,578) | (939) |
| Net loss before income taxes | \$ (57,007) | \$ (42,755) |

12. NET LOSS PER SHARE

The following table sets forth the computation of net loss and comprehensive loss per share attributable to common stockholders, basic and diluted:

| (in thousands, except share and per share amounts) | Three Months Ended March 31, | |
|---|---|-------------|
| | 2022 | 2021 |
| Net loss and comprehensive loss attributable to common stockholders | \$ (57,048) | \$ (42,755) |
| Weighted-average number of shares outstanding used to compute net loss per share attributable to common stockholders, basic and diluted | 81,825,252 | 77,909,110 |
| Net loss and comprehensive loss per share attributable to common stockholders, basic and diluted | \$ (0.70) | \$ (0.55) |

The following potentially dilutive shares were not included in the calculation of diluted shares outstanding for the periods presented as the effect would have been anti-dilutive:

| | As of March 31, | |
|--|------------------------|-------------|
| | 2022 | 2021 |
| Escrow Shares | 3,000,109 | 6,000,218 |
| Convertible Notes | 17,798,340 | — |
| Stock options | 1,563,028 | 2,045,690 |
| Restricted stock units | 7,481,626 | 7,338,804 |
| Contingently repurchasable early exercise shares | 48,009 | 147,659 |
| Total | 29,891,112 | 15,532,371 |

13. INCOME TAXES

The Company recorded a provision for income taxes of \$41 thousand and zero during the three months ended March 31, 2022 and 2021, respectively. The Company continues to maintain a full valuation allowance for its net U.S. federal and state deferred tax assets.

14. SUBSEQUENT EVENTS

On May 6, 2022, the Company entered into a Controlled Equity OfferingSM Sales Agreement (the “Sales Agreement”), with Cantor Fitzgerald & Co. (the “Agent”), pursuant to which the Company may offer and sell, at its option, shares of the Company’s Class A common stock, par value \$0.0001 per share, having an aggregate offering price of up to \$150.0 million (the “Placement Shares”), through the Agent, as its sales agent, from time to time at prevailing market prices in an “at-the-market offering” within the meaning of Rule 415 of the Securities Act of 1933, as amended (the “Securities Act”), including sales made to the public directly on or through the Nasdaq Capital Market and any other trading market for shares of our common stock (the “Offering”).

Under the Sales Agreement, the Company may from time to time deliver placement notices to the Agent designating the number of Placement Shares and the minimum price per share thereof to be offered. However, subject to the terms and conditions of the Sales Agreement, the Agent is not required to sell any specific number or dollar amount of Placement Shares but will act as Agent using their commercially reasonable efforts consistent with their normal trading and sales practices and applicable state and federal laws, rules and regulations and the rules of the Nasdaq Stock Market. The Company or the Agent may suspend the offering of Placement Shares by notifying the other party. The Offering will terminate after the sale of all of the Placement Shares subject to the Sales Agreement, or sooner in accordance with the Sales Agreement, upon proper notice by us and/or the Agents or by mutual agreement. The Company will pay the Agent a commission of up to 3.0% of the gross sales price of the shares of the Placement Shares sold under the Sales Agreement.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following management’s discussion and analysis together with our condensed consolidated financial statements and related notes included under Part I, Item 1 of this Quarterly Report on Form 10-Q and Part II, Item 8 of our Annual Report of Form 10-K for the year ended December 31, 2021. This discussion contains forward-looking statements about Shift’s business, operations and industry that involve risks and uncertainties, such as statements regarding Shift’s plans, objectives, expectations and intentions. Shift’s future results and financial condition may differ materially from those currently anticipated by Shift as a result of the factors described in the sections entitled “Risk Factors” and “Cautionary Note Regarding Forward-Looking Statements.” Throughout this section, unless otherwise noted “we”, “us”, “our” and the “Company” refer to Shift and its consolidated subsidiaries.

Insurance Acquisition Corp. Merger

On October 13, 2020, Insurance Acquisition Corp. (“IAC”), an entity listed on the Nasdaq Capital Market under the trade symbol “INSU”, acquired Shift Platform, Inc., formerly known as Shift Technologies, Inc. (“Legacy Shift”), by the merger of IAC Merger Sub, Inc., a direct wholly owned subsidiary of IAC, with and into Legacy Shift, with Legacy Shift continuing as the surviving entity and a wholly owned subsidiary of IAC (the “Merger”). The public company resulting from the merger was renamed Shift Technologies, Inc., which we refer to as Shift, we, us, our, SFT, or the Company. Upon the consummation of the Merger, Shift received approximately \$300.9 million, net of fees and expenses. For financial reporting purposes IAC was treated as the “acquired” company and Legacy Shift was treated as the accounting acquirer.

Overview

Shift is a leading end-to-end ecommerce platform transforming the used car industry with a technology-driven, hassle-free customer experience.

Shift’s mission is to make car purchase and ownership simple — to make buying or selling a used car fun, fair, and accessible to everyone. Shift provides comprehensive, technology-driven solutions throughout the car ownership lifecycle:

- finding the right car,
- having a test drive brought to you before buying the car,
- a seamless digitally-driven purchase transaction including financing and vehicle protection products,
- an efficient, fully-digital trade-in/sale transaction,
- and a vision to provide high-value support services during car ownership.

Each of these steps is powered by Shift’s software solutions, mobile transactions platform, and scalable logistics, combined with the Company’s ten centralized inspection, reconditioning and storage centers, called hubs.

Shift’s vision is to provide a comprehensive experience for car owners, driven by technology at every step of the consumer lifecycle. Our continued investments in our research and discovery functionality create a platform that draws customers to engage with the Shift website and provide a seamless search experience.

There are three ways to purchase a car from Shift:

- **On-demand test drive:** Shift conveniently brings the customer’s desired car to the customer’s desired location for a no-obligation, contactless test drive, usually at their home or work. If the customer chooses to purchase the vehicle, a Shift concierge staff can process the transaction on-the-spot via a mobile app.
- **Buy online:** Customers can buy a car sight-unseen without a test drive and have it delivered to their home quickly with the same seven-day return policy as is offered on cars bought in person.
- **Hub test drive:** Customers may come to one of Shift’s hub locations to see and test drive multiple cars. When they arrive, customers can scan a QR code on each car to immediately view all relevant details, including ownership & service history, inspection reports, vehicle history reports, and most importantly, dynamic pricing and market price comparisons. This immediate access to all relevant information — without having to rely on a salesman — puts customers in control.

Launched in 2014, Shift operates ten vehicle inventory inspection, reconditioning and storage centers, with six spanning the West Coast from San Diego to Seattle and four new facilities in Austin, San Antonio, Houston, and Dallas, Texas launched in 2021. Once fully launched, each region is supported by one hub location that acts as the central point for reconditioning and vehicle storage that also enables customers to browse inventory onsite. For the three months ended March 31, 2022, the Company had \$219.6 million in revenue, an increase of 107% compared to \$106.0 million of revenue for the three months ended March 31, 2021. By targeting urban, densely populated markets, Shift has used direct-to-consumer digital marketing and a responsive ecommerce sales approach to grow its market penetration. With hub locations in only four states, Shift has significant runway for continued geographic expansion.

Shift's differentiated strategy offers a wide variety of vehicles across the entire spectrum of model, price, age, and mileage to ensure that Shift has the right car for buyers regardless of interest, need, budget, or credit. Shift offers a fully omni-channel fulfillment model, led by Shift's patented system for managing on-demand test drives brought to customers at their preferred location, such as their home.

Regardless of the approach chosen by the customer, they will be supported by friendly Shift Concierge and Advisor team members. For all ecommerce buyers, Shift offers a full suite of options to consumers to finance and protect their vehicle through our mobile point-of-sale solution. Through our platform, we connect customers to various lending partners for a completely digital end-to-end process for financing and service products. A customer can also complete a short online prequalification form and immediately see a filtered view of cars that meet their budget based on the financing options for which they are likely to be able to qualify. Customers can also get approved for financing before they even test drive a car, making it much more likely that the customer will purchase a car from us.

Shift focuses on unit economics driven by direct vehicle acquisition channels, optimized inventory mix and ancillary product offerings, combined with streamlined inventory onboarding, controlled fulfillment costs, and centralized software. For the three months ended March 31, 2022, Shift sourced 96% of its inventory from consumer-sellers and partners driving improved margins and customer acquisition cost. Our data-driven vehicle evaluations help ensure acquisition of the right inventory at the right price to reduce days to sale. We believe that a differentiated ability to purchase vehicles directly from consumer-sellers provides Shift access to a deep pool of scarce, highly desirable inventory.

Sellers are able to go to Shift.com, submit information on their car, and get a quote instantly. Shift uses a proprietary algorithm for pricing that utilizes current market information about market conditions, demand and supply, and car option data, among other factors. Using proprietary pricing and Shift-built mobile diagnostic tools, Shift provides an immediate quote for a customer's trade-in vehicle, and will schedule an on-demand evaluation at the customer's location by a member of Shift's concierge staff. Shift provides selling customers with information on market rates and, when a customer is ready to sell their car, we can digitally initiate e-contracting and an ACH transfer and conveniently take the car on the seller's behalf so the seller doesn't even have to leave his or her home to sell their car.

Over time, we intend to expand our machine learning-enabled recommendation engine to better help customers find the cars best suited to them. Customer response to the Shift experience is extremely positive, resulting in a rating of 4.3 out of 5 stars on Trustpilot as of May 2022, compared to an average of 2.1 out of 5 stars for our two largest ecommerce peers. These positive experiences are expected to allow Shift to serve customers over the entire lifecycle of vehicle ownership and retain customers for repeat sales and purchases. By continuing to invest in services that benefit the customer throughout the ownership phase of the lifecycle (for example, vehicle maintenance plans), we will continue to establish a long-term customer base that will return for future transactions.

Revenue Model

Shift's two-sided model generates value from both the purchase and sale of vehicles along with financing and vehicle protection products. We acquire cars directly from consumers, partners, and other sources and sell vehicles through our ecommerce platform directly to consumers in a seamless end-to-end process. This model captures value from the difference in the price at which the car is acquired and sold, as well as through fees on the sale of ancillary products such as financing and vehicle protection products, also referred to as finance and insurance ("F&I"), and services. If a car that we purchase does not meet our standards for retail sale, we generate revenue by selling through wholesale channels. These vehicles are primarily acquired from customers who trade-in their existing vehicles in connection with a purchase from us. Our revenue for the three months ended March 31, 2022 and 2021, was \$219.6 million and \$106.0 million, respectively. We expect significant growth going forward as we expand geographically, increase market penetration, and increase ancillary product sales.

Inventory Sourcing

We source the majority of our vehicles directly from consumers and partners who use the Shift platform to resell trade-in and other vehicles. These channels provide scarce and desirable local inventory of used cars of greater quality than those typically found at auction. In addition to those primary channels, we supplement our vehicle acquisitions with purchases from auto auctions, as well as some vehicles sourced locally through the trade-in program of an original equipment manufacturer ("OEM").

Proprietary machine learning-enabled software inputs vast quantities of data across both the supply and demand sides to optimize our vehicle acquisition strategy. As we grow volumes, we expect to improve the performance of our model to optimize our vehicle selection and disposal.

Vehicle Reconditioning

All of the cars Shift sells undergo a rigorous 150+ point mechanical inspection and reconditioning process at one of our ten regional reconditioning facilities (or at a third-party partner when additional capacity is needed, such as during the establishment of a new hub location) to help ensure that they're safe, reliable, up to cosmetic standards, and comfortable. We have created two classifications of inventory for reconditioning — Value and Certified — to optimize the level of reconditioning for each vehicle classification. This allows us to efficiently provide each customer with the greatest value through a tailored reconditioning approach. Value cars are typically sold at a lower price point and are sought after by consumers who have different expectations and tolerances for cosmetic reconditioning standards — therefore, we focus on mechanical and safety issues for these vehicles, with less emphasis on cosmetic repair, in order to optimize reconditioning costs. This operational flexibility in our reconditioning process improves our ability to grow profitably and is a primary factor in our decision to conduct reconditioning in-house. With a test drive service radius from our hub to a customer's home averaging two hours of driving time, each reconditioning facility is able to cover a large geographic range and service the surrounding metropolitan area. We plan to grow our reconditioning center network as we expand geographically and launch new markets.

Logistics Network

The primary component of our logistics network consists of intra-city concierge personnel and inter-city third-party carriers. Shift concierges are able to transport vehicles to and from customers, while providing a customer friendly white glove experience, including delivery, disposal, and at-home test drives. This provides the benefit of a seamless experience as well as an on-site sales support agent to guide the customer through the process. Our agreements with long distance haulers allow us to combine the nodes in our network and deliver vehicles between cities. The Company has also recently invested in in-house long-distance hauling capabilities. Strategically, this provides customers with a broad set of inventory and a great speed of delivery.

Financing and Vehicle Protection Products

We generate revenue by earning no obligation referral fees for selling ancillary products to customers that purchase vehicles through the Shift platform. Since we earn fees for the F&I products we sell, our gross profit on these items is equal to the revenue we generate. Our current offering consists of financing from third-party lenders, guaranteed asset protection ("GAP") waiver, vehicle protection plans and vehicle service contracts. We plan to offer additional third-party products to provide a wider product offering to customers and expect these products to contribute to reaching our revenue and profitability targets.

Factors Affecting our Business Performance

Various trends and other factors have affected and may continue to affect our business, financial condition and operating results, including:

Deeper Market Penetration Within Our Existing Markets

We believe that there remains a substantial opportunity to capture additional market share within our existing service areas. We've proven our ability to command a strong market share through effective marketing channels, as demonstrated by our current market share in our most established cities. We believe that with effective brand marketing, we will be able to reach similar market penetration in our other geographic markets.

Expansion into New Markets

We believe that a phased, capital efficient expansion model results in the most cost-effective new market launch strategy in the industry. Our approach to market expansion is to implement controlled launches to expand our existing service territory. This approach both bolsters our existing markets (with new inventory being acquired in nearby cities), while simultaneously providing the new market with the local talent and resources required for a successful launch.

Improvements in Technology Platform

We are constantly investing in our technology platform to improve both customer experience and our business performance. We regularly implement changes to our software to help customers find the right car for them, while the machine learning component of our inventory and pricing model ensures we get the right cars at the right price. As our algorithms evolve, we are able to better monetize our inventory of vehicles through better pricing, while simultaneously customers are much more likely to purchase a car on our website, thus driving higher demand and sales volume.

Improvements in Reconditioning Processes

We learned early on from our experience in the used car sales business that to be a reliable used car resource with desirable inventory for all customer types, we needed to control our own reconditioning processes. Our reconditioning program has constantly improved over the course of our history, and we are happy with what we have achieved. Each unit of our inventory is reconditioned with a focus on safety first, while optimizing for repairs that will have the highest return on investment ("ROI"). We believe that our network of reconditioning centers and connecting logistics routes have excess capacity, which we plan to utilize as we increase retail sales volumes. Increasing capacity utilization will positively affect gross profit per unit by reducing per unit overhead costs.

Growth in Other Revenue from Existing Revenue Streams

We have made great strides over the past two years developing our “other revenue” streams, which comprise the financing and vehicle protection products that we can offer on our digital financing platform, and other ancillary products. We have invested in the technology, as well as the sales team, to increase the likelihood that consumers will purchase ancillary products in connection with the sale of a vehicle, and we see more opportunity for additional revenue within our existing channels purely from further expansion of our attach rates for our entire financing and vehicle protection product suite.

Growth in Other Revenue from Expansion of Product Offerings

We see great opportunity to further expand our other revenue streams through additional product offerings beyond the existing offerings on our platform. These incremental revenue streams will come in the form of on-boarding new lending partners to our existing loan program, as well as introducing entirely new financing and vehicle protection products to offer our customers. We intend to continue to grow this business segment to service every addressable need of our customers during the vehicle purchase process.

Seasonality

We expect our quarterly results of operations, including our revenue, gross profit, profitability, if any, and cash flow to vary significantly in the future, based in part on, among other things, consumers’ car buying patterns. We have typically experienced higher revenue growth rates in the second and third quarters of the calendar year than in each of the first or fourth quarters of the calendar year. We believe these results are due to seasonal buying patterns driven in part by the timing of income tax refunds, which we believe are an important source of car buyer down payments on used vehicle purchases. We believe that continued investments in growth, including effective marketing and new market entry, will allow us to maintain sales growth through seasonality. However, we recognize that in the future our revenues may be affected by these seasonal trends (including any disruptions to normal seasonal trends arising from the COVID-19 pandemic), as well as cyclical trends affecting the overall economy, specifically the automotive retail industry.

Impact of COVID-19

In March 2020, the World Health Organization declared a global pandemic related to the rapidly growing outbreak of a novel strain of coronavirus known as COVID-19, and in the following weeks, shelter-in-place ordinances were put into effect in regions where Shift operates. We saw a slowing of vehicle sales immediately following the shelter-in-place ordinances in March; however, within five weeks, we were back near our pre-COVID-19 weekly sales volumes. Although the ultimate impacts of COVID-19 remain uncertain, a 2020 survey found that 46% of U.S. adults surveyed plan to use their cars more often and public transportation less often in the future. Additionally, the pandemic has accelerated trends of online adoption more broadly. We believe that this global pandemic will push people to look to alternative means of personal transportation, and our product is well suited to provide customers with a safe, clean means of transportation, through our contactless purchase and delivery processes. Therefore, while it remains possible that sustained or deepened impact on consumer demand resulting from COVID-19 or the related economic recession could negatively impact Shift's performance, we believe that Shift is well positioned to weather the pandemic. In 2021 and 2022, pandemic-related economic stimulus and constraints in the supply of new and used vehicles have increased acquisition cost, demand and pricing for our products, while labor shortages have abated since the initial pandemic lockdowns.

Ultimately, the magnitude and duration of the impact to Shift's operations is impossible to predict due to:

- uncertainties regarding the duration of the COVID-19 pandemic and how long related disruptions will continue;
- the impact of governmental orders and regulations that have been, and may in the future be, imposed;
- the impact of COVID-19 on wholesale auctions, state DMV titling and registration services and other third parties on which we rely;
- uncertainties related to the impact of COVID-19 variants and government actions that that may be taken in response;
- uncertainties as to the impact of vaccination campaigns underway in key markets; and
- potential deterioration of economic conditions in the United States, which could have an adverse impact on discretionary consumer spending.

We will continue to monitor and assess the impact of the COVID-19 pandemic on our business and our results of operations and financial condition as the pandemic continues to evolve.

Key Operating Metrics

We regularly review a number of metrics, including the following key metrics, to evaluate our business, measure our progress and make strategic decisions. Our key operating metrics measure the key drivers of our growth, including opening new hubs, increasing our brand awareness through unique site visitors and continuing to offer a full spectrum of used vehicles to service all types of customers.

Ecommerce Units Sold

We define ecommerce units sold as the number of vehicles sold to customers in a given period, net of returns. We currently have a seven-day, 200 mile return policy. The number of ecommerce units sold is the primary driver of our revenues and, indirectly, gross profit, since ecommerce unit sales enable multiple complementary revenue streams, including all financing and protection products. We view ecommerce units sold as a key measure of our growth, as growth in this metric is an indicator of our ability to successfully scale our operations while maintaining product integrity and customer satisfaction.

Wholesale Units Sold

We define wholesale units sold as the number of vehicles sold through wholesale channels in a given period. While wholesale units are not the primary driver of revenue or gross profit, wholesale is a valuable channel as it allows us to be able to purchase vehicles regardless of condition, which is important for the purpose of accepting a trade-in from a customer making a vehicle purchase from us, and as an online destination for consumers to sell their cars even if not selling us a car that meets our retail standards.

Ecommerce Average Sale Price

We define ecommerce average sale price (“ASP”) as the average price paid by a customer for an ecommerce vehicle, calculated as ecommerce revenue divided by ecommerce units. Ecommerce average sale price helps us gauge market demand in real-time and allows us to maintain a range of inventory that most accurately reflects the overall price spectrum of used vehicle sales in the market. We believe this metric provides transparency and is comparable to our peers.

Wholesale Average Sale Price

We define wholesale average sale price as the average price paid by a customer for a wholesale vehicle, calculated as wholesale revenue divided by wholesale units. We believe this metric provides transparency and is comparable to our peers.

Gross Profit per Unit

We define gross profit per unit as the gross profit for ecommerce, other, and wholesale, each of which divided by the total number of ecommerce units sold in the period. We calculate gross profit as the revenue from vehicle sales and services less the costs associated with acquiring and reconditioning the vehicle prior to sale. Gross profit per unit is primarily driven by ecommerce vehicle revenue, which generates additional revenue through attachment of our financing and protection products, and gross profit generated from wholesale vehicle sales. We present gross profit per unit from our three revenues streams as Ecommerce gross profit per unit, Wholesale gross profit per unit and Other gross profit per unit.

Average Monthly Unique Visitors

We define a monthly unique visitor as an individual who has visited our website within a calendar month, based on data collected on our website. We calculate average monthly unique visitors as the sum of monthly unique visitors in a given period, divided by the number of months in that period. To classify whether a visitor is “unique”, we dedupe (a technique for eliminating duplicate copies of repeating data) each visitor based on email address and phone number, if available, and if not, we use the anonymous ID which lives in each user’s internet cookies. This practice ensures that we do not double-count individuals who visit our website multiple times within a month. We view average monthly unique visitors as a key indicator of the strength of our brand, the effectiveness of our advertising and merchandising campaigns and consumer awareness.

Average Days to Sale

We define average days to sale as the number of days between Shift’s acquisition of a vehicle and sale of that vehicle to a customer, averaged across all ecommerce units sold in a period. We view average days to sale as a useful metric in understanding the health of our inventory.

Ecommerce Vehicles Available for Sale

We define ecommerce vehicles available for sale as the number of ecommerce vehicles in inventory on the last day of a given reporting period. Until we reach an optimal pooled inventory level, we view ecommerce vehicles available for sale as a key measure of our growth. Growth in ecommerce vehicles available for sale increases the selection of vehicles available to consumers, which we believe will allow us to increase the number of vehicles we sell. Moreover, growth in ecommerce vehicles available for sale is an indicator of our ability to scale our vehicle purchasing, inspection and reconditioning operations.

Number of Regional Hubs

We define a hub as a physical location at which we recondition and store units bought and sold within a market. Because of our omni-channel fulfillment model with our on-demand delivery test drive offering, we are able to service super-regional areas with a radius of approximately two hours of driving time from a single hub location. This is a key metric as each hub expands our service area inspection, reconditioning and storage capacity.

Results of Operations

The following table presents our revenue, gross profit, and unit sales information by channel for the periods indicated:

| | Three Months Ended March 31, | | |
|---|------------------------------|-------------------|----------|
| | 2022 | 2021 | Change |
| (\$ in thousands, except per unit metrics) | | | |
| Revenue: | | | |
| Ecommerce vehicle revenue, net | \$ 183,081 | \$ 88,954 | 105.8 % |
| Other revenue, net | 8,712 | 4,019 | 116.8 % |
| Wholesale vehicle revenue | 27,787 | 13,031 | 113.2 % |
| Total revenue | <u>\$ 219,580</u> | <u>\$ 106,004</u> | 107.1 % |
| Cost of sales: | | | |
| Ecommerce vehicle cost of sales | \$ 180,867 | \$ 85,737 | 111.0 % |
| Wholesale vehicle cost of sales | 27,925 | 12,901 | 116.5 % |
| Total cost of sales | <u>\$ 208,792</u> | <u>\$ 98,638</u> | 111.7 % |
| Gross profit: | | | |
| Ecommerce vehicle gross profit | \$ 2,214 | \$ 3,217 | (31.2)% |
| Other gross profit | 8,712 | 4,019 | 116.8 % |
| Wholesale vehicle gross profit (loss) | (138) | 130 | (206.2)% |
| Total gross profit | <u>\$ 10,788</u> | <u>\$ 7,366</u> | 46.5 % |
| Unit sales information: | | | |
| Ecommerce vehicle unit sales | 6,714 | 4,452 | 50.8 % |
| Wholesale vehicle unit sales | 1,975 | 1,527 | 29.3 % |
| Average selling prices per unit ("ASP"): | | | |
| Ecommerce vehicles | \$ 27,269 | \$ 19,981 | 36.5 % |
| Wholesale vehicles | \$ 14,069 | \$ 8,534 | 64.9 % |
| Gross profit per unit⁽¹⁾: | | | |
| Ecommerce gross profit per unit | \$ 330 | \$ 723 | (54.4)% |
| Other gross profit per unit | 1,298 | 903 | 43.7 % |
| Wholesale gross profit (loss) per unit | (21) | 29 | (172.4)% |
| Total gross profit per unit | <u>\$ 1,607</u> | <u>\$ 1,655</u> | (2.9)% |
| Non-financial metrics | | | |
| Average monthly unique visitors | 822,856 | 709,409 | 16.0 % |
| Average days to sale | 56 | 47 | 19.1 % |
| Ecommerce vehicles available for sale | 5,464 | 3,736 | 46.3 % |
| # of regional hubs ⁽²⁾ | 10 | 6 | 66.7 % |

(1) Gross profit per unit is calculated as gross profit for ecommerce, other and wholesale, each of which divided by the total number of ecommerce units sold in the period.

(2) As of March 31, 2022, the Dallas and Austin Hubs were active for vehicle storage and sales and are included, but had not yet commenced vehicle reconditioning operations.

We present operating results down to gross profit from three distinct revenue channels:

Ecommerce Vehicles: The ecommerce channel within our Retail segment represents sales of used vehicles directly to our customers through our website.

Other: The other channel within our Retail segment represents fees earned on sales of value-added products associated with the sale of ecommerce vehicles.

Wholesale Vehicles: The Wholesale channel is the only component of our Wholesale segment and represents sales of used vehicles through wholesale auctions.

Three Months Ended March 31, 2022

Ecommerce Vehicle Revenue, Net

Ecommerce vehicle revenue increased by \$94.1 million, or 105.8%, to \$183.1 million during the three months ended March 31, 2022, from \$89.0 million in the comparable period in 2021. This increase was partly driven by an increase in ecommerce unit sales, as we sold 6,714 ecommerce vehicles in the three months ended March 31, 2022, compared to 4,452 ecommerce vehicles in the three months ended March 31, 2021. The increase in unit sales was driven by increased investment in marketing and by increased inventory units available for sale. The increase in sellable inventory levels was partly due to investments that increased our reconditioning throughput. The majority of our sales growth resulted from increased market penetration in our six most mature West Coast regions ranging from San Diego to Seattle, with the four more recent Texas locations expected to contribute to sales growth in future periods as their operations mature.

The increase in ecommerce vehicle revenue was also partly due to an increase in ecommerce ASP, which was \$27,269 for the three months ended March 31, 2022, compared to \$19,981 for the three months ended March 31, 2021. This increase in ecommerce ASP was primarily a reflection of increased demand for used vehicles coupled with lower than average inventory levels across the auto market as a whole.

Other Revenue, Net

Other revenue increased by \$4.7 million, or 116.8%, to \$8.7 million during the three months ended March 31, 2022, from \$4.0 million in the comparable period in 2021. This increase was primarily due to strategic investments to enhance and expand our ancillary product offerings to better monetize our growing unit sales.

Wholesale Vehicle Revenue

Wholesale vehicle revenue increased by \$14.8 million, or 113.2%, to \$27.8 million during the three months ended March 31, 2022, from \$13.0 million in the comparable period in 2021. The increase was primarily due to an increase in wholesale unit sales as we sold 1,975 wholesale vehicles in the three months ended March 31, 2022, compared to 1,527 wholesale vehicles in the three months ended March 31, 2021. This increase in wholesale vehicle revenue was also partly due to a 64.9% increase in ASP driven by favorable conditions in the wholesale auto market.

Cost of Sales

Cost of sales increased by \$110.2 million, or 111.7%, to \$208.8 million during the three months ended March 31, 2022, from \$98.6 million in the comparable period in 2021. The increase was primarily due to an increase in unit sales as we sold 8,689 total vehicles in the three months ended March 31, 2022, compared to 5,979 total vehicles in the three months ended March 31, 2021. The remainder of the increase is due to increased buying and selling prices in the used auto market as a whole, caused by constrained supplies of new and used vehicles.

Ecommerce Vehicle Gross Profit

Ecommerce vehicle gross profit decreased by \$1.0 million, or 31.2%, to \$2.2 million during the three months ended March 31, 2022, from \$3.2 million in the comparable period in 2021. The decrease was primarily driven by a decrease in ecommerce gross profit per unit, which shrank to \$330 per unit for the three months ended March 31, 2022, from \$723 per unit in the comparable period in 2021. The decrease in ecommerce vehicle gross profit was also offset by an increase in ecommerce units sold, as described in “Ecommerce Vehicle Revenue, Net” above. This decrease in ecommerce gross profit per unit was largely driven by sell-through of inventory acquired in 2021 during periods of abnormally high used vehicle pricing, which we sold in early in the first quarter of 2022. Ecommerce vehicle gross profit is expected to recover as cohorts of inventory acquired at higher prices are sold through and as pricing is expected to be seasonally higher in the second and third quarters.

Other Gross Profit

Other gross profit increased by \$4.7 million, or 116.8%, to \$8.7 million during the three months ended March 31, 2022, from \$4.0 million in the comparable period in 2021. The increase was primarily driven by an increase in ecommerce units sold, as described in “Ecommerce Vehicle Revenue, Net” above. The increase in other gross profit was also partly due to increase in other gross profit per unit to \$1,298 during the three months ended March 31, 2022, from \$903 per unit in the comparable period in 2021. Other revenue consists of 100% gross margin products for which gross profit equals revenue. Therefore, changes in other gross profit and the associated drivers are identical to changes in other revenue and the associated drivers.

Wholesale Vehicle Gross Profit

Wholesale vehicle gross profit decreased by \$0.3 million, or 206.2%, to \$(0.1) million during the three months ended March 31, 2022, from \$0.1 million in the comparable period in 2021. The decrease was primarily driven by a decrease in wholesale gross profit per unit, which shrank to \$(21) per unit for the three months ended March 31, 2022, from \$29 in the comparable period in 2021. The decrease was primarily due to unusually low seasonally adjusted prices in the wholesale market during the quarter.

Components of SG&A

| | Three Months Ended March 31, | | |
|--|------------------------------|-----------|---------|
| | 2022 | 2021 | Change |
| | (\$ in thousands) | | |
| Compensation and benefits ⁽¹⁾ | \$ 30,514 | \$ 23,362 | 30.6 % |
| as a % of revenue | 13.9 % | 22.0 % | |
| Marketing expenses | 11,909 | 15,327 | (22.3)% |
| as a % of revenue | 5.4 % | 14.5 % | |
| Other costs ⁽²⁾ | 21,114 | 11,545 | 82.9 % |
| as a % of revenue | 9.6 % | 10.9 % | |
| Total selling, general and administrative expenses | \$ 63,537 | \$ 50,234 | 26.5 % |
| as a % of revenue | 28.9 % | 47.4 % | |

(1) Compensation and benefits includes all payroll and related costs, including benefits, payroll taxes and equity-based compensation, except those related to preparing vehicles for sale, which are included in cost of sales, and those related to the development of software products for internal use, which are capitalized to software and amortized over the estimated useful lives of the related assets. Certain reclassifications have been made to the comparable period to conform to the current presentation. Specifically, \$1.1 million of contractor costs were reclassified from other costs to compensation and benefits, and \$66 thousand of public relations costs were reclassified from marketing expenses to other costs.

(2) Other costs include all other selling, general and administrative expenses such as hub operating costs, vehicle shipping costs for internal purposes, corporate occupancy, professional services, registration and licensing, and IT expenses.

Selling, general and administrative expenses increased by \$13.3 million, or 26.5%, to \$63.5 million during the three months ended March 31, 2022, from \$50.2 million in the comparable period in 2021. The increase was partly due to an increase in compensation costs of \$7.2 million, driven by the increase in average headcount from 1,037 to 1,299. The increase was offset by a decrease in marketing expense of \$3.4 million, which resulted from abnormally high marketing spend in the comparable period caused by overlapping marketing campaigns while the Company transitioned to its current, more efficient brand marketing strategy. Lastly, other costs increased by \$9.6 million due primarily to increased selling costs in support of revenue growth.

Selling, general and administrative expenses have decreased as a percentage of revenue from 47.4% to 28.9% as the Company increases in scale and begins to achieve operating leverage. The decrease in marketing expense as a percentage of revenue is also due to investments in brand marketing increasing the efficiency of our marketing spend and the transition-related expense in the comparable period discussed above.

Liquidity and Capital Resources

Sources of liquidity

Our main source of liquidity is cash generated from financing activities. Cash generated from financing activities through March 31, 2022 primarily includes proceeds from the Merger and PIPE financing completed in October 2020, issuance of convertible notes, and proceeds from the Flooring Line of Credit facility with Ally ("Ally FLOC"). Refer to Note 5 - Borrowings and Note 8 - Related Party Transactions in our "*Notes to Condensed Consolidated Financial Statements*" for additional information.

On May 27, 2021, the Company completed a private offering of its 4.75% Convertible Senior Notes due 2026 (the "Notes"). The aggregate principal amount of the Notes sold in the offering was \$150.0 million. The Notes accrue interest payable semi-annually in arrears at a rate of 4.75% per year. The Notes will mature on May 15, 2026, unless earlier converted, redeemed or repurchased by the Company. See Note 5 - Borrowings in the "*Notes to Condensed Consolidated Financial Statements*" for additional details regarding the Notes. The Company used approximately \$28.4 million of the net proceeds from the sale of the Notes to pay the cost of the Capped Call Transactions (see Note 6 - Stockholders' Equity), and is using the remaining proceeds for working capital and general corporate purposes.

Since inception, the Company has generated recurring losses which has resulted in an accumulated deficit of \$497.8 million as of March 31, 2022. During the three months ended March 31, 2022, the Company had negative operating cash flows of \$98.4 million. In the future, we may attempt to raise additional capital through the sale of equity securities or through equity-linked or debt financing arrangements. If we raise additional funds by issuing equity or equity-linked securities, the ownership of our existing stockholders will be diluted. If we raise additional financing by incurring indebtedness, we will be subject to increased fixed payment obligations and could also be subject to restrictive covenants, such as limitations on our ability to incur additional debt, and other operating restrictions that could adversely impact our ability to conduct our business. Any future indebtedness we incur may result in terms that could be unfavorable to equity investors.

Liquidity and Management's Plan

For the three months ended March 31, 2022 and 2021, the Company generated negative cash flows from operations of approximately \$98.4 million and \$71.5 million, respectively, and generated net losses of approximately \$57.0 million and \$42.8 million, respectively. As of March 31, 2022, the Company had unrestricted cash and cash equivalents of \$94.9 million and total working capital of \$127.9 million. Since inception, the Company has had negative cash flows and losses from operations which it has funded primarily through issuances of common and preferred stock and through a reverse recapitalization via its merger with Insurance Acquisition Corp. in October 2020. The Company has historically funded vehicle inventory purchases through its vehicle floorplan facilities (see Note 5 - Borrowings). As further discussed in Note 14 - Subsequent Events, the Company has entered into an "At the Market" (ATM) facility that allows it to raise capital via the sale of its Class A Common Stock. The Company is also actively engaged in other efforts to raise debt or equity capital.

The Company's plan is to raise additional capital through the ATM and other capital-raising efforts to provide net proceeds which the Company believes will be sufficient to provide the liquidity necessary to satisfy its obligations over the next twelve months. The Company's ability to raise capital from the ATM facility may be constrained by the price of and demand for the Company's Class A Common Stock. There can be no assurance that net proceeds from the ATM will be sufficient, or that the Company will be able to complete its other planned capital raising efforts and raise sufficient additional capital that will provide it with sufficient liquidity to satisfy its obligations over the next twelve months.

In accordance with Accounting Standards Update No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (Subtopic 205-40), the Company has evaluated whether there are conditions and events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the condensed consolidated financial statements are issued or available to be issued. Management determined as a result of this evaluation the Company's losses and negative cash flows from operations since inception, combined with its current cash and working capital position, raise substantial doubt about the Company's ability to continue as a going concern.

The condensed consolidated financial statements have been prepared on a basis that assumes the Company will continue as a going concern which contemplates the realization of assets and satisfaction of liabilities and commitments in the ordinary course of business. Accordingly, the accompanying condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Debt obligations

See Note 5 - Borrowings of the "Notes to Condensed Consolidated Financial Statements" for information regarding the Company's debt obligations.

Cash Flows — Three Months Ended March 31, 2022 and 2021

The following table summarizes our cash flows for the periods indicated:

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2022 | 2021 |
| | (\$ in thousands) | |
| Cash Flow Data: | | |
| Net cash, cash equivalents, and restricted cash used in operating activities | \$ (98,370) | \$ (71,475) |
| Net cash, cash equivalents, and restricted cash used in investing activities | (3,772) | (2,488) |
| Net cash, cash equivalents, and restricted cash provided by financing activities | 14,584 | 17,137 |

Operating Activities

For the three months ended March 31, 2022, net cash used in operating activities was \$98.4 million, an increase of \$26.9 million from cash used in operating activities of \$71.5 million for the three months ended March 31, 2021. The increase is primarily due to an increase in net loss of \$14.3 million, an increase in cash used to pay accrued expenses of \$9.2 million, and increase in cash used to acquire inventory of \$12.6 million and a decrease in stock-based compensation of \$4.0 million, offset by a \$12.9 million increase in cash provided by collections of accounts receivable.

Investing Activities

For the three months ended March 31, 2022, net cash used in investing activities of \$3.8 million was primarily driven by the capitalization of website and internal-use software costs and purchases of capital equipment.

Financing Activities

For the three months ended March 31, 2022, net cash provided by financing activities was \$14.6 million, primarily due to net proceeds from the Flooring Line of Credit of \$16.8 million (See Note 5 - Borrowings of the "Notes to Condensed Consolidated Financial Statements").

Contractual Obligations

As of March 31, 2022 and December 31, 2021, the Company reported a liability for vehicles acquired under OEM program of \$3.2 million and \$3.6 million, respectively. The Company records inventory received under the arrangement with the OEM equal to the amount of the liability due to the OEM to acquire such vehicles. The liability due to the OEM provider for such acquired vehicles is equal to the OEM's original acquisition price.

The Company has various operating leases of real estate and equipment. See Note 9 - Leases to the accompanying condensed consolidated financial statements for further discussion of the nature and timing of cash obligations due under these leases.

Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements, including guarantee contracts, retained or contingent interests, certain derivative instruments and variable interest entities that either have, or are reasonably likely to have, a current or future material effect on our condensed consolidated financial statements.

Critical Accounting Policies and Estimates

See Part II, Item 7, "Critical Accounting Policies and Estimates" in our Annual Report on Form 10-K for the year ended December 31, 2021. There have been no material changes to our critical accounting policies and estimates since our Annual Report on Form 10-K for the year ended December 31, 2021 except as described in Note 1 - Description of the Business and Accounting Policies to the accompanying condensed consolidated financial statements under the heading "Recently Adopted Accounting Standards."

Available Information

Our website is located at www.shift.com, and our investor relations website is located at www.investors.shift.com. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, our Proxy Statements, and any amendments to these reports, are available through our investor relations website, free of charge, after we file them with the SEC.

We webcast via our investor relations website our earnings calls and certain events we participate in or host with members of the investment community. Our investor relations website also provides notifications of news or announcements regarding our financial performance and other items of interest to our investors, including SEC filings, investor events, press releases, and earnings releases. Further, corporate governance information, including our certificate of incorporation, bylaws, governance guidelines, board committee charters, and code of conduct, is also available on our investor relations website. The content of our websites are not incorporated by reference into this Quarterly Report on Form 10-Q or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of exposure due to potential changes in inflation or interest rates. We do not hold financial instruments for trading purposes.

Interest Rate Risk

Our primary market risk exposure related to our debt is changing interest rates. We had total outstanding debt of \$100.0 million under our Flooring Line of Credit as of March 31, 2022. Amounts outstanding under our short-term revolving facilities are generally due within one year and bear a variable interest rate consisting of a fixed spread to a prime rate. Refer to Note 5 - Borrowings of the accompanying condensed consolidated financial statements for more detail on this variable interest rate. Based on the amounts outstanding, a 100-basis point increase or decrease in market interest rates would result in a change to annual interest expense of \$1 million at March 31, 2022.

Our long-term debt, consisting of our Convertible Notes (as defined in Note 5 - Borrowings to the accompanying condensed consolidated financial statements) and operating leases have fixed interest rates and terms, and as such, we consider the associated risk to our results of operations from changes in market rates of interest to be minimal.

Inflation Risk

Based on our analysis of the periods presented, we believe that inflation has not had a material effect on our operating results. There can be no assurance that future inflation will not have an adverse impact on our operating results and financial condition.

ITEM 4. CONTROLS AND PROCEDURES

1. Disclosure Controls and Procedures

We maintain disclosure controls and procedures (Disclosure Controls) within the meaning of Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Our Disclosure Controls are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act, such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Our Disclosure Controls are also designed to ensure that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our Disclosure Controls, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily applied its judgment in evaluating and implementing possible controls and procedures.

As of the end of the period covered by this Quarterly Report on Form 10-Q, we evaluated the effectiveness of the design and operation of our Disclosure Controls, which was done under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based on the evaluation of our Disclosure Controls, our Chief Executive Officer and Chief Financial Officer have concluded that, as of March 31, 2022, our Disclosure Controls were not effective due to material weaknesses in the Company's internal control over financial reporting as disclosed below.

2. Material Weaknesses

As previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2021, we identified material weaknesses in our internal control over financial reporting. The first material weakness relates to lack of a process to demonstrate commitment to attracting, developing, and retaining competent individuals in alignment with objectives. This material weakness impacted the effectiveness of our control environment, and our entity level controls. It resulted in the Company not maintaining a complement of personnel with an appropriate level of accounting knowledge, experience and training in the application of US GAAP commensurate with its financial reporting requirements and the complexity of the Company's operations and transactions. Remediation efforts undertaken by the Company in 2021 identified an additional material weakness related to insufficient selection and development of Information Technology General Controls (ITGCs) to support the achievement of objectives.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. These material weaknesses could result in a misstatement of account balances or disclosures that would result in a material misstatement of our annual or interim consolidated financial statements that may not be detected.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements or prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions, and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

3. Plan to Remediate Material Weaknesses

The Company is devoting significant time, attention, and resources to remediating the above material weaknesses. The Company has executed or continues to execute the following steps intended to remediate the material weaknesses described above and strengthen our internal control:

- The Company hired experienced finance and accounting executives in the positions of Chief Financial Officer, Chief Accounting Officer, Director of SEC Reporting, and Director of Internal Audit.
- The Company has invested in increased headcount and training for the accounting function.
- The Company engaged external consultants to assist the Company in designing, implementing, and monitoring an appropriate system of internal control, including ITGCs.
- The Company is executing several initiatives to strengthen our ITGC environment, including but not limited to:
 - Implementing additional training to ensure a clear understanding of risk assessment, controls and monitoring activities related to automated processes and systems and ITGCs related to financial reporting.
 - Implementing improved IT policies, procedures and control activities for key systems which impact our financial reporting.
 - Increasing the amount of resources dedicated to monitoring ITGCs related to financial reporting, including addition of personnel with the appropriate level of knowledge, experience and training to ensure compliance with policies and procedures.

The material weaknesses will not be considered remediated, however, until the accounting executives hired in 2021 have been in their roles for a sufficient period of time, and we have concluded, through testing, that applicable controls are designed and operating effectively.

We plan to continue to devote significant time and attention to remediate the above material weaknesses as soon as reasonably practicable. As we continue to evaluate our controls, we will make the changes described above as well as any others needed to enhance our control environment and remediate the material weaknesses. We believe these actions will be sufficient to remediate the identified material weaknesses and strengthen our internal control over financial reporting; however, there can be no guarantee that such remediation will be sufficient. We will continue to evaluate the effectiveness of our controls and will make any further changes management determines appropriate.

4. Changes in Internal Control over Financial Reporting

Except as described above, there were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2022, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II - Other Information

ITEM 1. LEGAL PROCEEDINGS

The Company may be subject to legal proceedings and claims that arise in the ordinary course of business. Other than the matter discussed below, Management is not currently aware of any matters that will have a material effect on the financial position, results of operations, or cash flows of the Company.

On May 7, 2021, we were named in a lawsuit filed in the U.S. District Court for the Southern District of New York (Stifel, Nicolaus & Company, Inc. v. Shift Technologies, Inc. 21-cv-04135) by a former financial advisor, Stifel, Nicolaus & Company, Inc. (“Stifel”), claiming that we are required to pay the former financial advisor certain compensation as a result of the Merger. In addition, the complaint seeks punitive damages as a result of alleged unjust enrichment for the amount of the benefits allegedly conferred on Shift by Stifel. The Company believes it has meritorious defenses against the claim, and the probable incurred losses related to the claim are immaterial as of March 31, 2022. Based on such information as is available to us, the range of additional reasonably possible losses related to the claim does not exceed \$4.0 million, excluding any punitive damages which the Company cannot currently estimate. The Company believes the claim is without merit and intends to defend itself vigorously; however, there can be no assurances that the Company will be successful in its defense.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021, except as follows:

The Company’s losses and negative cash flows from operations since inception, combined with its current cash and working capital position, raise substantial doubt about the Company’s ability to continue as a going concern.

Since inception, the Company has generated recurring losses which has resulted in an accumulated deficit of 497.8 million as of March 31, 2022. During the three months ended March 31, 2022, the Company had negative operating cash flows of \$98.4 million. As of March 31, 2022, the Company had unrestricted cash and cash equivalents of \$94.9 million and total working capital of \$127.9 million. The accompanying consolidated financial statements have been prepared under the assumption that we will continue as a going concern for the next twelve months. However, there is substantial doubt about the Company’s ability to continue as a going concern.

Our ability to continue as a going concern is dependent upon our ability to obtain additional equity or debt financing or generate profitable operations. Historically we have funded operations through issuances of common and preferred stock and through a reverse recapitalization via our merger with Insurance Acquisition Corp. in October 2020. We have also historically funded vehicle inventory purchases through our vehicle floorplan facilities. There can be no assurance that additional financing will be available or will be available on commercially reasonable terms. The inclusion of disclosures expressing substantial doubt about our ability to continue as a going concern could materially adversely affect our stock price and our ability to raise new capital or enter into strategic alliances.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS**EXHIBIT INDEX**

| Exhibit No. | Description |
|--------------------|---|
| 2.1 | Asset Purchase Agreement, dated as of March 14, 2022, by and among Shift Technologies, Inc., Fair Financial Corp., Fair IP, LLC, and, solely for purposes of Article IV, Article IX and Article X thereof, Cayman Project 2 Limited (incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K filed on March 15, 2022). |
| 10.1 | Commitment Letter, dated March 14, 2022, by and between Shift Technologies, Inc. and SoftBank Group Corp (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed on March 15, 2022). |
| 10.2 | Controlled Equity OfferingSM Sales Agreement, dated as of May 6, 2022, by and among Shift Technologies, Inc. and Cantor Fitzgerald & Co. (incorporated by reference to Exhibit 1.1 of the Current Report on Form 8-K filed on May 6, 2022). |
| 31.1 | Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15(d)-14(a), as adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 31.3 | Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15(d)-14(a), as adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 32.1 | Certification of Principal Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 101.INS | Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document |
| 101.SCH | Inline XBRL Taxonomy Extension Schema Document |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | Inline XBRL Taxonomy Extension Labels Linkbase Document |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase Document |
| 104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) |

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHIFT TECHNOLOGIES, INC.

/s/ Oded Shein

Oded Shein
Chief Financial Officer
May 10, 2022

**CERTIFICATIONS PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, George Arison, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Shift Technologies, Inc;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ George Arison

George Arison
Chief Executive Officer and Chairman of the Board of Directors
May 10, 2022

**CERTIFICATIONS PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Oded Shein, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Shift Technologies, Inc;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Oded Shein

Oded Shein
Chief Financial Officer
May 10, 2022

**CERTIFICATIONS PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Shift Technologies, Inc., a Delaware corporation (the "Company"), on Form 10-Q for the three months ended March 31, 2022, as filed with the Securities and Exchange Commission (the "Report"), George Arison, Chief Executive Officer of the Company, and Oded Shein, Chief Financial Officer (Principal Financial Officer) of the Company, each hereby certifies, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to his or her knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ George Arison

George Arison Chief Executive Officer
May 10, 2022

/s/ Oded Shein

Oded Shein
Chief Financial Officer
May 10, 2022