TRUPANION, INC.
Form 10-Q
November 09, 2018

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

or

o 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: 001-36537

TRUPANION, INC.

(Exact name of registrant as specified in its charter)

Delaware	**83-0480694**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

6100 4th Avenue S, Suite 200
Seattle, Washington 98108
(855) 727 - 9079

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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. xYes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if smaller reporting company)	Smaller reporting company	o
		Emerging growth company	x

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. x

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

As of November 1, 2018, there were approximately 33,419,934 shares of the registrant's common stock outstanding.

TRUPANION, INC.
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Note About Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and section 27A of the Securities Act of 1933, as amended (Securities Act). All statements contained in this Quarterly Report on Form 10-Q other than statements of historical fact, including statements regarding our future results of operations and financial position, our business strategy and plans and our objectives for future operations, are forward-looking statements. The words “believe,” “may,” “will,” “potentially,” “estimate,” “target,” “continue,” “anticipate,” “intend,” “could,” “would,” “project,” “plan” and “expect,” and similar expressio convey uncertainty of future events or outcomes, are intended to identify forward-looking statements.

These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in Part II. Item 1A. “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely on forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. We undertake no obligation to update publicly any forward-looking statements for any reason, except as required by law.

Unless otherwise stated or the context otherwise indicates, references to “we,” “us,” “our” and similar references refer to Trupanion, Inc. and its subsidiaries taken as a whole.

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
TRUPANION, INC.
Consolidated Statements of Operations
(in thousands, except share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue	$78,164	$ 63,118	$221,316	$176,122
Cost of revenue:				
Veterinary invoice expense	54,303	43,453	156,196	123,649
Other cost of revenue	10,117	7,858	27,959	21,160
Gross profit	13,744	11,807	37,161	31,313
Operating expenses:				
Technology and development	2,299	2,471	6,761	7,196
General and administrative	4,174	4,017	13,242	12,274
Sales and marketing	6,365	4,862	18,005	13,323
Total operating expenses	12,838	11,350	38,008	32,793
Operating income (loss)	906	457	(847)	(1,480)
Interest expense	336	124	887	370
Other (income) expense, net	(628)	(99)	(1,071)	(1,239)
Income (loss) before income taxes	1,198	432	(663)	(611)
Income tax (benefit) expense	(7)	26	(11)	54
Net income (loss)	$1,205	$ 406	$(652)	$(665)
Net income (loss) per share:				
Basic	$0.04	$ 0.01	$(0.02)	$(0.02)
Diluted	$0.03	$ 0.01	$(0.02)	$(0.02)
Weighted average shares of common stock outstanding:				
Basic	33,129,416	30,037,282	31,376,239	29,500,958
Diluted	36,385,360	33,113,981	31,376,239	29,500,958

See accompanying notes to the consolidated financial statements.

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TRUPANION, INC.
Consolidated Statements of Comprehensive Income (Loss)
(in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	$1,205	$406	$(652)	$(665)
Other comprehensive income (loss):				
Foreign currency translation adjustments	77	193	(242)	317
Net unrealized gain on available-for-sale debt securities	—	1	—	9
Other comprehensive income (loss), net of taxes	77	194	(242)	326
Comprehensive income (loss)	$1,282	$600	$(894)	$(339)

See accompanying notes to the consolidated financial statements.

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TRUPANION, INC.
Consolidated Balance Sheets
(in thousands, except share data)

	September 30, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$34,677	$25,706
Short-term investments	39,422	37,590
Accounts and other receivables	31,985	20,367
Prepaid expenses and other assets	4,184	2,895
Total current assets	110,268	86,558
Restricted cash	1,400	600
Long-term investments, at fair value	3,545	3,237
Property and equipment, net	69,998	7,868
Intangible assets, net	8,084	4,972
Other long-term assets	6,580	2,624
Total assets	$199,875	$105,859
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$2,163	$2,716
Accrued liabilities and other current liabilities	12,006	7,660
Reserve for veterinary invoices	14,216	12,756
Deferred revenue	32,848	22,734
Total current liabilities	61,233	45,866
Long-term debt	8,604	9,324
Deferred tax liabilities	1,002	1,002
Other liabilities	1,174	1,233
Total liabilities	72,013	57,425
Stockholders' equity:		
Common stock: $0.00001 par value, 100,000,000 shares authorized; 34,171,653 and 33,415,668 shares issued and outstanding at September 30, 2018; 30,778,796 and 30,121,496 shares issued and outstanding at December 31, 2017	—	—
Preferred stock: $0.00001 par value, 10,000,000 shares authorized; no shares issued and outstanding	—	—
Additional paid-in capital	217,833	134,511
Accumulated other comprehensive loss	(334)	(92)
Accumulated deficit	(83,436)	(82,784)
Treasury stock, at cost: 755,985 shares at September 30, 2018 and 657,300 shares at December 31, 2017	(6,201)	(3,201)
Total stockholders' equity	127,862	48,434
Total liabilities and stockholders' equity	$199,875	$105,859

See accompanying notes to the consolidated financial statements.

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TRUPANION, INC.
Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Nine Months Ended September 30, 2018	2017
Operating activities		
Net loss	$(652)	$(665)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	3,027	3,208
Stock-based compensation expense	3,553	2,564
Gain on sale of equity method investment	—	(1,036)
Other, net	(237)	243
Changes in operating assets and liabilities:		
Accounts and other receivables	(11,592)	(10,164)
Prepaid expenses and other assets	(549)	(297)
Accounts payable, accrued liabilities, and other liabilities	3,849	2,122
Reserve for veterinary invoices	1,484	1,639
Deferred revenue	10,133	9,075
Net cash provided by operating activities	9,016	6,689
Investing activities		
Purchases of fixed maturity investment securities	(29,567)	(20,704)
Maturities of fixed maturity investment securities	27,405	15,878
Purchases of other investments	(3,000)	—
Acquisition of lease intangibles, related to corporate real estate acquisition	(2,959)	—
Proceeds from sale of equity method investment	—	1,402
Purchases of property and equipment	(55,856)	(2,247)
Other	(852)	(2,762)
Net cash used in investing activities	(64,829)	(8,433)
Financing activities		
Proceeds from public offering of common stock, net of offering costs	65,690	—
Proceeds from exercise of stock options	2,872	2,082
Shares withheld to satisfy tax withholding	(1,839)	(1,170)
Proceeds from exercise of warrants	300	—
Proceeds from debt financing, net of financing fees	9,189	2,420
Repayment of debt financing	(10,000)	—
Other financing	(535)	(412)
Net cash provided by financing activities	65,677	2,920
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash, net	(93)	436
Net change in cash, cash equivalents, and restricted cash	9,771	1,612
Cash, cash equivalents, and restricted cash at beginning of period	26,306	24,237
Cash, cash equivalents, and restricted cash at end of period	$36,077	$25,849
Supplemental disclosures		
Noncash investing and financing activities:		
Issuance of common stock for cashless exercise of warrants	$3,000	$—
Issuance of common stock for acquisition of corporate real estate	$9,640	$—
Purchases of property and equipment included in accounts payable and accrued liabilities	$165	$531

Property and equipment acquired under lease	$917	$689

See accompanying notes to the consolidated financial statements.

TRUPANION, INC.
Notes to the Consolidated Financial Statements (unaudited)
1. Nature of Operations and Significant Accounting Policies
Description of Business and Basis of Presentation
Trupanion, Inc. (collectively with its wholly-owned subsidiaries, the Company) provides medical insurance for cats and dogs throughout the United States, Canada and Puerto Rico.
The financial data as of December 31, 2017 was derived from the Company's audited consolidated financial statements. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and, in management's opinion, have been prepared on the same basis as the audited financial statements and include all adjustments, consisting of normal recurring adjustments, necessary for the fair presentation of the Company's financial position, results of operations, comprehensive (loss) income, and cash flows for the interim periods. These unaudited interim consolidated financial statements should be read in conjunction with the Company’s audited financial statements included in the Company’s Annual Report on Form 10-K, filed with the U.S Securities and Exchange Commission (SEC) on February 13, 2018 (the 2017 10-K). The Company's accounting policies are described in Note 1 to the audited financial statements included in the 2017 10-K. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the full fiscal year or any other interim period.
Follow-on Common Stock Offerings
In June 2018, the Company completed a follow-on public offering (the June 2018 follow-on public offering) whereby the Company sold 2,090,909 shares of common stock (inclusive of 272,727 shares of common stock sold by the Company pursuant to the full exercise of the underwriters' option to purchase additional shares) at a price to the public of $33.00 per share. The Company received aggregate net proceeds from the June 2018 follow-on public offering of $65.7 million, after deducting underwriting discounts and commissions and offering expenses payable by the Company. The proceeds were primarily used to lower expenses through the purchase of real estate consisting of properties in use as corporate offices and leased to third parties. In addition, in August 2018, the Company issued 303,030 shares of common stock via a private placement to an accredited investor as a portion of the purchase price of the real estate. See Note 6, Acquisition of Corporate Real Estate.
Use of Estimates
The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from such estimates. See Note 1 to the audited financial statements included in the 2017 10-K for additional discussion of these estimates and assumptions.
Acquisition of Real Estate
The Company’s real estate acquisition was determined to be an asset acquisition, with the purchase price allocated based on relative fair value of the assets acquired. Additionally, acquisition-related expenses were capitalized as part of the purchase price.
The Company assessed fair value based on Level 3 inputs within the fair value framework, which included estimated cash flow projections that utilized appropriate discount rates, capitalization rates, renewal probability and available market information, which included market rental rates and market rent growth rates. Estimates of future cash flows were based on a number of factors including historical operating results, known and anticipated trends, and market and economic conditions.
The fair value of tangible assets of the acquired property considers the value of the property as if it were vacant. The fair value of acquired “above- and below-” market leases was based on the estimated cash flow projections utilizing discount rates that reflected the risks associated with the leases acquired. The amount recorded was based on the present value of the difference between (i) the contractual amounts to be paid pursuant to each in-place lease and (ii) management’s estimate of fair market lease rates for each in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the extended term for any leases with below-market renewal options. Other intangible assets acquired included amounts for in-place lease values that were based on the Company’s evaluation of the specific characteristics of each tenant’s lease. Factors considered include estimates of

carrying costs during hypothetical expected lease-up periods, market conditions and costs to execute similar leases. In estimating carrying costs, the Company included estimates of lost rents at market rates during the hypothetical expected lease-up periods, which were dependent on local market conditions. In estimating costs to execute similar leases, the Company considered leasing commissions, legal and other related costs.

The results of operations related to our ownership of the building are included in the Company’s Consolidated Statements of Operations from the date of acquisition.

Rental Income

The Company records rental income within general and administrative expense in the Consolidated Statements of Operations. The Company recorded rental income of $0.4 million for the three and nine months ended September 30, 2018.

The following table summarizes the Company's future rental payments from non-cancellable leases in place as of September 30, 2018 (in thousands):

Year ending December 31:	
2018	$497
2019	1,972
2020	1,224
2021	1,210
2022	1,173
2023	1,210
Thereafter	3,238
Total rental payments	$10,524

Accumulated Other Comprehensive Loss

There were no reclassifications out of accumulated other comprehensive loss during the three and nine months ended September 30, 2018 and 2017.

Income Taxes

On December 22, 2017, the U.S. government enacted the Tax Cuts and Jobs Act (Tax Act), making broad and complex changes to the Internal Revenue Code. The Company has made significant judgments and estimates in accordance with its interpretation of the Tax Act. As additional guidance on the Tax Act becomes available, the Company may adjust its interpretation of the requirements, which may result in a material change to income tax benefit or expense in the period in which the adjustment is made.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) amending the accounting for leases. The ASU requires recognition of lease assets and liabilities for operating leases on the consolidated balance sheets. This ASU is effective for fiscal years beginning after December 15, 2018 including interim periods within that reporting period, with early adoption permitted. The Company plans to adopt this guidance as of January 1, 2019 and is currently evaluating the impact the ASU will have on its consolidated financial statements pursuant to the purchase of real estate described in Note 6.

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, Disclosure Update and Simplification, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. This final rule is effective on November 5, 2018, for interim filings submitted thereafter. The SEC has provided relief to registrants that file Form 10-Q shortly after the final rule's effective date, allowing presentation changes to take effect in the subsequent interim period. As such, the Company plans to adopt this guidance as of January 1, 2019 and is currently evaluating the impact the ruling will have on its consolidated financial statements.

2. Net Income (Loss) per Share

Basic net income (loss) per share is computed using the weighted average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is calculated using the weighted average number of shares of common stock plus, when dilutive, potential shares of common stock outstanding using the treasury-stock method. Potential shares of common stock outstanding include stock options, unvested restricted stock awards and restricted stock units, and warrants.

The components of basic and diluted earnings per share were as follows (in thousands, except share and per share information):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Basic earnings per share:				
Net income (loss)	$1,205	$ 406	$(652)	$ (665)
Shares used in computation:				
Weighted average shares of common stock outstanding	33,129,416	30,037,282	31,376,239	29,500,958
Basic earnings per share	$0.04	$ 0.01	$(0.02)	$ (0.02)
Diluted earnings per share:				
Net income (loss)	$1,205	$ 406	$(652)	$ (665)
Shares used in computation:				
Weighted average shares of common stock outstanding	33,129,416	30,037,282	31,376,239	29,500,958
Stock options	2,663,375	2,618,567	—	—
Restricted stock awards and units	236,932	919	—	—
Warrants	355,637	457,213	—	—
Weighted average number of shares	36,385,360	33,113,981	31,376,239	29,500,958
Diluted earnings per share	$0.03	$ 0.01	$(0.02)	$ (0.02)

The following potentially dilutive equity securities were not included in the diluted earnings per share of common stock calculation because they would have had an antidilutive effect:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options	3,647	480,360	3,234,932	4,118,884
Restricted stock awards and restricted stock units	—	—	439,798	234,758
Warrants	—	—	480,000	810,000

3. Fixed Maturity Investments

Long-term investments are classified as available-for-sale and short-term investments are classified as held-to-maturity. The following table summarizes the amortized cost, gross unrealized holding gains and losses, and estimates of fair value of fixed maturity investments (in thousands) as of September 30, 2018 and December 31, 2017:

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of September 30, 2018				
Long-term investments:				
Foreign deposits	$2,545	$ —	$ —	$2,545
Municipal bond	1,000	—	—	1,000
	$3,545	$ —	$ —	$3,545
Short-term investments:				
U.S. Treasury securities	$6,646	$ —	$ (3)	$6,643
Certificates of deposit	439	1	—	440
U.S. government funds	32,337	—	—	32,337
	$39,422	$ 1	$ (3)	$39,420

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of December 31, 2017				
Long-term investments:				
Foreign deposits	$2,237	$ —	$ —	$2,237
Municipal bond	1,000	—	—	1,000
	$3,237	$ —	$ —	$3,237
Short-term investments:				
U.S. Treasury securities	$5,783	$ —	$ (4)	$5,779
Certificates of deposit	690	1	—	691
U.S. government funds	31,117	—	—	31,117
	$37,590	$ 1	$ (4)	$37,587

Maturities of debt securities classified as available-for-sale were as follows (in thousands):

	September 30, 2018	
	Amortized Cost	Fair Value
Available-for-sale:		
Due after one year through five years	$3,545	$3,545
	$3,545	$3,545

The Company evaluated its securities for other-than-temporary impairment and considers the decline in market value for the securities to be primarily attributable to current economic and market conditions. For debt securities, the Company does not intend to sell, nor is it more likely than not that the Company will be required to sell, the securities prior to maturity or prior to the recovery of the amortized cost basis.

4. Other Investments

Investment in Variable Interest Entity

In July 2018, the Company purchased $3.0 million in preferred stock of a privately held corporation with a complementary business line. The Company does not have power over the activities that most significantly impact the economic performance of the variable interest entity and is, therefore, not the primary beneficiary. The Company's preferred stock is accounted for as an available-for-sale debt security. Through January 2020, the Company has agreed to purchase an additional $4.0 million in preferred stock of the variable interest entity, contingent upon the exercise of this option by the variable interest entity. The Company has the option to purchase the variable interest entity on the fifth anniversary of the initial preferred stock purchase. Additionally, the Company has extended a $2.5 million revolving line of credit to the variable interest entity. The Company's investment and amounts loaned under the line of credit are recorded in other long-term assets on the consolidated balance sheet.

Investment in Joint Venture

In September 2018, the Company acquired a non-controlling equity interest in a joint venture, whereby it has committed to licensing certain intellectual property and contributing up to $2.2 million AUD upon the achievement of specific operational milestones over a period of at least four years from the agreement execution date.

5. Fair Value

Investments

The following table summarizes, by major security type, the Company's assets that are measured at fair value on a recurring basis, and placement within the fair value hierarchy (in thousands):

	As of September 30, 2018			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	$1,400	$1,400	$—	$—
Money market funds	4,741	4,741	—	—
Fixed maturities:				
Foreign deposits	2,545	2,545	—	—
Municipal bond	1,000	—	1,000	—
Investment in variable interest entity	3,000	—	—	3,000
Total	$12,686	$8,686	$1,000	$3,000

	As of December 31, 2017			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	$600	$600	$—	$—
Money market funds	5,167	5,167	—	—
Fixed maturities:				
Foreign deposits	2,237	2,237	—	—
Municipal bond	1,000	—	1,000	—
Total	$9,004	$8,004	$1,000	$—

The Company measures the fair value of restricted cash, foreign deposits, and money market funds based on quoted prices in active markets for identical assets. The fair value of the municipal bond is based on either recent trades in inactive markets or quoted market prices of similar instruments and other significant inputs derived from or corroborated by observable market data. The estimated fair value of the Company's investment in the variable interest entity is a Level 3 measurement, and is based on market interest rates, the assessed creditworthiness of the entity, and the estimated fair value of the entity's common stock. As of September 30, 2018, the Company estimates that the purchase price approximates the fair value. Short-term investments are carried at amortized cost and the fair value is disclosed in Note 3, Investment Securities. The fair value of these investments is determined in the same manner as for available-for-sale securities and is considered a Level 1 measurement.

Fair Value Disclosures

The Company's other long-term assets balance included $3.1 million of notes receivable as of September 30, 2018 and $2.5 million of notes receivable as of December 31, 2017, recorded at its estimated collectible amount. The Company estimates that the carrying value of the note receivable approximates its fair value. The estimated fair value represents a Level 3 measurement within the fair value hierarchy, and is based on market interest rates and the assessed creditworthiness of the third party.

The Company estimates the fair value of its long-term debt based upon rates currently available to the Company for debt with similar terms and remaining maturities. This is a Level 3 measurement. Based upon the terms of the debt, the carrying amount of long-term debt approximated fair value at September 30, 2018 and December 31, 2017.

6. Acquisition of Corporate Real Estate

In June 2018, the Company entered into a Real Estate Purchase and Sale Agreement (Real Estate Purchase Agreement) with Benaroya Capital Company, L.L.C to purchase certain properties (Properties) as defined within the Real Estate Purchase Agreement, located at 6100 Fourth Avenue South, Seattle, Washington, which is the site of the Company's corporate headquarters. The purchase closed in August 2018 and the Company paid consideration consisting of $55.0 million in cash and 303,030 shares of common stock with an estimated fair value of $9.6 million. The issued shares carry registration rights (as to which the Company filed a registration statement on Form S-3, File No. 333-226752) and are subject to a lock-up period that continues to and includes June 25, 2020. The fair value of the issued shares was estimated as of the closing date for the real estate acquisition using the Black-Scholes option pricing model and the following assumptions:

Assumptions	**August 9, 2018 Fair Value**
Risk free interest rate	2.5 %
Expected volatility	36.72%
Expected life (years)	1.88
Expected dividend yield	— %

The purchase price was allocated to the following assets based on estimates of their relative fair value (in thousands):

Building and improvements	$46,379
Land and improvements	15,833
Lease-related intangible assets	2,959

The building, building improvements, and land are recorded within property and equipment, net, on the consolidated balance sheet. The properties are generally carried at cost less accumulated depreciation and amortization. The Company computes depreciation and amortization using the straight-line method over the estimated useful lives of the assets. The Company believes the useful lives of the building and building improvements is 39 years and the land improvements will be depreciated over a useful life of 10 years. The lease-related intangible assets relate to in-place lease agreements and will be amortized over a weighted-average useful life of 5.1 years. Amortization is expected to be approximately $0.5 million in each of the five succeeding years.

7. Debt

In June 2018, the Company amended its credit agreement, increasing its borrowing capacity from $30.0 million to $50.0 million, extending the maturity date to June 2021, and increasing the required amount of restricted cash. The facility is secured by any and all interests in the Company's assets that are not otherwise restricted. Interest on the revolving line of credit is payable monthly at the greater of 4.5%, or 1.25% plus the prime rate (6.50% at September 30, 2018). The credit agreement includes other ancillary services and letters of credit of up to $4.5 million, and requires a deposit of restricted cash of $1.4 million. As of September 30, 2018, the Company was in compliance with all financial and non-financial covenants required by the credit agreement.

Borrowings on the revolving line of credit are limited to the lesser of $50.0 million and the total amount of cash and securities held by the Company's insurance subsidiaries (American Pet Insurance Company and Wyndham Insurance Company (SAC) Limited Segregated Account AX). As of September 30, 2018, available borrowing capacity on the line of credit was $28.9 million, with an outstanding balance of $0.4 million for ancillary services and letters of credit, and borrowings under the facility of $8.8 million, recorded net of financing fees of $0.2 million.

8. Commitments and Contingencies

Litigation

From time to time, the Company is subject to litigation matters and claims arising from the ordinary course of business. The Company records a provision for a liability relating to legal matters when it is both probable that a material liability has been incurred and the amount of the loss can be reasonably estimated. At this time, the Company does not believe any such matters to be material individually or in the aggregate. These views are subject to change following the outcome of future events or the results of future developments.

Obligation to Purchase Additional Preferred Stock of Variable Interest Entity

In connection with its July 2018 investment in a variable interest entity (see Note 4), the Company agreed to invest an additional $4.0 million in equity of the variable interest entity, contingent upon the exercise of this option by the variable interest entity.

9. Reserve for Veterinary Invoices

The reserve for veterinary invoices is an estimate of the future amount the Company will pay for veterinary invoices that are dated as of, or prior to, its balance sheet date. The reserve also includes the Company's estimate of related internal processing costs. The reserve estimate involves actuarial projections, and is based on management's assessment of facts and circumstances currently known, and assumptions about anticipated patterns, including expected future trends in the number of veterinary invoices the Company will receive and the average cost of those veterinary invoices. The reserve is made for each of the Company's segments, subscription and other business, and is continually refined as the Company receives and pays veterinary invoices. Changes in management's assumptions and estimates may have a relatively large impact to the reserve and associated expense.

Reserve for veterinary invoices

Summarized below are the changes in the total liability for the Company's subscription business segment (in thousands):

	Nine Months Ended September 30,	
Subscription	**2018**	**2017**
Reserve at beginning of year	$11,059	$8,538
Veterinary invoices during the period related to:		
Current year	139,504	113,833
Prior years	364	(85)
Total veterinary invoice expense	139,868	113,748
Amounts paid during the period related to:		
Current year	128,233	104,501
Prior years	9,836	7,533
Total paid	138,069	112,034
Non-cash expenses	497	306
Reserve at end of period	$12,361	$9,946

The Company's reserve for the subscription business segment increased from $11.1 million at December 31, 2017 to $12.4 million at September 30, 2018. This change was comprised of $139.9 million in expense recorded during the period less $138.1 million in payments of veterinary invoices. The $139.9 million in veterinary invoice expense incurred includes an adjustment of $0.4 million to the reserves relating to prior years, which is the result of ongoing analysis of recent payment trends. For the nine months ended September 30, 2017, the Company decreased prior year reserves by $0.1 million as a result of analysis of payment trends.

Summarized below are the changes in total liability for the Company's other business segment (in thousands):

Other Business	**Nine Months Ended September 30, 2018**	**2017**
Reserve at beginning of year	$1,697	$983
Veterinary invoices during the period related to:		
Current year	16,632	10,074
Prior years	(304)	(173)
Total veterinary invoice expense	16,328	9,901
Amounts paid during the period related to:		
Current year	14,822	8,786
Prior years	1,348	789
Total paid	16,170	9,575
Non-cash expenses	—	—
Reserve at end of period	$1,855	$1,309

The Company’s reserve for the other business segment increased from $1.7 million at December 31, 2017 to $1.9 million at September 30, 2018. This change was comprised of $16.3 million in expense recorded during the period less $16.2 million in payments of veterinary invoices. The $16.3 million in veterinary invoice expense incurred includes a reduction of $0.3 million to the reserves relating to prior years, which is the result of ongoing analysis of recent payment trends. For the nine months ended September 30, 2017, the Company decreased prior year reserves by $0.2 million as a result of analysis of payment trends.

Reserve for veterinary invoices, by year of occurrence

In the following tables, the reserve for veterinary invoices for each segment is presented as the amount (in thousands) by year the veterinary invoice relates to, referred to as the year of occurrence.

Subscription	**As of September 30, 2018**
Year of Occurrence	
2016	$408
2017	1,179
2018	10,774
	$12,361

Other Business	**As of September 30, 2018**
Year of Occurrence	
2017	$ 44
2018	1,811
	$ 1,855

10. Stock-Based Compensation and Stockholders' Equity

Stock-based Compensation

Stock-based compensation expense includes stock options, restricted stock awards, and restricted stock units granted to employees and non-employees and has been reported in the Company’s consolidated statements of operations depending on the function performed by the employee or non-employee. Stock-based compensation expense recognized in the consolidated statements of operations was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Veterinary invoice expense	$153	$101	$421	$260
Other cost of revenue	96	69	277	172
Technology and development	58	57	167	166
General and administrative	634	503	1,708	1,416
Sales and marketing	358	165	980	550
Total stock-based compensation	$1,299	$895	$3,553	$2,564

As of September 30, 2018, for all employees, the Company had 564,647 unvested stock options and 439,798 unvested restricted stock awards and restricted stock units that are expected to vest. Stock-based compensation expense of $3.6 million related to unvested stock options and $8.0 million related to unvested restricted stock awards and restricted stock units, expected to be recognized over a weighted average period of approximately 2.1 years and 2.7 years, respectively.

Stock Options

A summary of the Company's stock option activity is as follows:

	Number Of Options	Weighted Average Exercise Price per Share	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2017	4,006,399	$ 7.16	$ 88,578
Granted	—	—	
Exercised	(695,452)	4.19	22,213
Forfeited	(76,015)	15.26	
Outstanding as of September 30, 2018	3,234,932	$ 7.61	$ 90,967
Exercisable as of September 30, 2018	2,666,951	$ 5.88	$ 79,606

As of September 30, 2018, stock options outstanding and stock options exercisable had a weighted average remaining contractual life of 4.9 years and 4.2 years, respectively.

Restricted Stock Awards and Restricted Stock Units

A summary of the Company’s restricted stock award and restricted stock unit activity is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested shares as of December 31, 2017	256,842	$4.77
Granted	339,856	28.33
Vested	(136,330)	8.05
Forfeited	(20,570)	28.25
Unvested shares as of September 30, 2018	439,798	$22.20

Stockholders' Equity

In the June 2018 follow-on public offering, the Company sold 2,090,909 shares of common stock (inclusive of 272,727 shares of common stock sold by the Company pursuant to the full exercise of the underwriters' option to purchase additional shares) at a price to the public of $33.00 per share. The Company received aggregate net proceeds of $65.7 million, after deducting underwriting discounts and commissions and offering expenses payable by the Company. As a part of the purchase of real estate described in Note 6, an additional 303,030 shares of common stock were issued via a private placement during August 2018.

During the nine months ended September 30, 2018, 330,000 of the Company's outstanding warrants were exercised. As of September 30, 2018, warrants to purchase 480,000 shares of the Company's common stock at $10.00 per share remained outstanding. The warrants automatically convert to common stock in 2019.

11. Segments

The Company has two segments: subscription business and other business. The subscription business segment includes monthly subscription fees related to the Company's medical insurance which is marketed directly to consumers, while the other business segment includes all other business that is not directly marketed to consumers. The chief operating decision maker uses two measures to evaluate segment performance: revenue and gross profit. Additionally, other operating expenses, such as sales and marketing expenses, are allocated to each segment and evaluated when material. Interest and other expenses and income taxes are not allocated to the segments, nor included in the measure of segment profit or loss. The Company does not analyze discrete segment balance sheet information related to long-term assets.

Revenue and gross profit of the Company's segments were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue:				
Subscription business	$67,421	$56,493	$192,805	$159,363
Other business	10,743	6,625	28,511	16,759
	78,164	63,118	221,316	176,122
Veterinary invoice expense:				
Subscription business	48,285	39,761	139,868	113,748
Other business	6,018	3,692	16,328	9,901
	54,303	43,453	156,196	123,649
Other cost of revenue:				
Subscription business	6,468	5,454	18,232	15,304
Other business	3,649	2,404	9,727	5,856
	10,117	7,858	27,959	21,160
Gross profit:				
Subscription business	12,668	11,278	34,705	30,311
Other business	1,076	529	2,456	1,002
	13,744	11,807	37,161	31,313
Technology and development	2,299	2,471	6,761	7,196
General and administrative	4,174	4,017	13,242	12,274
Sales and marketing:				
Subscription business	6,266	4,811	17,730	13,161
Other business	99	51	275	162
	6,365	4,862	18,005	13,323
Operating income (loss)	$906	$457	$(847)	$(1,480)

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The following table presents the Company’s revenue by geographic region of the member (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
United States	$63,517	$50,506	$178,957	$141,946
Canada	14,647	12,612	42,359	34,176
Total revenue	$78,164	$63,118	$221,316	$176,122

Substantially all of the Company’s long-lived assets were located in the United States as of September 30, 2018 and December 31, 2017.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Overview
We provide medical insurance for cats and dogs throughout the United States, Canada and Puerto Rico. Our data-driven, vertically-integrated approach enables us to provide pet owners with what we believe is the highest value medical insurance for their pets, priced specifically for each pet's unique characteristics. Our growing and loyal member base provides us with highly predictable and recurring revenue. We operate our business similar to other subscription-based businesses, with a focus on maximizing the lifetime value of each pet while sustaining a favorable ratio of lifetime value relative to pet acquisition cost, based on our desired return on investment.
We operate in two business segments: subscription business and other business. We generate revenue in our subscription business segment primarily from subscription fees for our medical insurance, which we market to consumers. Fees are paid at the beginning of each subscription period, which automatically renews on a monthly basis. We generate revenue in our other business segment writing policies on behalf of third parties, where we do not undertake the marketing, and have more of a business-to-business relationship. Our other business segment consists of companies or organizations that choose to provide medical insurance for cats and dogs as a benefit to their employees or members, and contracts include multiple pets. The policies in our other business segment may be materially different from our subscription business. Our ultimate goal is to build the Trupanion brand by continuing to offer the highest value proposition in the industry and maintain strong alignment with the veterinary community. We believe our activities in our other business segment benefit the overall market for pet medical insurance by expanding upon product options and distribution models within other market niches.
We generate leads for our subscription business through both third-party referrals and direct-to-consumer acquisition channels, which we then convert into members through our website and contact center. Veterinary practices represent our largest referral source. We engage a national referral group of Territory Partners. These independent contractors are dedicated to cultivating direct veterinary relationships and building awareness of the benefits of our subscription to veterinarians and their clients. Veterinarians then educate pet owners, who visit our website or call our contact center to learn more about, and potentially enroll in, Trupanion. We pay Territory Partners fees based on activity in their regions. We also receive a significant number of new leads from existing members adding pets and referring their friends and family members. Our direct-to-consumer acquisition channels serve as important resources for pet owner education and drive new member leads and conversion. We continuously evaluate the effectiveness of our member acquisition channels and marketing initiatives based upon their return on investment, which we measure by comparing the ratio of the lifetime value of a pet generated through each specific channel or initiative to the related acquisition cost. We believe our patent-protected, proprietary software platform, Trupanion Express®, which allows direct invoicing by veterinarians, provides a significant strategic advantage.

Key Operating Metrics

The following table sets forth our key operating metrics for our subscription business and total pets enrolled for the nine-month periods ended September 30, 2018 and 2017 and each of the last eight fiscal quarters.

	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Total pets enrolled (at period end)	497,942	404,069
Total subscription pets enrolled (at period end)	416,527	359,102
Monthly average revenue per pet	$54.06	$51.67
Lifetime value of a pet (LVP)	$714	$701
Average pet acquisition cost (PAC)	$157	$141
Average monthly retention	98.61 %	98.61 %

	Period Ended Sept. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sept. 30, 2017	Jun. 30, 2017	Mar. 31, 2017	Dec. 31, 2016
Total pets enrolled (at period end)	497,942	472,480	446,533	423,194	404,069	383,293	364,259	343,649
Total subscription pets enrolled (at period end)	416,527	401,033	385,640	371,683	359,102	346,409	334,909	323,233
Monthly average revenue per pet	$54.55	$53.96	$53.62	$53.17	$52.95	$51.47	$50.50	$49.17
Lifetime value of a pet (LVP)	$714	$732	$727	$727	$701	$654	$637	$631
Average pet acquisition cost (PAC)	$155	$150	$165	$184	$151	$143	$128	$133
Average monthly retention	98.61 %	98.64 %	98.63 %	98.63 %	98.61 %	98.57 %	98.58 %	98.60 %

Total pets enrolled. Total pets enrolled reflects the number of subscription pets or pets enrolled in one of the insurance products offered in our other business segment at the end of each period presented. We monitor total pets enrolled because it provides an indication of the growth of our consolidated business.

Total subscription pets enrolled. Total subscription pets enrolled reflects the number of pets in active memberships at the end of each period presented. We monitor total subscription pets enrolled because it provides an indication of the growth of our subscription business.

Monthly average revenue per pet. Monthly average revenue per pet is calculated as amounts billed in a given month for subscriptions divided by the total number of subscription pet months in the period. Total subscription pet months in a period represents the sum of all pets enrolled for each month during the period. We monitor monthly average revenue per pet because it is an indicator of the per pet unit economics of our business.

Lifetime value of a pet. Lifetime value of a pet (LVP) is a business operating metric that we believe reflects the lifetime value we might expect from a new subscription pet enrollment. We calculate LVP based on gross profit from our subscription business segment for the 12 months prior to the period end date excluding stock-based compensation expense related to cost of revenue from our subscription business segment, sign-up fee revenue and the change in deferred revenue between periods, multiplied by the implied average subscriber life in months. Implied average subscriber life in months is calculated as the quotient obtained by dividing one by one minus the average monthly retention rate. We monitor LVP to assess how much lifetime value we might expect from new pets over their implied average subscriber life in months and to evaluate the amount of sales and marketing expenses we may want to incur to attract new pet enrollments.

Average pet acquisition cost. Average pet acquisition cost (PAC) is calculated as net acquisition cost divided by the total number of new subscription pets enrolled in that period. Net acquisition cost, a non-GAAP financial measure, is calculated in a reporting period as sales and marketing expense, excluding stock-based compensation expense and other business segment sales and marketing expense, offset by sign-up fee revenue. We exclude stock-based compensation expense because the amount varies from period to period based on number of awards issued and market-based valuation inputs. We offset sign-up fee revenue because it is a one-time charge to new members collected at the time of enrollment used to partially offset initial setup costs, which are included in sales and marketing expenses. We exclude other business segment sales and marketing expense because that does not relate to subscription enrollments. We monitor average pet acquisition cost to evaluate the efficiency of our sales and marketing programs in acquiring new members and measure effectiveness using the ratio of our lifetime value of a pet to average pet acquisition cost, based on our desired return on investment.

Average monthly retention. Average monthly retention is measured as the monthly retention rate of enrolled subscription pets for each applicable period averaged over the 12 months prior to the period end date. As such, our average monthly retention rate as of September 30, 2018 is an average of each month's retention from October 1, 2017 through September 30, 2018. We calculate monthly retention as the number of pets that remain after subtracting all pets that cancel during a month, including pets that enroll and cancel within that month, divided by the total pets enrolled at the beginning of that month. We monitor average monthly retention because it provides a measure of member satisfaction and allows us to calculate the implied average subscriber life in months.

Non-GAAP Financial Measures

We believe that using net acquisition cost to calculate and present certain of our other key metrics is helpful to our investors and an important tool for financial and operational decision-making and evaluating our operating results over different periods of time. Measuring net acquisition cost by removing stock-based compensation expense and other business segment sales and marketing expense offset by sign-up fee revenue provides for a more comparable metric across periods.

This measure, which is a non-GAAP financial measure, may not provide information that is directly comparable to that provided by other companies in our industry. In addition, this measure excludes stock-based compensation expense, which has been, and is expected to continue to be for the foreseeable future, a significant recurring component of our sales and marketing expense. The presentation and utilization of non-GAAP financial measures is not meant to be considered in isolation or as a substitute for the directly comparable financial measures prepared in accordance with GAAP.

The following table reflects the reconciliation of net acquisition cost to sales and marketing expense (in thousands):

	Nine Months Ended September 30,	
	2018	2017
Sales and marketing expense	$18,005	$13,323
Net of sign-up fee revenue	(1,933)	(1,619)
Excluding:		
Stock-based compensation expense	(980)	(550)
Other business segment sales and marketing expense	(275)	(162)
Net acquisition cost	$14,817	$10,992

	Period Ended							
	Sept. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sept. 30, 2017	Jun. 30, 2017	Mar. 31, 2017	Dec. 31, 2016
Sales and marketing expense	$6,365	$5,702	$5,938	$5,781	$4,862	$4,372	$4,089	$3,951
Net of sign-up fee revenue	(693)	(624)	(616)	(550)	(558)	(517)	(544)	(526)
Excluding:								
Stock-based compensation expense	(358)	(349)	(273)	(172)	(165)	(198)	(187)	(113)
Other business segment sales and marketing expense	(99)	(88)	(87)	(56)	(51)	(63)	(48)	(62)
Net acquisition cost	$5,215	$4,641	$4,962	$5,003	$4,088	$3,594	$3,310	$3,250

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Components of Operating Results

General

We operate in two business segments: subscription business and other business. Our subscription business segment includes revenue and expenses related to monthly subscriptions for pet medical insurance, which we market to consumers. When we do not directly market and sell to consumers, we classify the related revenue and expenses in our other business segment.

Revenue

We generate revenue in our subscription business segment primarily from subscription fees for our pet medical insurance. Fees are paid at the beginning of each subscription period, which automatically renews on a monthly basis. In most cases, our members authorize us to directly charge their credit card, debit card or bank account through automatic funds transfer. Subscription revenue is recognized on a pro rata basis over the monthly enrollment term. Membership may be canceled at any time without penalty, and we issue a refund for the unused portion of the canceled membership.

We generate revenue in our other business segment primarily from writing policies on behalf of third parties where we do not undertake the direct consumer marketing. This segment includes the writing of policies that may be materially different from our subscription.

Cost of Revenue

Cost of revenue in each of our segments is comprised of the following:

Veterinary invoice expense

Veterinary invoice expense includes our costs to review veterinary invoices, administer the payments, and provide member services, and other operating expenses directly or indirectly related to this process. We also accrue for veterinary invoices that have been incurred but not yet received. This also includes amounts paid by unaffiliated general agents, and an estimate of amounts incurred and not yet paid for our other business segment.

Other cost of revenue

Other cost of revenue for the subscription business segment includes direct and indirect member service expenses, Territory Partner renewal fees, credit card transaction fees and premium tax expenses. Other cost of revenue for the other business segment includes the commissions we pay to unaffiliated general agents, costs to administer the programs in the other business segment and premium taxes on the sales in this segment.

Operating Expenses

Our operating expenses are classified into three categories: technology and development, general and administrative, and sales and marketing. For each category, the largest component is personnel costs, which include salaries, employee benefit costs, bonuses and stock-based compensation expense.

Technology and Development

Technology and development expenses primarily consist of personnel costs and related expenses for our technology staff, which includes information technology development and infrastructure support, third-party services and depreciation of hardware and capitalized software.

General and Administrative

General and administrative expenses consist primarily of personnel costs and related expenses for our finance, actuarial, human resources, regulatory, legal and general management functions, facilities, income and expenses related to owning our corporate headquarters building, and professional services.

Sales and Marketing

Sales and marketing expenses primarily consist of the cost to educate veterinarians and consumers about the benefits of Trupanion, to generate leads and to convert leads into enrolled pets, as well as print, online and promotional advertising costs, and employee compensation and related costs. Sales and marketing expenses are driven primarily by investments to acquire new members.

Factors Affecting Our Performance

Average monthly retention. Our performance depends on our ability to continue to retain our existing and newly enrolled pets and is impacted by our ability to provide a best-in-class value and member experience. Our ability to retain enrolled pets depends on a number of factors, including the actual and perceived value of our services and the quality of our member experience, the ease and transparency of the process for reviewing and paying veterinary invoices for our members, and the competitive environment. In addition, other initiatives across our business may temporarily impact retention and make it difficult for us to improve or maintain this metric. For example, if the number of new pets enrolled increases at a faster rate than our historical experience, our average monthly retention rate could be adversely impacted, as our retention rate is generally lower during the first year of member enrollment.

Investment in pet acquisition. We have made and plan to continue to make significant investments to grow our member base. Our net acquisition cost and the number of new members we enroll depends on a number of factors, including the amount we elect to invest in sales and marketing activities in any particular period in the aggregate and by channel, the frequency of existing members adding a pet or referring their friends or family, effectiveness of our sales execution and marketing initiatives, changes in costs of media, the mix of our sales and marketing expenditures and the competitive environment. Our average pet acquisition cost has in the past significantly varied, and in the future may significantly vary, from period to period based upon specific marketing initiatives and the actual or expected relationship to LVP and estimated rates of return on pet acquisition spend. We also regularly test new member acquisition channels and marketing initiatives, which may be more expensive than our traditional marketing channels and may increase our average acquisition costs. We continually assess our sales and marketing activities by monitoring the ratio of LVP to PAC and the return on PAC spend both on a detailed level by acquisition channel and in the aggregate.

Timing of initiatives. Over time we plan to implement new initiatives to improve our member experience, make modifications to our subscription plan and find other ways to maintain a strong value proposition for our members. These initiatives will sometimes be accompanied by price adjustments, in order to compensate for an increase in benefits received by our members. The implementation of such initiatives may not always coincide with the timing of price adjustments, resulting in fluctuations in revenue and gross profit in our subscription business segment.

Geographic mix of sales. The relative mix of our business between the United States and Canada impacts the monthly average revenue per pet we receive. Prices for our plan in Canada are generally higher than in the United States (in local currencies), which is consistent with the relative cost of veterinary care in each country. In addition, as our mix of business between the United States and Canada changes, our exposure to foreign exchange fluctuations will be impacted.

Other business segment. Our other business segment primarily includes revenue and expenses related to policies written on behalf of third parties. This segment includes the writing of policies that may be materially different from our subscription. Our relationships in our other business segment are generally subject to termination provisions and are non-exclusive. Accordingly, we cannot control the volume of business, even if a contract is not terminated. Loss of an entire program via contract termination could result in the associated policies and revenues being lost over a period of 12 to 18 months, which could have a material impact on our results of operations. We may enter into additional relationships in the future to the extent we believe they will be profitable to us, which could also impact our operating results.

Results of Operations

The following tables set forth our results of operations for the periods presented both in absolute dollars and as a percentage of total revenue for those periods. The period-to-period comparison of financial results is not necessarily indicative of future results.

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
	(in thousands)			
Revenue:				
Subscription business	$67,421	$56,493	$192,805	$159,363
Other business	10,743	6,625	28,511	16,759
Total revenue	78,164	63,118	221,316	176,122
Cost of revenue:				
Subscription business(1)	54,753	45,215	158,100	129,052
Other business	9,667	6,096	26,055	15,757
Total cost of revenue	64,420	51,311	184,155	144,809
Gross profit:				
Subscription business	12,668	11,278	34,705	30,311
Other business	1,076	529	2,456	1,002
Total gross profit	13,744	11,807	37,161	31,313
Operating expenses:				
Technology and development(1)	2,299	2,471	6,761	7,196
General and administrative(1)	4,174	4,017	13,242	12,274
Sales and marketing(1)	6,365	4,862	18,005	13,323
Total operating expenses	12,838	11,350	38,008	32,793
Operating income (loss)	906	457	(847)	(1,480)
Interest expense	336	124	887	370
Other (income) expense, net	(628)	(99)	(1,071)	(1,239)
Income (loss) before income taxes	1,198	432	(663)	(611)
Income tax (benefit) expense	(7)	26	(11)	54
Net income (loss)	$1,205	$406	$(652)	$(665)

(1) Includes stock-based compensation expense as follows:

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
	(in thousands)			
Cost of revenue	$249	$170	$698	$432
Technology and development	58	57	167	166
General and administrative	634	503	1,708	1,416
Sales and marketing	358	165	980	550
Total stock-based compensation expense	$1,299	$895	$3,553	$2,564

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(as a percentage of revenue)			
Revenue	100 %	100 %	100 %	100 %
Cost of revenue	82	81	83	82
Gross profit	18	19	17	18
Operating expenses:				
Technology and development	3	4	3	4
General and administrative	5	6	6	7
Sales and marketing	8	8	8	8
Total operating expenses	16	18	17	19
Operating income (loss)	1	1	—	(1)
Interest expense	—	—	—	—
Other (income) expense, net	(1)	—	—	(1)
Income (loss) before income taxes	2	1	—	—
Income tax (benefit) expense	—	—	—	—
Net income (loss)	2 %	1 %	— %	— %

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(as a percentage of subscription revenue)			
Subscription business revenue	100 %	100 %	100 %	100 %
Subscription business cost of revenue	81	80	82	81
Subscription business gross profit	19 %	20 %	18 %	19 %

Comparison of the Three and Nine Months Ended September 30, 2018 and 2017

Revenue

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	% Change	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017	% Change
	(in thousands, except percentages, pet and per pet data)					
Revenue:						
Subscription business	$67,421	$56,493	19 %	$192,805	$159,363	21 %
Other business	10,743	6,625	62	28,511	16,759	70
Total revenue	$78,164	$63,118	24	$221,316	$176,122	26
Percentage of Revenue by Segment:						
Subscription business	86 %	90 %		87 %	90 %	
Other business	14	10		13	10	
Total revenue	100	100		100	100	
Total pets enrolled (at period end)	497,942	404,069	23	497,942	404,069	23
Total subscription pets enrolled (at period end)	416,527	359,102	16	416,527	359,102	16
Monthly average revenue per pet	$54.55	$52.95	3	$54.06	$51.67	5
Average monthly retention	98.61 %	98.61 %		98.61 %	98.61 %	

Three months ended September 30, 2018 compared to three months ended September 30, 2017. Total revenue increased by $15.0 million to $78.2 million for the three months ended September 30, 2018, or 24%. Revenue from our subscription business segment increased by $10.9 million to $67.4 million for the three months ended September 30, 2018, or 19%. This increase in subscription business revenue was primarily due to a 16% increase in total subscription pets enrolled as of September 30, 2018 compared to September 30, 2017, and an increase in average revenue per pet of 3% for the same period. Increases in pricing were primarily due to the increased cost and utilization of veterinary care. Revenue from our other business segment increased $4.1 million to $10.7 million for the three months ended September 30, 2018, or 62%, primarily due to an 81% increase in enrolled pets in this segment.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017. Total revenue increased by $45.2 million to $221.3 million for the nine months ended September 30, 2018, or 26%. Revenue from our subscription business segment increased by $33.4 million to $192.8 million for the nine months ended September 30, 2018, or 21%. This increase in subscription business revenue was primarily due to a 16% increase in total subscription pets enrolled as of September 30, 2018 compared to September 30, 2017, and an increase in average revenue per pet of 5% for the same period. Increases in pricing were primarily due to the increased cost and utilization of veterinary care. Revenue from our other business segment increased $11.8 million to $28.5 million for the nine months ended September 30, 2018, or 70%, primarily due to an 81% increase in enrolled pets in this segment.

Cost of Revenue

	Three Months Ended September 30, 2018	2017	% Change	Nine Months Ended September 30, 2018	2017	% Change
	(in thousands, except percentages, pet and per pet data)					
Cost of Revenue:						
Subscription business:						
Veterinary invoice expense	$48,285	$39,761	21 %	$139,868	$113,748	23 %
Other cost of revenue	6,468	5,454	19	18,232	15,304	19
Total cost of revenue	$54,753	$45,215	21	$158,100	$129,052	23
Gross profit	$12,668	$11,278	12	$34,705	$30,311	14
Other business:						
Veterinary invoice expense	6,018	3,692	63	16,328	9,901	65
Other cost of revenue	3,649	2,404	52	9,727	5,856	66
Total cost of revenue	$9,667	$6,096	59	$26,055	$15,757	65
Gross profit	$1,076	$529	103	$2,456	$1,002	145
Percentage of Revenue by Segment:						
Subscription business:						
Veterinary invoice expense	71 %	70 %		73 %	71 %	
Other cost of revenue	10	10		9	10	
Total cost of revenue	81	80		82	81	
Gross profit	19	20		18	19	
Other business:						
Veterinary invoice expense	56	56		57	59	
Other cost of revenue	34	36		34	35	
Total cost of revenue	90	92		91	94	
Gross profit	10	8		9	6	
Total pets enrolled (at period end)	497,942	404,069	23	497,942	404,069	23
Total subscription pets enrolled (at period end)	416,527	359,102	16	416,527	359,102	16
Monthly average revenue per pet	$54.55	$52.95	3	$54.06	$51.67	5

Three months ended September 30, 2018 compared to three months ended September 30, 2017. Total cost of revenue for our subscription business segment increased by $9.5 million to $54.8 million for the three months ended September 30, 2018, or 21%. This increase in subscription cost of revenue was primarily the result of a 16% increase in subscription pets enrolled and increases in the cost and utilization of veterinary care. As a percentage of revenue, cost of revenue for our subscription business segment increased to 81% for the three months ended September 30, 2018, compared to 80% for the three months ended September 30, 2017. Total cost of revenue for our other business segment increased by $3.6 million to $9.7 million for the three months ended September 30, 2018, primarily due to an increase in enrolled pets in this segment.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017. Total cost of revenue for our subscription business segment increased by $29.0 million to $158.1 million for the nine months ended September 30, 2018, or 23%. This increase in subscription cost of revenue was primarily the result of a 16% increase in subscription pets enrolled and increases in the cost and utilization of veterinary care. As a percentage of revenue, cost of revenue for our subscription business segment increased to 82% of revenue, for the nine months ended September 30, 2018, compared to 81% for the nine months ended September 30, 2017. Total cost of revenue for our other business segment increased by $10.3 million to $26.1 million for the nine months ended September 30, 2018, primarily due to an increase in enrolled pets in this segment.

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Technology and Development Expenses

	Three Months Ended September 30,		% Change	Nine Months Ended September 30,		% Change
	2018	2017		2018	2017	
	(in thousands, except percentages)					
Technology and development	$2,299	$2,471	(7)%	$6,761	$7,196	(6)%
Percentage of total revenue	3 %	4 %		3 %	4 %	

Three months ended September 30, 2018 compared to three months ended September 30, 2017. Technology and development expenses decreased $0.2 million, or 7%, to $2.3 million for the three months ended September 30, 2018. The cost of IT personnel, both internal employees and consultants, remained consistent between periods. Technology and development expenses saw a benefit from more resources dedicated to capital projects, resulting in a higher proportion of costs being capitalized than in the prior year.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017. Technology and development expenses decreased $0.4 million, or 6%, to $6.8 million for the nine months ended September 30, 2018. This was primarily due to having more resources dedicated to capital projects, resulting in a higher proportion of costs being capitalized than in the prior year. In addition, amortization on previously capitalized internally-developed software projects decreased as projects became fully amortized.

General and Administrative Expenses

	Three Months Ended September 30,		% Change	Nine Months Ended September 30,		% Change
	2018	2017		2018	2017	
	(in thousands, except percentages)					
General and administrative	$4,174	$4,017	4 %	$13,242	$12,274	8 %
Percentage of total revenue	5 %	6 %		6 %	7 %	

Three months ended September 30, 2018 compared to three months ended September 30, 2017. General and administrative expenses increased $0.2 million, or 4%, to $4.2 million for the three months ended September 30, 2018. This increase was primarily the result of increased compensation expense, offset by a $0.5 million benefit from owning our corporate headquarters. General and administrative expenses decreased from 6% to 5% as a percentage of revenue for the three months ended September 30, 2018, as we experienced scale in our support functions.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017. General and administrative expenses increased $0.9 million, or 8%, to $13.2 million for the nine months ended September 30, 2018. This increase was primarily the result of increased compensation expense, offset by a $0.5 million benefit from owning our corporate headquarters. General and administrative expenses decreased from 7% to 6% as a percentage of revenue for the nine months ended September 30, 2018, as we experienced scale in our support functions.

Sales and Marketing Expenses

	Three Months Ended September 30,		% Change	Nine Months Ended September 30,		% Change
	2018	2017		2018	2017	
	(in thousands, except percentages, pet and per pet data)					
Sales and marketing	$6,365	$4,862	31 %	$18,005	$13,323	35 %
Subscription Business:						
Total subscription pets enrolled (at period end)	416,527	359,102	16	416,527	359,102	16
Average pet acquisition cost (PAC)	$155	$151	3	$157	$141	11

Three months ended September 30, 2018 compared to three months ended September 30, 2017. Sales and marketing expense increased $1.5 million, or 31%, to $6.4 million, while subscription gross new pets increased 25%, to 33,617, and PAC increased 3% for the three months ended September 30, 2018. The increase in expense consisted primarily of an additional $0.8 million in compensation expense, due to a 20% increase in headcount and $0.8 million related to new marketing initiatives.

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Nine months ended September 30, 2018 compared to nine months ended September 30, 2017. Sales and marketing expense increased $4.7 million, or 35%, to $18.0 million, while subscription gross new pets increased 21%, to 94,539, and PAC increased 11% for the nine months ended September 30, 2018. The increase in expense consisted primarily of an additional $2.7 million in compensation expense, due to a 24% increase in headcount, a timing shift of approximately $0.6 million in expense related to our annual territory partner conference which we previously held in the fourth quarter of each year and moved to the second quarter of 2018, and $1.0 million related to new marketing initiatives.

Total Other (Income) Expense, Net

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Interest expense	$336	$124	$887	$370
Other (income) expense, net	(628)	(99)	(1,071)	(1,239)
Total other (income) expense, net	$(292)	$25	$(184)	$(869)

Three months ended September 30, 2018 compared to three months ended September 30, 2017. Total other (income) expense, net increased $0.3 million primarily due to a $0.5 million gain on lease extinguishment in conjunction with the purchase of our corporate headquarters, offset by a $0.3 million loss on the write off of leasehold improvements upon purchase of our corporate headquarters.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017. Total other (income) expense, net decreased $0.7 million primarily due to a $1.0 million gain on sale of an equity method investment in the nine months ended September 30, 2017. This was offset by net gains of $0.3 million upon purchase of our corporate headquarters.

Liquidity and Capital Resources

The following table summarizes our cash flows for the periods indicated (in thousands):

	Nine Months Ended September 30,	
	2018	2017
Net cash provided by operating activities	$9,016	$6,689
Net cash used in investing activities	(64,829)	(8,433)
Net cash provided by financing activities	65,677	2,920
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash, net	(93)	436
Net change in cash, cash equivalents and restricted cash	$9,771	$1,612

Our primary sources of liquidity are cash provided by operations and available borrowings on our line of credit. In June 2018, we increased the borrowing capacity on our line of credit from $30.0 million to $50.0 million. For further information, see Note 7, Debt. In addition, we completed the June 2018 follow-on public offering, raising aggregate net proceeds of $65.7 million, primarily to fund the purchase of our home office building. Our primary requirements for liquidity are paying veterinary invoices, funding operations and capital requirements, investing in new member acquisition, investing in enhancements to our member experience, and servicing debt.

As of September 30, 2018, we had $74.1 million in cash, cash equivalents and short-term investments and $28.9 million available under our line of credit, which excludes $0.4 million reserved under the credit agreement for an outstanding letter of credit and other ancillary services. Most of the assets in our insurance subsidiary, American Pet Insurance Company (APIC), and our segregated cell business, Wyndham Insurance Company (SAC) Limited (WICL) Segregated Account AX, are subject to certain capital and dividend rules and regulations prescribed by jurisdictions in which they are authorized to operate. As of September 30, 2018, total assets and liabilities held outside of our insurance entities totaled $115.5 million and $22.9 million, respectively, including $23.2 million of cash and cash equivalents that are segregated from other operating funds and held in trust for the payment of claims on behalf of our insurance subsidiaries. For further information, refer to "Regulation."

We believe our cash and cash equivalents, short-term investments and line of credit are sufficient to fund our operations and capital requirements for the next 12 months. As we continue to grow, however, we may explore additional financing to fund our operations or to meet capital requirements. Financing could include equity, equity-linked, or debt financing. Additional financing may not be available to us on acceptable terms, or at all.

Operating Cash Flows

We derive operating cash flows from the sale of our subscription plans, which is used to pay veterinary invoices and other cost of revenue. Additionally, cash is used to support the growth of our business by reinvesting to acquire new pet enrollments and to fund projects that improve our members' experience. Cash provided by operating activities was $9.0 million for the nine months ended September 30, 2018 compared to cash provided by operating activities of $6.7 million for the nine months ended September 30, 2017. The increase in cash provided by operating activities was primarily related to timing differences between collections from members and payments of veterinary invoices and payments to vendors.

Investing Cash Flows

In the third quarter of 2018, we purchased our corporate headquarters and had net cash outflows for this investment of $55.5 million. Historically, net cash used in investing activities was primarily related to the net purchase of investments to increase our statutory capital. As of September 30, 2018, we had $50.5 million in short-term and long-term investments in our insurance entities, APIC and WICL Segregated Account AX. This includes $7.6 million of APIC's ownership of our corporate headquarters building. These investments are held to satisfy statutory requirements. Our regulators may increase the required levels of risk-based capital in the future, and we anticipate that we will need to maintain greater amounts of risk-based capital if our pet enrollment continues to grow.

Financing Cash Flows

Cash provided by financing activities was $65.7 million and $2.9 million for the nine months ended September 30, 2018 and 2017, respectively. The increase of $62.8 million was primarily due to net proceeds of $65.7 million received from the June 2018 follow-on public offering offset by a payment on long-term debt.

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Long-Term Debt

Pacific Western Bank Loan and Security Agreement

The Company has a syndicated loan agreement with Pacific Western Bank (PWB) and Western Alliance Bank (WAB), amended in June 2018 to increase the borrowing capacity from $30.0 million to $50.0 million and extend the maturity date to June 2021. The required restricted cash increased to $1.4 million. We refer to this line of credit as our PWB credit facility. The maximum amount available to us under the PWB credit facility, inclusive of any amounts outstanding under the revolving line of credit, is the lesser of $50.0 million or the total amount of cash and securities held by our insurance entities, less amounts outstanding relating to other ancillary services and letters of credit, totaling $0.4 million as of September 30, 2018. Interest on the PWB credit facility accrues at a variable annual rate equal to the greater of 4.5%, or 1.25% plus the prime rate (6.50% at September 30, 2018).

The PWB credit facility requires us to maintain certain financial and non-financial covenants, including maintaining a minimum cash balance of $1.4 million in our account at WAB and/or WAB affiliates and other cash or investments of $2.1 million in our accounts at PWB. As of September 30, 2018, we were in compliance with each of the financial and non-financial covenants.

Our obligations under the PWB credit facility are secured by substantially all of our assets and a pledge of certain of our subsidiaries' stock. As of September 30, 2018, we had $8.8 million in aggregate borrowings outstanding under the PWB credit facility.

Regulation

As of September 30, 2018, our insurance entities, APIC and WICL Segregated Account AX, held $39.4 million in short-term investments and $33.9 million in other current assets, including $5.4 million held in cash and cash equivalents to be used for operating expenses of our insurance subsidiaries. Most of the assets in APIC and WICL Segregated Account AX are subject to certain capital and dividend rules and regulations prescribed by jurisdictions in which they are authorized to operate.

To comply with the regulations and contractual obligations of APIC and WICL Segregated Account AX, we may be required to maintain capital that we would otherwise invest in our growth and operations, which may require us to modify our operating plan or marketing initiatives, delay the implementation of new solutions or development of new technologies, decrease the rate at which we hire additional personnel and enter into relationships with Territory Partners, incur indebtedness or pursue equity or debt financings or otherwise modify our business operations.

APIC

The majority of our investments are held by our insurance entities to satisfy risk-based capital requirements of the National Association of Insurance Commissioners (NAIC). The NAIC requirements provide a method for analyzing the minimum amount of risk-based capital (statutory capital and surplus plus other adjustments) appropriate for an insurance company to support its overall business operations, taking into account the risk characteristics of the company's assets, liabilities and certain other items. An insurance company found to have insufficient statutory capital based on its risk-based capital ratio may be subject to varying levels of additional regulatory oversight depending on the level of capital inadequacy. APIC must hold certain capital amounts in order to comply with the statutory regulations and, therefore, we cannot use these amounts for general operating purposes without regulatory approval. As our business grows, the amount of capital we are required to maintain to satisfy our risk-based capital requirements may increase significantly. As of December 31, 2017, APIC was required to maintain at least $22.2 million of risk-based capital to avoid this additional regulatory oversight. As of that date, APIC maintained $37.2 million of risk-based capital. The New York Department of Financial Services may increase the required levels of risk-based capital in the future, and we anticipate that we will need to maintain greater amounts of risk-based capital if our pet enrollment continues to grow. Following the acquisition of our home office building, we may satisfy up to 10% of our required risk-based capital through our ownership interest in Trupanion-APIC, LLC.

New York laws also restrict the ability of APIC to pay dividends to our parent holding company. The dividend restrictions are based in part on the prior year's statutory income and surplus. Dividends up to specified levels are considered ordinary and may be paid without prior approval. In general, dividends or distributions that, in the aggregate in any 12-month period exceed the lesser of (i) 10% of surplus as of the preceding December 31 or (ii) the insurer's adjusted net investment income for such 12-month period ended the preceding December 31, not including realized capital gains, are subject to approval by regulatory authorities. As of December 31, 2017, $0.2 million was able to be paid in the form of a dividend from APIC to our parent holding company without prior approval from regulatory authorities.

WICL Segregated Account AX

WICL Segregated Account AX was established by WICL, with Trupanion, Inc. as the shareholder, to enter into a reinsurance agreement with Omega General Insurance Company. All of the assets and liabilities of WICL Segregated Account AX are legally segregated from other assets and liabilities within WICL, and all shares of the segregated account are owned by Trupanion, Inc. During February 2018, our parent entity received a dividend of $2.2 million from WICL Segregated Account AX as allowed under our agreements with WICL. As required by the Office of the Superintendent of Financial Institutions regulations related to our reinsurance agreement with Omega General Insurance Company, we are required to maintain a Canadian Trust account with the greater of CAD $2.0 million or 115% of unearned Canadian premium plus 15% of outstanding Canadian claims, including all incurred but not reported claims. As of December 31, 2017, the account held CAD $2.8 million.

Though we are not directly regulated by the Bermuda Monetary Authority (BMA), WICL's regulation and compliance impacts us as it could have an adverse impact on the ability of WICL Segregated Account AX to pay dividends. WICL is regulated by the BMA under the Insurance Act of 1978 (Insurance Act) and the Segregated Accounts Company Act of 2000. The Insurance Act imposes on Bermuda insurance companies, solvency and liquidity standards, certain restrictions on the declaration and payment of dividends and distributions, certain restrictions on the reduction of statutory capital, and auditing and reporting requirements, and grants the BMA powers to supervise and, in certain circumstances, to investigate and intervene in the affairs of insurance companies. Under the Insurance Act, WICL, as a class 3 insurer, is required to maintain available statutory capital and surplus at a level equal to or in excess of a prescribed minimum established by reference to net written premiums and loss reserves.

Under the Bermuda Companies Act 1981, as amended, a Bermuda company may not declare or pay a dividend or make a distribution out of contributed surplus if there are reasonable grounds for believing that: (a) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of the company’s assets would thereby be less than its liabilities. The Segregated Accounts Company Act of 2000 further requires that dividends out of a segregated account can only be paid to the extent that the cell remains solvent and the value of its assets remain greater than the aggregate of its liabilities and its issued share capital and share premium accounts.

Contractual Obligations

We enter into long-term contractual obligations and commitments in the normal course of business, primarily debt obligations and non-cancellable operating leases. In July 2018, we invested in the preferred stock of a privately held corporation and committed to purchasing $4.0 million in additional preferred stock at the election of that corporation. This option can be exercised through January 2020. We also extended a revolving line of credit to that corporation, with a maximum borrowing capacity of $2.5 million. In August 2018, we purchased our corporate headquarters resulting in the termination of our operating lease. In September 2018, we entered into a 20-year software license agreement. License fees do not exceed $0.1 million annually. Management believes these are the only material changes to our contractual obligation disclosure as of September 30, 2018, compared to those discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Critical Accounting Policies and Significant Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements, as well as the reported revenue and expenses during the reporting periods.

Critical accounting policies and estimates are those that we consider the most important to the portrayal of our financial condition and results of operations because they require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Generally, we base our estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates.

There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K for the fiscal year ended

December 31, 2017.

Item 3. Quantitative and Qualitative Disclosures About Market Risks

Management believes there have been no material changes to our quantitative and qualitative disclosures about market risks during the three and nine months ended September 30, 2018, compared to those discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a- 15(e) and 15d- 15(e) under the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are subject to litigation matters and claims arising from the ordinary course of business, including, but not limited to, claims of alleged infringement of trademarks, copyrights, and other intellectual property rights; employment claims; coverage disputes with policyholders; disputes regarding general contracts; and regulatory or governmental investigations or disputes. We record an estimated liability relating to such matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The outcomes of legal proceedings are inherently unpredictable, subject to significant uncertainties, and could be material to our operating results for a particular period. We review our estimates at least quarterly and makes adjustments to reflect the outcome of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter.

Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information in this report, including our consolidated financial statements and related notes, as well as in our other filings with the SEC, in evaluating our business and before investing in our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that are not expressly stated, that we are unaware of, or that we currently believe are not material, may also become important factors that affect us. If any of the following risks occur, our business, operating results, financial condition and prospects could be materially harmed. In that event, the price of our common stock could decline, and you could lose part or all of your investment.

Risks Related to Our Business and Industry

We have incurred significant cumulative net losses since our inception and may not be able to achieve or maintain profitability in the future.

We have incurred significant cumulative net losses since our inception. We have funded our operations through equity financings, borrowings under a revolving line of credit and term loans and, more recently, positive cash flows from operations. We may not be able to achieve or maintain profitability in the near future or at all. Our recent growth, including our growth in revenue and membership, may not be sustainable or may decrease, and we may not generate sufficient revenue to achieve or maintain profitability. Additionally, our expense levels are based, in significant part, on our estimates of future revenue and many of these expenses are fixed in the short term. As a result, we may be unable to adjust our spending in a timely manner if our revenue falls short of our expectations. Accordingly, any significant shortfall of revenue in relation to our estimates could have an immediate negative effect on our financial results.

We have made and plan to continue to make significant investments to grow our member base. Our average pet acquisition cost and the number of new pets we enroll depends on a number of factors, including the effectiveness of our sales execution and marketing initiatives, changes in costs of media, the mix of our sales and marketing expenditures and the competitive environment. Our average pet acquisition cost has in the past significantly varied and in the future may significantly vary period to period based upon specific marketing initiatives. We also regularly test new member acquisition channels and marketing initiatives, which often are more expensive than our traditional marketing channels and generally increase our average acquisition costs. We plan to expand the number of Territory Partners we use to reach veterinarians and other referral sources and to engage in other marketing activities, including direct to consumer advertising, which are likely to increase our acquisition costs.

We expect to continue to make significant expenditures to maintain and expand our business including expenditures relating to the acquisition of new members, retention of our existing members and development and implementation of our technology platforms. These increased expenditures will make it more difficult for us to achieve and maintain future profitability. Our ability to achieve and maintain profitability depends on a number of factors, including our ability to attract and service members on a profitable basis. If we are unable to achieve or maintain profitability, we may not be able to execute our business plan, our prospects may be harmed and our stock price could be materially and adversely affected.

We base our decisions regarding our member acquisition expenditures primarily on the projected lifetime value of the pets that we expect to acquire and the projected internal rate of return on marketing spend. Our estimates and assumptions may not accurately reflect our future results, we may overspend on member acquisition, and we may not be able to recover our member acquisition costs or generate profits from these investments.

We invest significantly in member acquisition. We expect to continue to spend significant amounts to acquire additional members. We utilize Territory Partners, who are paid fees based on activity in their regions, to communicate the benefits of our subscription to veterinarians through in-person visits. Veterinarians then educate pet owners, who visit our website or call our contact center to learn more about, and potentially enroll in, our subscription. We also invest in other third-party referrals and direct to consumer member acquisition channels, though we have limited experience with some of them.

We base our decisions regarding our member acquisition expenditures primarily on the lifetime value of the pets that we project to acquire. This analysis depends substantially on estimates and assumptions based on our historical experience with pets enrolled in earlier periods, including our key operating metrics described in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Operating Metrics."

If our estimates and assumptions regarding the lifetime value of the pets that we project to acquire and our related decisions regarding investments in member acquisition prove incorrect, or if the expected lifetime value of the pets that we project to acquire differs significantly from that of pets acquired in prior periods, we may be unable to recover our member acquisition costs or generate profits from our investment in acquiring new members. Moreover, if our member acquisition costs increase or we invest in member acquisition channels that do not ultimately result in any or an adequate number of new member enrollments, the return on our investment may be lower than we anticipate irrespective of the lifetime value of the pets that we project to acquire as a result of the new members. If we cannot generate profits from this investment, we may need to alter our growth strategy, and our growth rate and operating results may be adversely affected.

If we are unable to maintain high member retention rates, our growth prospects and revenue will be adversely affected.

We have historically experienced high average monthly retention rates. For example, our average monthly retention rate between 2010 and 2017 was 98.5%. If our efforts to satisfy our existing members are not successful or if new marketing initiatives result in enrolling more pets that inherently have a lower retention rate, we may not be able to maintain our retention rates. Members we obtain through aggressive promotions or other channels that involve relatively less meaningful contact between us and the member may be more likely to terminate their subscription. In the past, we have experienced reduced retention rates during periods of rapid member growth, as our retention rate generally has been lower during the first year of member enrollment. Members may choose to terminate their subscription for a variety of reasons, including perceived or actual lack of value, delays or other unsatisfactory experiences in how we review and process veterinary invoice payments, unsatisfactory member service, an economic downturn, increased subscription fees, loss of a pet, a more attractive offer from a competitor, changes in our subscription or other reasons, including reasons that are outside of our control. Our cost of acquiring a new member is substantially greater than the cost involved in maintaining our relationship with an existing member. If we are not able to successfully retain existing members and limit terminations, our revenue and operating margins will be adversely impacted and our business, operating results and financial condition would be harmed.

The prices of our subscriptions are based on assumptions and estimates and may be subject to regulatory approvals. If our actual experience differs from the assumptions and estimates used in pricing our subscriptions or if we are unable to obtain any necessary regulatory pricing approvals we need, at all or in a timely manner, our revenue and financial condition could be adversely affected.

The pricing of our subscriptions reflect amounts we expect to pay for a pet's medical care derived from assumptions that we make regarding a number of factors, including a pet's species, breed, age, gender and location. Factors related to pet location include the current and assumed changes in the cost and availability of veterinary technology and treatments and local veterinary practice preferences. The prices of our subscriptions also include assumptions and estimates regarding our own operating costs and expenses. We monitor and manage our pricing and overall sales mix to achieve target returns. Profitability from new members emerges over a period of years depending on the nature and length of time a pet is enrolled, and is subject to variability as actual results may differ from pricing assumptions. If the subscription fees we collect are insufficient to cover actual costs, including veterinary invoice expense, operating costs and expenses within anticipated pricing allowances, or if our member retention rates are not high enough to ensure recovery of member acquisition costs, then our gross profit could be adversely affected, and our revenue may be insufficient to achieve profitability. Conversely, if our pricing assumptions differed from actual results such that we overpriced risks, our competitiveness and growth prospects could be adversely affected. Further, even if our pricing assumptions are accurate, we may not be able to obtain the necessary regulatory approvals for any pricing changes that we may determine are appropriate based on our pricing assumptions, which could prevent us from obtaining sufficient revenue from subscriptions to cover our costs, including veterinary invoice expense, processing costs, pet acquisition costs and other expenses in any such jurisdiction unless and until such regulatory approvals are obtained in appropriate amounts.

The anticipated benefits of our analytics platform may not be fully realized.

Our analytics platform draws upon our proprietary pet data to price our subscriptions. The assumptions we make about breeds and other factors in pricing may prove to be inaccurate and, accordingly, these pricing analytics may not accurately reflect the expense that we will ultimately incur. Furthermore, if any of our competitors develop similar or better data systems, adopt similar or better underwriting criteria and pricing models or receive our data, our competitive advantage could decline or be lost.

Our actual veterinary invoice expense may exceed our current reserve established for veterinary invoices and may adversely affect our operating results and financial condition.

Our recorded reserve for veterinary invoices is based on our best estimates of the amount of veterinary invoices we expect to pay, inclusive of an estimate for veterinary invoices we have not yet received, after considering known facts and interpretations of circumstances and the estimated cost to process and pay those veterinary invoices. We consider internal factors, including data from our proprietary data analytics platform, experience with similar cases, actual veterinary invoices paid, historical trends involving veterinary invoice payment patterns, patterns of receipt of veterinary invoices, seasonality, pending levels of unpaid veterinary invoices, veterinary invoice processing programs and contractual terms. We may also consider external factors, including changes in the law, court decisions, changes to regulatory requirements and economic conditions. Because reserves are estimates of veterinary invoices that have been incurred but are not yet submitted to us, the establishment of appropriate reserves is an inherently uncertain and complex process that involves significant subjective judgment. Further, we do not transfer or cede our risk as an insurer and, therefore, we maintain more risk than we would if we purchased reinsurance. The ultimate cost of paying veterinary invoices and the related administration may vary materially from recorded reserves, and such variance may result in adjustments to the reserve for veterinary invoices, which could have a material effect on our operating results.

We rely significantly on Territory Partners, veterinarians and other third parties to recommend us.

We rely significantly on Territory Partners and other third parties to cultivate direct veterinary relationships and build awareness of the benefits that we offer veterinarians and their clients. In turn, we rely on veterinarians to introduce and recommend Trupanion to their clients. We also rely significantly on other third parties, such as existing members, online and other businesses, animal shelters, breeders and veterinary affiliates, including veterinarian purchasing groups and associations, to help generate leads for our subscription. Veterinary referred leads represent our largest member acquisition channel. In the nine months ended September 30, 2018, approximately 72% of our enrollments came from referrals from veterinarians and existing members, as well as people adding pets to their existing subscription.

Many factors influence the success of our relationships with these referral sources, including:

- the continued positive market presence, reputation and growth of our company and of the referral sources;
- the effectiveness of referral sources;
- the decision of any such referral source to support one or more of our competitors;
- the interest of the referral sources’ customers or clients in our subscription;
- the relationship and level of trust between Territory Partners and veterinarians, and between us and the referral source;
- the percentage of the referral sources’ customers or clients that submit applications or use trial certificates to enroll through our website or contact center;
- our ability to implement or maintain any marketing programs, including trial certificates, in any jurisdiction; and
- our ability to work with the referral source to implement any changes in our marketing initiatives, including website changes, infrastructure and technology and other programs and initiatives necessary to generate positive consumer experiences.

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In order for us to implement our business strategy and grow our revenue, we must effectively maintain and increase the number and quality of our relationships with Territory Partners, veterinarians and other referral sources, and continue to scale and improve our processes, programs and procedures that support them. Those processes, programs and procedures could become increasingly complex and difficult to manage. We expend significant time and resources attracting qualified Territory Partners and providing them with complete and current information about our business. Their relationship with us may be terminated at any time, and, if terminated, we may not recoup the costs associated with educating them about our subscription or be able to maintain any relationships they may have developed with veterinarians within their territories. Sometimes a single relationship may be used to cover multiple territories so that a terminated relationship could significantly impact our company. Further, if we experience an increase in the rate at which Territory Partner relationships are terminated, we may not develop or maintain relationships with veterinarians as quickly as we have in the past. If the financial cost to maintain our relationships with Territory Partners outweighs the benefits provided by Territory Partners, or if they feel unsupported or undervalued by us and terminate their relationship with us, our growth and financial performance could be adversely affected.

The success of our relationships with veterinary practices depends on the overall value we can provide to veterinarians. If the scope of our subscription is perceived to be inadequate or if our process for paying veterinary invoices is unsatisfactory to the veterinarians' clients because, for example, a service is not included in our subscription, member requests for reimbursement are denied or we fail to timely settle and pay veterinary invoices, veterinarians may be unwilling to recommend us to their clients and they may encourage their existing clients who have subscribed to stop or to purchase a competing product. If veterinarians determine our subscription is unreliable, cumbersome or otherwise does not provide sufficient value, they may terminate their relationship with us or begin recommending a competing product, which could negatively impact our ability to increase our member base and grow our business.

If we fail to establish or are unable to maintain successful relationships with Territory Partners, veterinarians and other referral sources, or experience an increase in the rate at which any of these relationships are terminated, it could negatively impact our ability to increase and retain our member base and our financial results. If we are unable to maintain our existing member acquisition channels and/or continue to add new member acquisition channels, if the cost of our existing sources increases or does not scale as we anticipate, or if we are unable to continue to use any existing channels or programs in any jurisdiction, including our trial certificate program, our member levels and sales and marketing expenses may be adversely affected.

Territory Partners are independent contractors and, as such, may pose additional risks to our business.

Territory Partners are independent contractors and, accordingly, we do not directly provide the same direction, motivation and oversight over Territory Partners as we otherwise could if Territory Partners were our own employees. Further, Territory Partners may themselves employ or engage others; we refer to these partners and their associates, collectively, as our Territory Partners. We do not control a Territory Partner’s employment or engagement of others, and it is possible that the actions of their employees and/or contractors could create threatened or actual legal proceedings against us.

Territory Partners may decide not to participate in our marketing initiatives and/or training opportunities, accept our introduction of new solutions or comply with our policies and procedures applicable to them, any of which may adversely affect our ability to develop relationships with veterinarians and grow our membership. Our sole recourse against Territory Partners who fail to perform is to terminate their contract, which could also trigger contractually obligated termination payments or result in disputes, including threatened or actual legal or regulatory proceedings.

We believe that Territory Partners are not and should not be classified as employees under existing interpretations of the applicable laws of the jurisdictions in which we operate. We do not pay or withhold any employment tax with respect to or on behalf of Territory Partners or extend any benefits to them that we generally extend to our employees, and we otherwise treat Territory Partners as independent contractors. Applicable authorities or the Territory Partners have in the past questioned and may in the future challenge this classification. Further, the applicable laws or regulations, including tax laws or interpretations, may change. If it were determined that we had misclassified any of our Territory Partners, we may be subjected to penalties and/or be required to pay withholding taxes, extend employee benefits, provide compensation for unpaid overtime, or otherwise incur substantially greater expenses with respect to

Territory Partners.

Any of the foregoing circumstances could have a material adverse impact on our operating results and financial condition.

Our member base has grown rapidly in recent periods, and we may not be able to maintain the same rate of membership growth.

Our ability to grow our business and to generate revenue depends significantly on attracting new members. In order to continue to increase our membership, we must continue to offer a superior value to our members. Our ability to continue to grow our membership will also depend in part on the effectiveness of our sales and marketing programs. Our member base may not continue to grow or may decline as a result of increased competition or the maturation of our business.

We may not maintain our current rate of revenue growth.

Our revenue has increased quickly and substantially in recent periods. We believe that our continued revenue growth will depend on, among other factors, our ability to:

- improve our market penetration through efficient and effective sales and marketing programs to attract new members;
- maintain high retention rates;
- increase the lifetime value per pet to, in turn, enable us to spend more on sales and marketing programs;
- maintain positive relationships with veterinarians and other referral sources, and convince them to recommend our subscription;
- maintain positive relationships with and increase the number and efficiency of Territory Partners;
- continue to offer a superior value with competitive features and rates;
- accurately price our subscriptions in relation to actual member costs and operating expenses and achieve required regulatory approval for pricing changes;
- provide our members with superior member service, including timely and efficient payment of veterinary invoices, and by recruiting, integrating and retaining skilled and experienced personnel who can appropriately and efficiently review veterinary invoices and process payments;
- generate new and maintain existing relationships and programs in our other business segment;
- recruit, integrate and retain skilled, qualified and experienced sales department professionals who can demonstrate our value proposition to new and existing members;
- react to changes in technology and challenges in the industry, including from existing and new competitors;
- increase awareness of and positive associations with our brand; and
- successfully respond to any regulatory matters and defend any litigation.

You should not rely on our historical rate of revenue growth as an indication of our future performance.

Our use of capital may be constrained by risk-based capital regulations or contractual obligations.

Our subsidiary, American Pet Insurance Company, is subject to risk-based capital regulations that require us to maintain certain levels of surplus to support our overall business operations in consideration of our size and risk profile. We have in the past and may in the future fail to maintain the amount of risk-based capital required to avoid additional regulatory oversight. To comply with these regulations and our related contractual obligations, we may be required to maintain capital that we would otherwise invest in our growth and operations, which may require us to modify our operating plan or marketing initiatives, delay the implementation of new solutions or development of new technologies, decrease the rate at which we hire additional personnel and enter into relationships with Territory Partners, incur indebtedness or pursue equity or debt financings or otherwise modify our business operations, any of which could have a material adverse effect on our operating results and financial condition.

We are also subject to a contractual obligation related to our reinsurance agreement with Omega General Insurance Company (Omega). Under this agreement, we are required to fund a Canadian Trust account in accordance with Canadian regulations.

Unexpected increases in the number or amounts of veterinary invoices received, or that we expect to receive, may negatively impact our operating results.

Unexpected changes in the number or amounts of veterinary invoices received, or that we expect to receive, may negatively impact our operating results. Rising costs of veterinary care and the increasing availability and usage of more expensive, technologically advanced medical treatments may increase the amounts of veterinary invoices we receive. Increases in the number of veterinary invoices we receive could arise from unexpected events that are inherently difficult to predict, such as a pandemic that spreads through the pet population, tainted pet food or supplies or an unusually high number of serious injuries or illnesses. We may experience volatility in the number of veterinary invoices we receive from time to time, and short-term trends may not continue over the longer term. The number of veterinary invoices may be affected by the level of care and attentiveness an owner provides to the pet, the pet’s breed and age and other factors outside of our control, as well as fluctuations in member retention rates and by new member initiatives that encourage an increase in veterinary invoices and other new member acquisition activities. A significant increase in the number or amounts of veterinary invoices could increase our cost of revenue and have a material adverse effect on our financial condition.

Our success depends on our ability to review, process, and pay veterinary invoices timely and accurately.
We must accurately evaluate and pay veterinary invoices timely in a manner that gives our members high satisfaction. Many factors can affect our ability to do this, including the training, experience and skill of our personnel, our ability to reduce the number of payment requests made for services not included in our subscription, the department’s culture and the effectiveness of its management, our ability to develop or select and implement appropriate procedures, supporting technologies and systems, and changes in our policy. Our failure to fairly pay veterinary invoices, accurately and in a timely manner, or to deploy resources appropriately, could result in unanticipated costs to us, lead to material litigation, undermine member goodwill and our reputation, and impair our brand image and, as a result, materially and adversely affect our competitiveness, financial results, prospects and liquidity.
We may not identify fraudulent or improperly inflated veterinary invoices.
It is possible that a member, or a third-party actually or purportedly on behalf of the member, could submit a veterinary invoice which we would then pay that appears authentic but in fact does not reflect services provided or products purchased for which the member paid. It is also possible that veterinarians will charge insured customers higher amounts than they would charge their non-insured clients for the same service or product. Such activity could lead to unanticipated costs to us and/or to time and expense to recover such costs. They could also lead to strained relationships with veterinarians and/or members, and could adversely affect our competitiveness, financial results and liquidity.
Changes in foreign exchange rates may adversely affect our revenue and operating results.
We offer our subscription in Canada, and in the future may offer it in other countries, which exposes us to the risk of changes in currency exchange rates. Fluctuations in the relative strength of the US dollar has in the past and could in the future adversely affect our revenue and operating results.
We are and will continue to be faced with many competitive challenges, any of which could adversely affect our prospects, operating results and financial condition.
We compete with pet owners that self-finance unexpected veterinary invoices with savings or credit, as well as traditional "pet insurance" providers and relatively new entrants into our market. The vast majority of pet owners in the United States and Canada do not currently have medical insurance for their pets. We are focused primarily on expanding our share of the overall market, and we view our primary competitive challenge as educating pet owners on why our subscription is a better alternative to self-financing.
Additionally, there are traditional insurance companies that provide pet insurance products, either as a stand-alone product or along with a broad range of other insurance products. In addition, new entrants backed by large insurance companies have attempted to enter the pet insurance market in the past and may do so again in the future. Further, traditional "pet insurance" providers may consolidate or take other actions to mimic the efficiencies from our vertically-integrated structure or create other operational efficiencies, which could lead to increased competition.
Some of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, technical, marketing and other resources than we do. Some of our competitors may be able to undertake more extensive marketing initiatives for their brands and services, devote more resources to website and systems development and make more attractive offers to potential employees, referral sources and third-party service providers.
To compete effectively, we will need to continue to invest significant resources in sales and marketing, in improving our member service levels, in the online experience and functionalities of our website and in other technologies and infrastructure. Failure to compete effectively against our current or future competitors could result in loss of current or potential members, subscription terminations or a reduction in member retention rates, which could adversely affect our pricing, lower our revenue and prevent us from achieving or maintaining profitability. We may not be able to compete effectively for members in the future against existing or new competitors, and the failure to do so could result in loss of existing or potential members, increased sales and marketing expenses or diminished brand strength, any of which could harm our business.
If we are not successful in cost-effectively converting visitors to our website and contact center into members, our business and operating results would be harmed.

Our growth depends in large part upon growth in our member base. We seek to convert consumers who visit our website and call our contact center into members. The rate at which consumers visiting our website and contact center considering enrollment in our subscription are converted into members is a significant factor in the growth of our member base. A number of factors have influenced, and could in the future influence, the conversion rates for any given period, some of which are outside of our control. These factors include:

- the competitiveness of our subscription, including its perceived value, simplicity, and fairness;
- changes in consumer shopping behaviors due to circumstances outside of our control, such as economic conditions and consumers' ability or willingness to pay for our product;

- the quality of and changes to the consumer experience when speaking with us on the phone or using our website;
- regulatory requirements, including those that make the experience on our website cumbersome or difficult to navigate or that hinder our ability to speak with potential members quickly and in a way that is conducive to converting leads, enrolling new pets, and/or resolving member concerns;
- system failures or interruptions in the operation of our abilities to write policies or operate our website or contact center; and
- changes in the mix of consumers who are referred to us through various member acquisition channels, such as veterinary referrals, existing members adding a pet and referring their friends and family members and other third-party referrals and direct-to-consumer acquisition channels.

Our ability to convert consumers into members can be impacted by a change in the mix of referrals received through our member acquisition channels. In addition, changes to our website or contact center, or other programs or initiatives we undertake, may adversely impact our ability to convert consumers into members at our current rate, or at all. These changes may have the unintended consequence of adversely impacting our conversion rates. A decline in the percentage of members who enroll in our subscription on our website or by calling our contact center also could result in increased member acquisition costs. To the extent the rate at which we convert consumers into members suffers, the growth rate of our member base may decline, which would harm our business, operating results and financial condition.

We have made and plan to continue to make substantial investments in features and functionality for our website and training and staffing for our contact center that are designed to generate traffic, increase member engagement and improve new and existing member service. These activities do not directly generate revenue, however, and we may never realize any benefit from these investments. If the expenses that we incur in connection with these activities do not result in sufficient growth in members to offset the cost, our business, operating results and financial condition will be adversely affected.

If we are unable to maintain and enhance our brand recognition and reputation, our business and operating results will be harmed.

We believe that maintaining and enhancing our brand recognition and reputation is critical to our relationships with existing members, Territory Partners, veterinarians and other referral sources, and to our ability to attract new members, new Territory Partners, additional supportive veterinarians and other referral sources. We also believe that the importance of our brand recognition and reputation will continue to increase as competition in our market continues to develop and mature. Our success in this area will depend on a wide range of factors, some of which are out of our control, including the following:

- the efficacy and viability of our sales and marketing programs;
- the perceived value of our subscription;
- quality of service provided, including the fairness, ease and timeliness of reviewing and paying veterinary invoices;
- actions of our competitors, Territory Partners, veterinarians and other referral sources;
- positive or negative publicity, including regulatory pronouncements and material on the Internet or social media;
- regulatory and other government-related developments; and
- litigation-related developments.

The promotion of our brand may require us to make substantial investments, and we anticipate that, as our market becomes increasingly competitive, these branding initiatives may become increasingly difficult and expensive. Our brand promotion activities may not be successful or yield increased revenue, and to the extent that these activities result in increased revenue, the increased revenue may not offset the expenses we incur and our operating results could be harmed. If we do not successfully maintain and enhance our brand, our business may not grow and our relationships with veterinarians and other referral sources could be terminated, which would harm our business, operating results and financial condition.

Furthermore, negative publicity, whether or not justified, relating to events or activities attributed to us, our employees, our strategic partners, our affiliates, or others associated with any of these parties, may tarnish our reputation and reduce the value of our brands. Damage to our reputation and loss of brand equity may reduce demand for our services and have an adverse effect on our business, operating results, and financial condition. Moreover, any attempts to rebuild our reputation and restore the value of our brands may be costly and time consuming, and such efforts may not ultimately be successful.

Our business depends on our ability to maintain and scale the infrastructure necessary to operate our technology platform and could be adversely affected by a system failure.

Our business depends on our ability to maintain and scale the infrastructure necessary to operate our technology platform, which includes our analytics and pricing engine, systems for managing veterinary invoice payments, customer relationship management system, billing system, contact center phone system and website. We use these technology frameworks to price our subscriptions, enroll members, engage with current members and pay veterinary invoices. Our members review and purchase subscriptions through our website and contact center, and we receive and pay veterinarian invoices directly through Trupanion Express®. Our reputation and ability to acquire, retain and serve our members depends on the reliable performance of our technology platform and the underlying network systems and infrastructure, and on providing best-in-class member service, including through our contact center and website. As our member base continues to grow, the amount of information collected and stored on the systems and infrastructure supporting our technology platform will continue to grow, and we expect to require an increasing amount of network capacity, computing power and information technology personnel to develop and maintain our technology platform and service our departments involved in member interaction.

We have made, and expect to continue to make, substantial investments in equipment and related network infrastructure to handle the operational demands on our technology platform, including increasing data collection, software development, traffic on our website and the volume of calls at our contact center. The operation of the systems and infrastructure supporting our technology platform is expensive and complex and could experience operational failures. In the event that our data collection, member base or amount of traffic on these systems grows more quickly than anticipated, we may be required to incur significant additional costs to increase the capacity in our systems. Any system failure that causes an interruption in or decreases the responsiveness of our services could impair our revenue-generating capabilities, harm our business and operating results and damage our reputation. In addition, any loss or mishandling of data could result in breach of confidence, competitive disadvantage or loss of members, and subject us to potential liability. Any failure of the systems and infrastructure that we rely on could negatively impact our enrollments as well as our relationship with members. If we do not maintain or expand the systems and infrastructure underlying our technology platform successfully, or if we experience operational failures, our reputation could be harmed and we could lose current and potential members, which could harm our operating results and financial condition.

We have made, and expect to continue to make, significant investments in new solutions and enhancements to our technology platform. These new solutions and enhancements may not be successful, and we may not recognize the expected benefits.

We have a team of product and engineering professionals dedicated in part to enhancing our technology platform and developing new solutions. We have made, and expect to continue to make, significant investments in these new solutions and enhancements. For example, we have made significant investments in Trupanion Express®, which is designed to facilitate the direct payment of invoices to veterinary practices. These development and implementation activities may not be successful, and we may incur delays or cost overruns or elect to curtail our currently planned expenditures related to them. Further, if or when these new solutions or enhancements are introduced, they may not be well received by veterinarians or by new or existing members, particularly if they are costly, cumbersome or unreliable. Even if they are well-received, they may be or become obsolete due to technological reasons or to the availability of alternative solutions in the marketplace. If new solutions and enhancements are not successful on a long-term basis, we may not realize benefits from these investments, and our business and financial condition could be adversely affected.

If we fail to effectively manage our growth, our business, operating results and financial condition may suffer.

We have recently experienced, and expect to continue to experience, significant growth, which has placed, and may continue to place, significant demands on our management and our operational and financial systems and infrastructure. We expect that our growth strategy will require us to commit substantial financial, operational and technical resources. It may also result in increased costs, including unexpected increases in our underlying costs (such as member acquisition costs or increases in the number or amounts of veterinary invoices received) generated by our new business, which could prevent us from becoming profitable and could impair our ability to compete effectively for business. Additionally, we have in the past, and may in the future, experience increases in terminations as our membership grows, which negatively affects our retention rate. If we do not effectively manage growth at any time, our financial condition could be harmed and the quality of our services could suffer.

In order to successfully expand our business, we need to hire, integrate and retain highly skilled and motivated employees. We also need to continue to improve our existing systems for operational and financial management. These improvements could require significant capital expenditures and place increasing demands on our management. We may not be successful in managing or expanding our operations or in maintaining adequate financial and operating systems and controls. If we do not successfully implement improvements in these areas, our business, operating results and financial condition will be harmed.

Our operating results may vary, which could cause the trading price of our stock to fluctuate or decline, make period-to-period comparisons less meaningful, and make our future results difficult to predict.

We may experience fluctuations in our revenue, expenses and operating results in future periods. Our operating results may fluctuate in the future as a result of a number of factors, many of which are beyond our control. These fluctuations may lead analysts to change their long-term models for valuing our common stock, cause us to face short-term liquidity issues, impact our ability to retain or attract key personnel or cause other unanticipated issues, all of which could result in declines in our stock price. Moreover, these fluctuations may make comparing our operating results on a period-to-period basis less meaningful and make our future results difficult to predict. You should not rely on our past results as an indication of our future performance. In addition, if revenue levels do not meet our expectations, our operating results and ability to execute on our business plan are likely to be harmed. In addition to the other factors listed in this “Risk Factors” section, factors that could affect our operating results include the following:

- our ability to retain our current members and grow our member base;
- the level of operating expense we elect to incur related to sales and marketing and technology and development initiatives that are discretionary in nature;
- the effectiveness of our sales and marketing programs;
- our ability to improve veterinarians’ and other third-parties’ willingness to recommend our subscription;
- the timing, volume and amount of veterinary invoices and the adequacy of our related reserve;
- our ability to accurately price our subscription and achieve required regulatory pricing approvals;
- regulatory limitations or other constraints on our ability or our willingness to implement pricing changes;
- the level of demand for and cost of our subscription or competing products;
- fluctuations in applicable foreign currency exchange rates;
- the perceived value of our subscription to veterinarians and pet owners;
- spending decisions by our members and prospective members;
- our costs and expenses, including pet acquisition costs and costs to pay and process veterinary invoices;
- our ability to expand the scope and efficiency of our Territory Partner group;
- our ability to effectively manage our growth;
- the effects of increased competition in our business;
- our ability to keep pace with changes in technology and our competitors;
- the impact of any security incidents or service interruptions;
- costs associated with defending any regulatory action or litigation or with enforcing our intellectual property, contractual or other rights;
- the impact of economic conditions on our revenue and expenses; and
- changes in government regulation affecting our business.

Seasonal or periodic variations in the behavior of our members also may cause fluctuations in our financial results. Enrollment in our subscription tends to be discretionary in nature and may be sporadic, reflecting overall economic conditions, budgeting constraints, pet-buying patterns and a variety of other factors, many of which are outside our control. For example, we expect to experience some effects of seasonal trends in visits to veterinarians in the fourth quarter and in the beginning of the first quarter of each year in connection with the traditional holiday season. While we believe seasonal trends have affected and will continue to affect our quarterly results, our growth may have overshadowed these effects to date. We believe that our business will continue to be subject to seasonality in the future, which may result in fluctuations in our financial results.

Due to these and other factors, our financial results for any quarterly or annual period may not meet our expectations or the expectations of investors or analysts that follow our stock and may not be meaningful indications of our future performance.

Our vertical integration may result in higher costs.

We manage all aspects of our business, including operating our own insurance subsidiary, implementing our own national independent referral group of Territory Partners, pricing our subscriptions with our in-house actuarial team, processing and paying veterinary invoices, operating our own contact center and owning our own brand. While we believe this vertically integrated approach reduces frictional costs and enhances members' experiences, third-party providers may, now or in the future, be able to replicate this model, partially or entirely, on a more efficient and effective basis. If our in-house services are or become less efficient or less effective than the same services provided by a third party, we may not realize the related cost savings and may be unable to provide a superior membership experience, which may have an adverse effect on our operating results.

Our forecasts of market growth may prove to be inaccurate, and even if the market for medical insurance for cats and dogs in North America achieves the forecasted growth, our business may not grow at similar rates, if at all.

Growth forecasts are subject to significant uncertainty and are based on assumptions and estimates, which may not prove to be accurate. Although we believe that the North American market for pet medical insurance will grow over time if consumers are offered a high-value product, the market in North America has been historically growing slowly, if at all, and may not be capable of growing further. Even if this market experiences significant growth, we may not grow our business at similar rates, or at all. For example, the market for medical insurance for cats and dogs in North America has been highly fragmented and competitive and may become even more so in the future. Our growth is subject to many factors, including our success in implementing our business strategy and maintaining our position in a highly competitive market, which are subject to many risks and uncertainties.

We depend on key personnel to operate our business and, if we are unable to retain, attract and integrate qualified personnel, our ability to develop and successfully grow our business could be harmed.

Our success depends to a significant extent on the continued services of our current management team, including Darryl Rawlings, our founder and Chief Executive Officer. The loss of Mr. Rawlings or several other key executives or employees within a short time frame could have a material adverse effect on our business. We employ all of our executive officers and key employees on an at-will basis, and their employment can be terminated by us or them at any time, for any reason and without notice, subject, in certain cases, to severance payment rights. In order to retain valuable employees, in addition to salary and cash incentives, we have provided stock options and restricted stock that vest over time and may in the future grant equity awards tied to company performance. The value to employees of stock options and restricted stock that vest over time will be significantly affected by movements in our stock price that are beyond our control and may at any time be insufficient to maintain their retention benefit or counteract offers from other companies. Additionally, if we were to lose a large percentage of our current employees in a relatively short time period, or our employees were to engage in a work stoppage or unionize, we may be unable to hire and train new employees quickly enough to prevent disruptions in our operations, which may result in the loss of members, Territory Partners or referral sources.

Our success also depends on our ability to attract, retain and motivate additional skilled management personnel. We plan to continue to expand our work force, which we believe will enhance our business and operating results. We believe that there is significant competition for qualified personnel with the skills and knowledge that we require. Many of the other companies with which we compete for qualified personnel have greater financial and other resources than we do. They also may provide more diverse opportunities and better chances for career advancement. Some of these characteristics may be more appealing to high-quality candidates than those we have to offer. If we are unable to attract and retain the necessary qualified personnel to accomplish our business objectives, we may experience constraints that will significantly impede the achievement of our business objectives and our ability to pursue our business strategy. New hires require significant training and, in most cases, take significant time before they achieve full productivity. New employees may not become as productive as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals. If our recruiting, training and retention efforts are not successful or do not generate a corresponding increase in revenue, our business will be harmed.

If we cannot maintain our corporate culture as we grow, we could lose the innovation, teamwork and focus that contribute crucially to our business.

Our culture is fundamental to our success and defines who we are and how we operate our business. We were founded on a deep appreciation of the special relationship between pet owners, their beloved pets and their trusted veterinarians. We have invested substantial time, energy and resources in developing a culture that fosters teamwork, innovation, creativity and a focus on providing value for our members as well as for Territory Partners and veterinarians. As we develop our infrastructure while we grow, we may find it difficult to maintain these valuable aspects of our corporate culture. Any failure to preserve our culture could negatively impact our future success, including our ability to attract and retain personnel, encourage innovation and teamwork and effectively focus on and pursue our corporate objectives.

We depend on relationships with strategic partners, and our inability to maintain our existing and secure new relationships with strategic partners could harm our revenue and operating results.

A portion of our enrollment leads are attributable to a variety of different types of strategic partnership arrangements. These partnerships involve various risks, depending on their structure, including the following:

- we may be unable to maintain or secure favorable relationships with strategic partners;
- our strategic partners may not be successful in creating leads;
- we may be unable to convert leads from our strategic partners into enrolled pets;
- our strategic partners could terminate their relationships with us;
- we may not experience a consistent correlation between revenues and expenditures related to the partnership, and
- bad publicity and other issues faced by our strategic partners could negatively impact us.

Our business and financial condition is subject to risks related to our writing of policies pursuant to contractual relationships with unaffiliated third parties.

Our other business segment generally includes revenues and expenses involving contractual relationships with unaffiliated third parties and marketing to enterprises. We have relatively limited experience in writing policies for unaffiliated third parties. This business is not expected to grow at the same rate as our core business and may decline. Changes to this business may be volatile due to the nature of the relationships. Further, this business historically has had, and we expect it to continue to have, lower margins than our core business. As a result of this line of business, we are subject to additional regulatory requirements and scrutiny, which increase our costs, risks and may have an adverse effect on our operations. Further, administration of this business and any similar business in the future may divert our time and attention away from our core business, which could adversely affect our operating results in the aggregate.

For example, we have written pet insurance policies for general agents since 2012. These policies are subject to materially different terms and conditions than our subscription. Further, the unaffiliated general agents administer these policies and market them to consumers. These relationships can be terminated by either party and, if terminated, would result in a reduction in our revenue to the extent we cannot enter other relationships and generate equivalent revenues with different general agents. In addition, the general agents control trust accounts they maintain on our behalf. If the general agents make operating decisions that adversely affect its business or brand, our business or brand could also be adversely affected.

In Canada, our medical plan is written by Omega General Insurance Company. If Omega were to terminate its underwriting arrangement with us, our business could be adversely affected.

In Canada, our medical plan is written by Omega, and we assume all premiums written by Omega and the related veterinary invoice expense through an agency agreement and a fronting and administration agreement. These agreements may be terminated by either party with one year’s prior written notice. If Omega were to terminate our agreement or be unable to write insurance for regulatory or other reasons, we may have to terminate subscriptions with our existing members, or suspend member enrollment and renewals, in Canada until we entered into a relationship with another third party to write our subscription, which may take a significant amount of time and require significant expense. We may not be able to enter into a new relationship, and any new relationship would likely be on less favorable terms. Any delay in entry into a new relationship or suspension of member enrollment and renewals could have a material adverse effect on our operating results and financial condition.

If we are unable to implement and maintain effective internal control over financial reporting in the future, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock may be negatively affected.

We are required to maintain internal control over financial reporting and to report any material weaknesses in such internal control. Section 404 of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) requires that we evaluate and determine the effectiveness of our internal control over financial reporting and provide a management report on the internal control over financial reporting, which must be attested to by our independent registered public accounting firm.

We may not detect errors on a timely basis and our financial statements may be materially misstated. We have had in the past, and may have in the future, material weaknesses and significant deficiencies in our internal control over financial reporting. If we or our independent registered public accounting firm identify future material weaknesses in our internal control over financial reporting, we are unable to comply with the requirements of Section 404 in a timely manner, we are unable to assert that our internal control over financial reporting is effective or our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be negatively affected. We could also become subject to investigations by the stock exchange on which our securities are listed, the SEC or other regulatory authorities, which could require additional financial and management resources.

If our security measures are breached and unauthorized access is obtained to our data, including our members' data, we may lose our competitive advantage, our systems may be perceived as not being secure and we may incur third-party liability.

Our data repository contains proprietary information that we believe gives us a competitive advantage, including data on veterinary invoices received and other data with respect to members, Territory Partners, veterinarians and other third parties. Security breaches could expose us to a risk of loss of our data and/or disclosure of this data, either publicly or to a third party who could use the information to gain a competitive advantage. In the event of a loss of our systems or data, we could experience increased costs or delays, which in turn may harm our financial condition, damage our brand and result in the loss of members. Such a disclosure also could lead to litigation and possible liability.

In the course of operating our business, we may store and/or transmit our members' confidential information, including credit card and bank account numbers and other private information. Security breaches could expose us to a risk of loss of this information, litigation and possible liability. Our payment services may be susceptible to credit card and other payment fraud schemes, including unauthorized use of credit cards, debit cards or bank account information, identity theft or merchant fraud.

If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, and, as a result, someone obtains unauthorized access to our data, including data of our members, our reputation may be damaged, our business may suffer and we could incur significant liability. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or implement adequate preventative measures. If an actual or perceived breach of our security occurs, the public perception of the effectiveness of our security measures could be harmed and we could lose members, which would adversely affect our business.

Any legal liability, regulatory penalties or negative publicity we encounter, including based on the information on our website or that we otherwise distribute or provide, directly or through Territory Partners or other referral sources, could harm our business, operating results and financial condition.

Any legal disputes or regulatory penalties involving us may be publicly announced, which could materially harm our reputation and adversely affect our business. We also provide information on our website, through our contact center and in other ways regarding pet health, the pet insurance industry in general and our subscription, including information relating to subscription fees, benefits, exclusions, limitations, availability and medical plan comparisons. A significant amount of both automated and manual effort is required to maintain the information on our website. Separately, from time to time, we use the information provided on our website and otherwise collected by us to publish reports designed to educate consumers. For example, we produce a significant amount of marketing materials regarding our subscription. If the information we provide on our website, through our contact centers or otherwise is not accurate or is construed as misleading, or if we improperly assist individuals in purchasing subscriptions, our members, competitors or others could attempt to hold us liable for damages, our relationships with veterinarians and other referral sources could be terminated and regulators could attempt to subject us to penalties, revoke our licenses to transact business in one or more jurisdictions or compromise the status of our licenses to transact our business in other jurisdictions, which could result in our loss of revenue. In the ordinary course of operating our business, we may receive complaints that the information we provided was not accurate or was misleading. These types of claims could be time-consuming and expensive to defend, could divert our management's attention and other resources and could cause a loss of confidence in our business. As a result, whether or not we are able to successfully resolve these claims, they could harm our business, operating results and financial condition.

We are subject to a number of risks related to accepting automatic fund transfers and credit card and debit card payments.

We accept payments of subscription fees from our members through automatic fund transfers and credit and debit card transactions. For credit and debit card payments, we pay interchange and other fees, which may increase over time. An increase in the number of members who utilize credit and debit cards to pay their subscription fees or related credit and debit card fees would reduce our margins and could require us to increase subscription fees, which could cause us to lose members and revenue, or suffer an increase in our operating expenses, either of which could adversely affect our operating results.

If we, or any of our processing vendors or banks have problems with our billing software, or if the billing software malfunctions, it could have an adverse effect on our member satisfaction and could cause one or more of the major credit card companies or banks to disallow our continued use of their payment products. In addition, if our billing software fails to work properly and, as a result, we do not automatically charge our members' credit cards on a timely basis or at all, or a bank withdraws the incorrect amount or fails to timely transfer the correct amount to us, we could lose revenue and harm our member experience, which could adversely affect our business and operating results. Moreover, a vendor could fail to process payments, or could process payments in the wrong amounts, which could result in us failing to collect premiums, could result in increased cancellations and could adversely affect our reputation.

We are also subject to payment card association operating rules, certification requirements and rules governing electronic funds transfers, including the Payment Card Industry Data Security Standard (PCI DSS), a security standard applicable to companies that collect, store or transmit certain data regarding credit and debit cards, holders and transactions. In the past we may not have been, we currently are not and in the future we may not be, fully or materially compliant with PCI DSS, or other payment card operating rules. Any failure to comply fully or materially with the PCI DSS now or at any point in the future may violate payment card association operating rules, federal and state laws and regulations, and the terms of our contracts with payment processors and merchant banks. Such failure to comply fully or materially also may subject us to fines, penalties, damages and civil liability, and may result in the loss of our ability to accept credit and debit card payments. In addition, there is no guarantee that PCI DSS compliance, if we are able to become compliant, will prevent illegal or improper use of our payment systems or the theft, loss or misuse of data pertaining to credit and debit cards, credit and debit card holders and credit and debit card transactions.

If we fail to adequately control fraudulent credit card transactions, we may face civil liability, diminished public perception of our security measures and significantly higher credit card-related costs, each of which could adversely affect our business, operating results and financial condition.

If we are unable to maintain our chargeback rate at acceptable levels, our credit card fees for chargeback transactions, or our fees for many or all categories of credit and debit card transactions, credit card companies and debit card issuers may increase our fees or terminate their relationship with us. Any increases in our credit card and debit card fees could adversely affect our operating results, particularly if we elect not to raise our subscription fees. The termination of our ability to process payments on any major credit or debit card would significantly impair our ability to operate our business.

We have no experience owning an office building and may face unexpected costs.

We used $55 million of the net proceeds from the June 2018 follow-on public offering to help fund the purchase of our home office building, which closed in August 2018. Before then, we leased our current home office since July 2016, and we had no experience owning an office building. While we believe our home office building is in reasonable condition, it is difficult to predict all costs associated with maintaining the building and ensuring it is suitable for our use and that of other tenants. It is possible that the other current tenants in the building may decide to move to newer facilities, wind up operations, or otherwise cease to rent space in the building, which would decrease rental income we expect to receive from them. Tenants may also negotiate tenant improvements, requiring capital expenditures that may adversely impact our financial position. In addition, we may identify structural defects or other conditions, or we may determine that remodeling or renovations are necessary given our business operations and objectives. Managing tenants, maintaining the building, and otherwise facing the costs and responsibilities of being the owner of a building may be a distraction from our core business and cause our performance to suffer.

Our building acquisition may not result in a meaningful or long-term ability to increase our cash.

We acquired our home office building because a portion of the value of the building may be used as an admitted asset on the balance sheet of American Pet Insurance Company (APIC). Over time, if APIC continues to grow its operations and increase its admitted assets, this percentage of admitted assets may result in an increasingly larger dollar amount being invested in our home office building. While the New York Department of Financial Services (NY DFS) approved the use of up to 10% of APIC's admitted assets to own the building, the NY DFS is not prevented from subsequently reducing the percentage of admitted assets that we may use or completely withdrawing its approval. Any such action could reduce the percentage of APIC's admitted assets that could be invested in our home office building to between 1% and 5%, according to current regulations. If the amount of admitted assets invested in our home office decreases, we may be required to meet our risk-based capital obligations using other forms of capital that we would otherwise invest in our growth and operations. This may require us to modify our operating plan or marketing initiatives, delay the implementation of new initiatives and solutions or development of new technologies, decrease the rate at which we hire additional personnel and enter into relationships with Territory Partners, incur additional indebtedness or pursue equity or debt financings or otherwise modify our business operations, any of which could have a material adverse effect on our operating results and financial condition.

Failure to adequately protect our intellectual property could substantially harm our business and operating results.
We rely on a combination of intellectual property rights, including trade secrets, patents, copyrights, trademarks and domain names, as well as contractual restrictions, to establish and protect our intellectual property. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy our digital content, pricing analytics, technology, software, branding and functionality, or obtain and use information that we consider proprietary. Moreover, policing our proprietary rights is difficult and may not always be effective. If we continue to expand internationally, we may need to enforce our rights under the laws of countries that do not protect proprietary rights to as great an extent as do the laws of the United States, which may be expensive and divert management's attention away from other operations.

Our digital content is not protected by any registered copyrights or other registered intellectual property. Rather, our digital content is protected by statutory and common law rights, user agreements that limit access to and use of our data and by technological measures. Compliance with use restrictions is difficult to monitor, and our proprietary rights in our digital content databases may be more difficult to enforce than other forms of intellectual property rights.

We currently hold several registered trademarks, including "Trupanion". Trademark protection may not always be available, or sought by us, in every country in which our subscription is available. Competitors may adopt names similar to ours, or purchase our trademarks and confusingly similar terms as keywords in Internet search engine advertising programs, thereby impeding our ability to build brand identity and possibly confusing members. Moreover, there could be potential trade name or trademark infringement claims brought by owners of other registered trademarks or trademarks that incorporate marks similar to our trademarks.

We may take action, including initiating litigation, to protect our intellectual property rights and the integrity of our brand, and these efforts may prove costly, ineffective and increase the likelihood of counterclaims against us.
We currently hold the "Trupanion.com" Internet domain name and numerous other related domain names. Domain names generally are regulated by Internet regulatory bodies. If we lose the ability to use a domain name in the United States, Canada or any other country, we may be forced to acquire domain names at significant cost or, in the alternative, be forced to incur significant additional expenses to market our subscription, including the development of a new brand and the creation of new promotional materials, which could substantially harm our business and operating results. The regulation of domain names in the United States, Canada and in other foreign countries is subject to change. Regulatory bodies could establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may not be able to acquire or maintain the domain names that utilize the "Trupanion" name in all of the countries in which we currently intend to conduct business.

We seek to control access to our proprietary technology, software and documentation by entering into confidentiality and invention assignment agreements with our employees and partners, confidentiality agreements with third parties, such as service providers, vendors, individuals and entities that may be exploring a business relationship with us, and terms of use with third parties, such as veterinary hospitals desiring to use our technology, software and documentation. These agreements may not prevent disclosure of intellectual property, trade secrets and/or other confidential information, and may not provide an adequate remedy in the event of misappropriation of trade secrets or any unauthorized disclosure of trade secrets and other confidential information. In addition, others may independently discover trade secrets and confidential information and, in such cases, we may not be able to assert any trade secret rights against such parties. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our intellectual property rights and related confidentiality and nondisclosure provisions, and failure to obtain or maintain trade secret protection, or our competitors being able to obtain our trade secrets or to independently develop technology similar to ours or competing technologies, could adversely affect our competitive business position.

Litigation or proceedings before the U.S. Patent and Trademark Office or other governmental authorities and administrative bodies in the United States and abroad may be necessary in the future to enforce our intellectual property rights, to protect our domain names and to determine the validity and scope of the proprietary rights of others. Our efforts to enforce or protect our proprietary rights may be ineffective, could result in substantial costs and diversion of resources and could substantially harm our operating results.

Assertions by third parties of infringement or other violation by us of their intellectual property rights could result in significant costs and substantially harm our business and operating results.

Third parties have in the past and may in the future claim that our services infringe or otherwise violate their intellectual property rights. We may be subject to legal proceedings and claims, including claims of alleged infringement by us of the intellectual property rights of third parties. Any dispute or litigation regarding intellectual property could be expensive and time consuming, regardless of the merits of any claim, and could divert our management and key personnel from our operations.

If we were to discover or be notified that our services potentially infringe or otherwise violate the intellectual property rights of others, we may need to obtain licenses from these parties in order to avoid infringement. We may not be able to obtain the necessary licenses on acceptable terms, or at all, and any such license may substantially restrict our use of the intellectual property. Moreover, if we are sued for infringement and lose the lawsuit, we could be required to pay substantial damages or be enjoined from offering the infringing services. Any of the foregoing could cause us to incur significant costs and prevent us from selling or properly administering subscriptions or performing under our other contractual relationships.

We rely on third parties to provide intellectual property and technology necessary for the operation of our business.

We utilize intellectual property and technology owned by third parties in developing and operating our technology platform and operating our business. From time to time, we may be required to renegotiate with these third parties or negotiate with other third parties to include or continue using their intellectual property or technology in our existing technology platform or business operations or in modifications or enhancements to our technology platform or business operations. We may not be able to obtain the necessary rights from these third parties on commercially reasonable terms, or at all, and the third-party intellectual property and technology we use or desire to use may not be appropriately supported, maintained or enhanced by the third parties. If we are unable to obtain the rights necessary to use or continue to use third-party intellectual property and technology in our operations, or if those third parties are unable to support, maintain and enhance their intellectual property and technology, we could experience increased costs or delays, which in turn may harm our financial condition, damage our brand and result in the loss of members.

Our technology platform and our data are also hosted by a third-party service provider. The terms under which such third-party service provider provides us services may change and we may be required to renegotiate with that third party. If we are unable to renegotiate satisfactory terms, we may not be able to transition to an alternative service provider without interrupting the availability of our technology platform and any interruption could materially and adversely affect our business. Additionally, if our third-party service provider experiences any disruptions, outages or catastrophes, or if it ceases to conduct business for any reason, we could experience an interruption in our business, which in turn may damage our brand, result in a loss of members and harm our financial condition.

The outcome of litigation or regulatory proceedings could subject us to significant monetary damages, restrict our ability to conduct our business, harm our reputation and otherwise negatively impact our business.

From time to time, we have been, and in the future may become, subject to litigation, claims and regulatory proceedings and inquiries, including market conduct examinations and investigations by state insurance regulatory agencies and threatened or filed lawsuits by, among others, government agencies, employees, competitors, current or former members, or business partners.

We cannot predict the outcome of these actions or proceedings, and the cost of defending such actions or proceedings could be material. Further, defending such actions or proceedings could divert our management and key personnel from our business operations. If we are found liable in any action or proceeding, we may have to pay substantial damages or fines, or change the way we conduct our business, either of which may have a material adverse effect on our business, operating results, financial condition and prospects. There may also be negative publicity associated with litigation or regulatory proceedings that could harm our reputation or decrease acceptance of our services. These claims may be costly to defend and may result in assessment of damages, adverse tax consequences and harm to our reputation.

Covenants in the credit agreement governing our revolving line of credit may restrict our operations, and if we do not effectively manage our business to comply with these covenants, our financial condition could be adversely affected.

The credit agreement governing our revolving line of credit contains various restrictive covenants, including restrictions on our ability to dispose of our assets, change the name, location, office or executive management of our business, merge with or acquire other entities, incur other indebtedness, incur encumbrances, pay dividends or make distributions to holders of our capital stock, make investments, engage in transactions with our affiliates, permit withdrawals from APIC (with certain exceptions) and conduct operations in certain of our Canadian subsidiaries. Our credit agreement also contains certain financial covenants, including having APIC maintain statutory capital and surplus at all times of not less than the greater of the amount required by regulatory statute or 110% of the highest amount of statutory capital and surplus required in any state in which APIC is licensed; maintaining a minimum cash balance of $1.4 million in our account at Western Alliance Bank (WAB) and/or WAB affiliates and other cash or investments of $2.1 million in our accounts at Pacific Western Bank (PWB); maintaining all of our depository and operating accounts at PWB and/or WAB; maintaining certain investment accounts at PWB and/or PWB affiliates; achieving certain quarterly revenue levels and claims ratio thresholds; maintaining greater than negative $1.0 million net total of operating cash flow and capital expenditures quarterly; and remaining within certain monthly maximum EBITDA loss levels. EBITDA is defined as earnings, plus an amount equal to the sum of (i) tax, plus (ii) depreciation and amortization, plus (iii) interest and non-cash expenses, plus (iv) any non-cash stock-based compensation expense, plus (v) (gain)/loss from equity method investments. Our ability to meet these restrictive covenants can be affected by events beyond our control, and we have been in the past, and may be in the future, unable to do so. In addition, our failure to maintain effective internal controls to measure compliance with our financial covenants could affect our ability to take corrective actions on a timely basis and could result in our being in breach of these covenants. Our credit agreement provides that our breach or failure to satisfy certain covenants constitutes an event of default. Upon the occurrence of an event of default, our lenders could elect to declare any future amounts outstanding under our credit agreement to be immediately due and payable. If we are unable to repay those amounts, our financial condition could be adversely affected.

Any indebtedness we incur could adversely affect our business and limit our ability to expand our business or respond to changes, and we may be unable to generate sufficient cash flow to satisfy any of our debt service obligations.

We have a revolving line of credit and may incur indebtedness in the future, including any additional borrowings available under our revolving line of credit. Any substantial indebtedness and the fact that a substantial portion of our cash flow from operating activities could be needed to make payments on this indebtedness could have adverse consequences, including the following:

- reducing the availability of our cash flow for our operations, capital expenditures, future business opportunities and other purposes;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate, which could place us at a competitive disadvantage compared to our competitors that may have less debt;
- limiting our ability to borrow additional funds; and
- increasing our vulnerability to general adverse economic and industry conditions.

Our ability to borrow any funds needed to operate and expand our business will depend in part on our ability to generate cash. Our ability to generate cash is subject to the performance of our business, as well as general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. We may also need to use operating funds to support risk-based capital requirements and borrow additional funds to support our growth. If our business does not generate sufficient cash flow from operating activities or if future borrowings are not available to us, under our revolving credit facility or otherwise, in amounts sufficient to enable us to fund our liquidity needs, our operating results, financial condition and ability to expand our business and meet our risk-based capital requirements may be adversely affected.

Our financial results may be negatively affected if we are required to pay income tax, premium tax, transaction tax or other taxes in jurisdictions where we are currently not collecting and reporting tax.

We currently pay income tax, premium tax, transaction tax and other taxes in certain jurisdictions in which we do business. A successful assertion by one or more jurisdictions that we should be paying income, premium, transaction or other taxes on our income or in connection with enrollment or intercompany services, or the enactment of new laws requiring the payment of income, premium, transfer or other taxes in connection with our business operations, including enrollment or intercompany services, could result in substantial tax liabilities.

We may have additional tax liabilities.

We are subject to income and other taxes in the U.S. and foreign jurisdictions. Significant judgment is required in determining our provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. Further, we often make elections for tax purposes which may ultimately not be upheld. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation in the jurisdictions where we are subject to taxation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material effect on our consolidated financial statements in the period or periods in which that determination is made.

If consumer acceptance of the Internet as an acceptable marketplace for our subscription does not continue to increase, our growth prospects will be harmed.

Our success depends in part on widespread consumer acceptance of the Internet as a marketplace for the purchase of medical insurance for cats and dogs. Internet use may not continue to develop at historical rates, and consumers may not continue to use the Internet to research, select and purchase insurance. In addition, the Internet may not be accepted as a viable resource for a number of reasons, including lack of security of information or privacy protection, possible disruptions, computer viruses or other damage to Internet servers or to users’ computers, and excessive governmental regulation.

Our success will depend, in large part, on third parties maintaining the Internet infrastructure to provide a reliable network backbone with the speed, data capacity, security and hardware necessary for reliable Internet access and services.

We depend in part on Internet search engines to attract potential new members to visit our website. If Internet search engines’ methodologies are modified or our search result page rankings decline for other reasons, our new member growth could decline, and our business and operating results could be harmed.

We derive a significant amount of traffic to our website from consumers who search for pet medical insurance through Internet search engines, such as Google, Bing and Yahoo!. A critical factor in attracting consumers searching for pet medical insurance on the Internet to our website is whether we are prominently displayed in response to an Internet search relating to pet insurance. Algorithmic search result listings are determined and displayed in accordance with a set of formulas or algorithms developed by the particular Internet search engine, which may change from time to time. If we are listed less prominently in, or removed altogether from, search result listings for any reason, the traffic to our websites would decline and we may not be able to replace this traffic, which in turn would harm our business, operating results and financial condition. If we decide to attempt to replace this traffic, we may be required to increase our sales and marketing expenditures, including by utilizing paid search advertising, which would also increase our pet acquisition costs and harm our business, operating results and financial condition.

Changes in the economy may negatively impact our business, operating results and financial condition.

Our business may be affected by changes in the economic environment. Medical insurance for cats and dogs is a discretionary purchase, and members may reduce or eliminate their discretionary spending during an economic downturn, resulting in an increase in terminations and a reduction in the number of new member enrollments. We may experience a material increase in terminations or a material reduction in our member retention rate in the future, especially in the event of a prolonged recessionary period or a downturn in economic conditions. Conversely, consumers may have more income to pay veterinary costs out-of-pocket and less desire to purchase our subscription during a period of economic growth. In addition, media prices may increase during a period of economic growth, which could increase our sales and marketing expenses. As a result, our business, operating results and financial condition may be significantly affected by changes in the economic environment.

We may invest in or acquire other companies or technologies, which could divert our management’s attention, result in additional dilution to our stockholders, otherwise disrupt our operations or harm our operating results.

We may decide to invest in or acquire businesses, products or technologies. Our ability to successfully evaluate and manage investment opportunities, or make and integrate acquisitions, is unproven. The pursuit of potential investments or acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable opportunities, whether or not they are consummated. Further, even if we successfully invest in or acquire additional businesses or technologies, we may not achieve the anticipated benefits from the transaction. The investment or acquisition may also expose us to additional risks, including from unknowingly inheriting liabilities that are not adequately covered by indemnities. Acquisitions or investments could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. If an investment or acquisition fails to meet our expectations, our business, operating results and financial condition may suffer.

Our ability to use our net operating loss carryforwards and certain other tax attributes may be limited.

As of December 31, 2017, we had U.S. federal net operating loss carryforwards of approximately $86.7 million that will begin to expire in 2027. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (the Code), if a corporation undergoes an "ownership change," the corporation's ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes, such as research tax credits, to offset its post-change income taxes may be limited. In general, an "ownership change" generally occurs if there is a cumulative change in our ownership by "5-percent stockholders" that exceeds 50 percentage points over a rolling three-year period. Similar rules may apply under state tax laws. Pursuant to Sections 382 and 383 of the Code, annual use of our net operating loss carryforwards and credit carryforwards may be limited by previous and future ownership changes. We believe the utilization of approximately $0.5 million of net operating losses are subject to limitation as a result of prior ownership changes based on our Section 382 study performed as of September 30, 2016.

We are expanding our operations internationally, and we may therefore become subject to a number of risks associated with international expansion and operations.

As part of our growth plan, we have explored, and expect to continue to explore, opportunities to expand our operations internationally. We have agreements to enter the Australian market on a limited basis. We have no history of marketing, selling, administrating and supporting our subscription for consumers outside of the United States, Canada and Puerto Rico. In general, international sales and operations may be subject to a number of risks, including the following:

- regulatory rules and practices, foreign exchange controls, tariffs, tax laws and treaties that are different than those we operate under in the United States, Canada and Puerto Rico and that carry a greater risk of unexpected changes;
- the costs and resources required to modify our technology and sell our subscription in non-English speaking countries;
- the costs and resources required to modify our subscription appropriately to suit the needs and expectations of residents and veterinarians in such foreign countries;
- our data analytics platform may have limited applicability in foreign countries, which may impact our ability to develop adequate underwriting criteria and accurately price subscriptions in such countries;
- increased expenses incurred in establishing and maintaining office space and equipment for our international operations;
- technological incompatibility;
- fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business;
- difficulties in attracting and retaining personnel with experience in international operations;
- difficulties in modifying our business model in a manner suitable for any particular foreign country, including any modifications to our Territory Partner model to the extent we determine that our existing model is not suitable for use in foreign countries;
- our lack of experience in marketing to consumers and veterinarians, and encouraging online marketing, in foreign countries;
- our relative lack of industry connections in many foreign countries;
- difficulties in managing operations due to language barriers, distance and time zone differences, staffing, cultural differences and business infrastructure constraints, including difficulty in obtaining foreign and domestic visas;
- application of foreign laws and regulations to us, including more stringent or materially different insurance, employment, consumer and data protection laws;
- the uncertainty of protection for intellectual property rights in some countries;
- greater risk of a failure of foreign employees to comply with applicable U.S. and foreign laws, including antitrust regulations, the U.S. Foreign Corrupt Practices Act and any trade regulations ensuring fair trade practices; and
- general economic and political conditions in these foreign markets.

These factors and other factors could harm our ability to gain future international revenue and, consequently, materially impact our business and operating results. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources, detracting from management attention and financial resources otherwise available to our existing business. Our failure to successfully manage our international operations and the associated risks effectively could limit the future growth of our business and could have an adverse effect on our operating results and financial condition.

A downgrade in the financial strength rating of our insurance company may have an adverse effect on our competitive position, the marketability of our subscription, and/or on our liquidity, access to and cost of borrowing, operating results and financial condition.

Although we do not believe that the financial strength rating of APIC is material for customers or to understand our business beyond what is already publicly available, financial strength ratings can be important factors in establishing the competitive position of insurance companies and generally have an effect on an insurance company's business. On an ongoing basis, rating agencies review the financial performance and condition of APIC and could downgrade or change the outlook on its ratings due to, for example, a change in its statutory capital, a change in the rating agency's determination of the amount of risk-based capital required to maintain a particular rating or a reduced confidence in management or its business strategy, as well as a number of other considerations that may or may not be under our control. The insurance financial strength rating of APIC is subject to quarterly review, and APIC may not retain the current rating. A downgrade in this or any future ratings could have a material effect on our sales, our competitiveness, the marketability of our subscription, our liquidity, access to and cost of borrowing, operating results and financial condition.

Our business is subject to the risks of earthquakes, floods, fires and other natural catastrophic events and to interruption by man-made problems such as computer viruses or terrorism.

Our systems and operations are vulnerable to damage or interruption from earthquakes, human error, intentional bad acts, hurricanes, floods, fires, power losses, telecommunications failures, hardware and system failures, terrorist attacks, acts of war, break-ins or similar events. For example, our corporate headquarters and facilities are located in Seattle, Washington near known earthquake fault zones and are vulnerable to significant damage from earthquakes. In addition, cyber-attacks or acts of terrorism could cause disruptions in our business or the economy as a whole. Our servers and systems may also be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems, which could lead to interruptions, delays, loss of critical data or the unauthorized disclosure of confidential member data. We currently have limited disaster recovery capability, and our business interruption insurance may be insufficient to compensate us for losses that may occur. Such disruptions could negatively impact our ability to run our business, which could have an adverse effect on our operating results and financial condition.

Risks Related to Compliance with Laws and Regulations

We may not maintain the amount of risk-based capital required to avoid additional regulatory oversight, which may adversely affect our ability to operate our business.

Memberships in our U.S. subscription are written by APIC. APIC is an insurance company domiciled in the state of New York and licensed by the New York Department of Financial Services. Regulators in the states in which we do business impose risk-based capital requirements on APIC that generally are approved by the National Association of Insurance Commissioners to ensure APIC maintains reasonably appropriate levels of surplus to protect our members against adverse developments in APIC's financial circumstances, taking into account the risk characteristics of our assets, liabilities and certain other items. Generally, the NY DFS will compare, on an annual basis as of December 31 or more often as deemed necessary, an insurer's total adjusted capital and surplus against what is referred to as an "Authorized Control Level" of risk-based capital that is calculated based on a formula designed to estimate an insurer's capital adequacy. There generally are five outcomes possible from this comparison, depending on the insurer's level of risk-based capital as compared to the applicable Authorized Control Level.

- *No Action Level*: Insurer's total adjusted capital is equal to or greater than 200% of the Authorized Control Level.
- *Company Action Level*: Insurer's total adjusted capital is less than 200% but greater than 150% of the Authorized Control Level. When at this level, an insurer must prepare and submit a financial plan to the NY DFS for review and approval. Generally, a risk-based capital plan would identify the conditions that contributed to the Company Action Level and include the insurer's proposed plans for increasing its risk-based capital in order to satisfy the No Action Level. The failure to provide the NY DFS with a risk-based capital plan on a timely basis or the inability of the NY DFS and the insurer to mutually agree on an appropriate risk-based capital plan could trigger a Regulatory Action Level outcome, subject to the insurer's right to a hearing on the issue.
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Regulatory Action Level: Insurer's total adjusted capital is less than 150% but greater than 100% of the Authorized Control Level. When at this level, an insurer generally must provide a risk-based capital plan to the NY DFS and be subject to examination or analysis by the NY DFS to the extent it deems necessary, including such corrective actions as the NY DFS may require.

Authorized Control Level: Insurer's total adjusted capital is less than 100% but greater than 70% of the Authorized Control Level. At this level, the NY DFS generally could take remedial actions that it determines necessary to protect the insurer's assets, including placing the insurer under regulatory control.

- *Mandatory Control Level*: Insurer's total adjusted capital is less than 70% of the Authorized Control Level. At this level, the NY DFS generally is required to take steps to place the insurer under regulatory control, even if the insurer is still solvent.

The NY DFS may increase the required levels of risk-based capital in the future, and we anticipate that we will need to maintain greater amounts of risk-based capital if our pet enrollment continues to grow. Additionally, if our risk-based capital falls below the Company Action Level, we may be in breach of various contractual relationships, including, for example, with the unaffiliated general agents for which we write pet insurance policies, which may give such parties the ability to cancel their contracts with us and/or sue us for damages related to our risk-based capital levels, which could have a material adverse effect on our financial condition.

We may require additional capital to meet our risk-based capital requirements, pursue our business objectives and respond to business opportunities, challenges or unforeseen circumstances. If capital is not available to us at any time, our business, operating results and financial condition may be harmed.

We may require additional capital to meet our risk-based capital requirements, operate or expand our business or respond to unforeseen circumstances. Additional funds may not be available when we need them, on terms that are acceptable to us, or at all. If we raise additional funds through the issuance of equity or convertible securities, the percentage ownership of holders of our common stock could be significantly diluted and these newly issued securities may have rights, preferences or privileges senior to those of holders of our common stock. Further, volatility in the credit or equity markets may have an adverse effect on our ability to obtain debt or equity financing or the cost of such financing. Similarly, our access to funds may be impaired if regulatory authorities or rating agencies take negative actions against us. If a combination of these factors were to occur, our internal sources of liquidity may prove to be insufficient and, in such case, we may not be able to successfully obtain additional financing on favorable terms. If funds are unavailable to us on reasonable terms when we need them, we may be unable to meet our risk-based capital requirements, train and support our employees, support Territory Partners, maintain the competitiveness of our technology, pursue business opportunities, service our existing debt, pay veterinary invoices or acquire new members, any of which could have an adverse effect on our business, operating results and financial condition.

If we fail to comply with the numerous laws and regulations that are applicable to the sale of medical insurance for cats and dogs, our business and operating results could be harmed.

The sale of medical insurance for cats and dogs, which is considered a type of property and casualty insurance in most jurisdictions, is heavily regulated by each state in the United States, in the District of Columbia, in Puerto Rico and by Canadian federal, provincial and territorial governments. In the United States, state insurance regulators are charged with protecting policyholders and have broad regulatory, supervisory and administrative powers over our business practices. Because we do business in all 50 states, the District of Columbia, all Canadian provinces and territories and Puerto Rico, compliance with insurance-related laws, rules and regulations is difficult and imposes significant costs on our business. Each jurisdiction's insurance department typically has the power, among other things, to:

- grant and revoke licenses to transact insurance business;
- conduct inquiries into the insurance-related activities and conduct of agents and agencies and others in the sales, marketing and promotional channels;
- require and regulate disclosure in connection with the sale and solicitation of insurance policies;
- authorize how, by which personnel and under what circumstances insurance premiums can be quoted and published and an insurance policy sold;
- regulate which entities or individuals can be incentivized and the circumstances under which this may occur;
- regulate the content of insurance-related advertisements, including web pages, and other marketing practices;
- approve policy forms, require specific benefits and benefit levels and regulate premium rates;
- impose fines and other penalties; and
- impose continuing education requirements.

While the U.S. federal government does not directly regulate the insurance industry, federal legislation and administrative policies can also affect us. Congress and various federal agencies periodically discuss proposals that would provide for federal oversight of insurance companies. We cannot predict whether any such laws will be enacted or the effect that such laws would have on our business. We also do business in all ten provinces and three territories of Canada. The provincial and territorial insurance regulators have the power to regulate the market conduct of insurers and insurance intermediaries, and the licensing and supervision of insurance agents, and brokers, along with enforcement rights, including the right to assess administrative monetary penalties in certain provinces.

Insurance companies are also regulated at the federal level in Canada, and the Insurance Companies Act prohibits a foreign entity from insuring risks in Canada unless it is authorized by an Order made by the Superintendent of Financial Institutions (Canada) permitting it to do so.

Due to the complexity, periodic modification and differing interpretations of insurance laws and regulations, we have not always been, and we may not always be, in compliance with them. New insurance laws, regulations and guidelines also may not be compatible with the manner in which we market and sell subscriptions in all of our jurisdictions and member acquisition channels, including over the Internet. Failure to comply with insurance laws, regulations and guidelines or other laws and regulations applicable to our business could result in significant liability, additional department of insurance licensing requirements, the revocation of licenses in a particular jurisdiction or our inability to sell subscriptions, which could significantly increase our operating expenses, result in the loss of our revenue and otherwise harm our business, operating results and financial condition.

Moreover, an adverse regulatory action in one jurisdiction could result in penalties and adversely affect our license status or reputation in other jurisdictions, including due to the current requirement that adverse regulatory actions in one jurisdiction be reported to other jurisdictions. Even if the allegations in any regulatory or other action against us ultimately are determined to be unfounded, we could incur significant time and expense defending against the allegations, and any related negative publicity could harm consumer and third-party confidence in us, which could significantly damage our brand.

In addition, we have received, and may in the future receive, inquiries from regulators regarding our marketing and business practices. These inquires may include investigations regarding a number of our business practices, including the manner in which we market and sell subscriptions, the manner in which we write policies for any unaffiliated general agent, and whether any amounts we pay to hospitals or hospital groups is appropriate. Any modification of our marketing or business practices in response to regulatory inquiries could harm our business, operating results or financial condition and lead to reputational harm.

A regulatory environment that limits rate increases may adversely affect our operating results and financial condition.

Many states, including New York, have adopted laws or are considering proposed legislation that, among other things, limit the ability of insurance companies to effect rate increases or to cancel, reduce or not renew existing policies, and many state regulators have the power to reduce, or to disallow increases in premium rates. Most states, including New York, require licensure and regulatory approval prior to marketing new insurance products. Our practice has been to regularly reevaluate the price of our subscriptions, with any pricing changes implemented at least annually, subject to the review and approval of the state regulators, who may reduce or disallow our pricing changes. Such review has often in the past resulted, and may in the future result, in delayed implementation of pricing changes and prevent us from making changes we believe are necessary to achieve our targeted payout ratio, which could adversely affect our operating results and financial condition. In addition, we may be prevented by regulators from limiting significant pricing changes, requiring us to raise rates more quickly than we otherwise may desire. This could damage our reputation with our members and reduce our retention rates, which could significantly damage our brand, result in the loss of expected revenue and otherwise harm our business, operating results and financial condition.

In addition to regulating rates, certain states have enacted laws that require a property-casualty insurer, which includes a pet insurance company, conducting business in that state to participate in assigned risk plans, reinsurance facilities, joint underwriting associations (JUAs), Fair Access to Insurance Requirements (FAIR) plans and wind pools. In these markets, if the state reinsurance facilities, wind pools, FAIR plans or JUAs recognize a financial deficit, they may in turn have the ability to assess participating insurers, adversely affecting our operating results and financial condition if we are a part of such state reinsurance facilities, wind pools, FAIR plans or JUAs. Additionally, certain states require insurers to participate in guaranty funds for impaired or insolvent insurance companies. These funds periodically assess losses against all insurance companies doing business in the state. Our operating results and financial condition could be adversely affected by any of these factors.

Regulations that require individuals or entities that sell medical insurance for cats and dogs or process claims to be licensed may be interpreted to apply to our business more broadly than we expect them to, which could require us to modify our business practices, create liabilities, damage our reputation, and harm our business.

Insurance regulations generally require that each individual who transacts pet insurance business on our behalf must maintain a valid license in one or more jurisdictions. Regulations may also require certain individuals who process claims to be licensed. These requirements are subject to a variety of interpretations between jurisdictions. We may not interpret and apply the requirements in the same manner as all applicable regulators, and, even if we have, the requirements or regulatory interpretations of those requirements may change. Regulators have in the past and/or may in the future determine that certain of our personnel or referral sources were performing licensable activities without the required license. If such persons were not in fact licensed in any such jurisdiction, we could become subject to conviction for an offense or the imposition of an administrative penalty, and liable for significant penalties. We would also likely be required to modify our business practices and/or sales and marketing programs, or license the affected individuals, which may be impractical or costly and time-consuming to implement. Any modification of our business or marketing practices in response to regulatory licensing requirements could harm our business, operating results or financial condition.

Most insurance legislation requires entities that solicit the sale of pet insurance to be validly licensed in the applicable jurisdiction. If an insurance regulator were to determine that any entity soliciting the sale of a subscription on our behalf did not hold the required license, we may have to modify our business practices or marketing efforts, or license the affected entities, which may be costly and time-consuming to implement.

We are subject to numerous laws and regulations, and compliance with one law or regulation may result in non-compliance with another.

We are subject to numerous laws and regulations that are administered and enforced by a number of different governmental authorities, each of which exercises a degree of interpretive latitude, including, in the United States, state insurance regulators, state securities administrators, state attorneys general and federal agencies including the SEC, Internal Revenue Service and the U.S. Department of Justice. Consequently, we are subject to the risk that compliance with any particular regulator’s or enforcement authority’s interpretation of a legal issue may not result in compliance with another’s interpretation of the same issue, particularly when compliance is judged in hindsight. In addition, there is risk that laws and regulations or any particular regulator’s or enforcement authority’s interpretation of a legal issue may change over time to our detriment, or that changes in the overall legal environment may, even absent any particular regulator’s or enforcement authority’s interpretation of a legal issue changing, cause us to change our views regarding the actions we need to take from a legal risk management perspective, thus necessitating changes to our practices that may, in some cases, increase our costs and limit our ability to grow or to improve the profitability of our business. Further, in some cases, these laws and regulations are designed to protect or benefit the interests of a specific constituency rather than a range of constituencies. For example, state insurance laws and regulations generally are intended to protect or benefit purchasers or users of insurance products, not holders of securities, which generally is the jurisdiction of the SEC. In many respects, these laws and regulations limit our ability to grow or to improve the profitability of our business.

Regulation of the sale of medical insurance for cats and dogs is subject to change, and future regulations could harm our business and operating results.

The laws and regulations governing the offer, sale and purchase of medical insurance for cats and dogs are subject to change, and future changes may be adverse to our business. For example, if a jurisdiction were to increase our risk-based capital requirements or alter the requirements for obtaining or maintaining an agent’s license in connection with the enrollment of a member, it could have a material adverse effect on our operations. Some states in the United States have adopted, and others are expected to adopt, new laws and regulations related to the insurance industry. It is difficult to predict how these or any other new laws and regulations will impact our business, but, in some cases, changes in insurance laws, regulations and guidelines may be incompatible with various aspects of our business and require that we make significant modifications to our existing technology or practices, which may be costly and time-consuming to implement and could also harm our business, operating results and financial condition.

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Failure to comply with federal, state and provincial laws and regulations relating to privacy and security of personal information, and civil liabilities relating to breaches of privacy and security of personal information, could create liabilities for us, damage our reputation and harm our business.

A variety of U.S. and Canadian federal, state and provincial laws and regulations govern the collection, use, retention, sharing and security of personal information. We collect and utilize demographic and other information from and about our members when they visit our website, call our contact center and apply for enrollment. Further, we use tracking technologies, including "cookies," to help us manage and track our members' interactions and deliver relevant advice and advertising. Claims or allegations that we have violated applicable laws or regulations related to privacy and data security could in the future result in negative publicity and a loss of confidence in us by our members and our participating service providers, and may subject us to fines by credit card companies and the loss of our ability to accept credit and debit card payments. In addition, we have posted privacy policies and practices concerning the collection, use and disclosure of member data on our website. Several Internet companies have incurred penalties for failing to abide by the representations made in their privacy policies and practices. In addition, our use and retention of personal information could lead to civil liability exposure in the event of any disclosure of such information due to hacking, viruses, inadvertent action or other use or disclosure. Several companies have been subject to civil actions, including class actions, relating to this exposure.

We have incurred, and will continue to incur, expenses to comply with privacy and security standards and protocols for personal information imposed by law, regulation, self-regulatory bodies, industry standards and contractual obligations. Such laws, standards and regulations, however, are evolving and subject to potentially differing interpretations, and federal, state and provincial legislative and regulatory bodies may expand current or enact new laws or regulations regarding privacy matters. We are unable to predict what additional legislation, standards or regulation in the area of privacy and security of personal information could be enacted or its effect on our operations and business.

Government regulation of the Internet and email could adversely affect our business.

The laws governing general commerce on the Internet remain unsettled and it may take years to fully determine whether and how existing laws such as those governing insurance, intellectual property, privacy and taxation apply to the Internet. In addition, the growth and development of the market for electronic commerce and Internet-related pet insurance advertisements and transactions may prompt calls for more stringent consumer protection laws that may impose additional burdens on companies conducting business and selling subscriptions over the Internet. Any new laws or regulations or new interpretations of existing laws or regulations relating to the Internet could harm our business and we could be forced to incur substantial costs in order to comply with them, which would harm our business, operating results and financial condition.

Additionally, we use email to market our services to potential members and as a means of communicating with our existing members. The laws and regulations governing the use of email for commercial purposes continue to evolve and the growth and development of the market for commerce over the Internet may lead to the adoption of additional legislation. Failure to comply with existing or new laws regarding electronic communications with members could lead to significant damages. We have incurred, and will continue to incur, expenses to comply with electronic messaging laws. If new laws or regulations are adopted, or existing laws and regulations are interpreted, to impose additional restrictions on our ability to send email to our members or potential members, we may not be able to communicate with them in a cost-effective manner. In addition to legal restrictions on the use of email for commercial purposes, Internet and email service providers and others attempt to block the transmission of unsolicited email, commonly known as "spam." Many service providers have relationships with organizations whose purpose it is to detect and notify the Internet and email service providers of entities that the organization believes is sending unsolicited email. If an Internet or email service provider identifies messaging and email from us as "spam" as a result of reports from these organizations or otherwise, we could be placed on a restricted list that will block our emails to members or potential members. If we are restricted or unable to communicate by email with our members and potential members as a result of legislation, blockage or otherwise, our business, operating results and financial condition would be harmed.

Applicable insurance laws regarding the change in control of our company may impede potential acquisitions that our stockholders might consider to be desirable.

We are subject to statutes and regulations of the state of New York that generally require that any person or entity desiring to acquire direct or indirect control of APIC obtain prior regulatory approval. These laws may discourage potential acquisition proposals and may delay, deter or prevent a change in control of our company, including through transactions, and in particular unsolicited transactions, that some of our stockholders might consider to be desirable. Similar laws or regulations may also apply in other states in which we may operate.

Our segregated account in Bermuda, WICL segregated account AX, could be adversely impacted by regulatory compliance of a third party.

Wyndham Insurance Company (SAC) Limited (WICL) is a class 3 insurer regulated by the Bermuda Monetary Authority (BMA). WICL's ability to continue operations and pay dividends could impact the ability of our segregated account to do the same. WICL's failure to meet regulatory requirements set forth by the BMA could result in our inability to transact business with WICL segregated account AX. Further, WICL could be limited from allowing dividends to be paid out of segregated account AX in the event of adverse regulatory actions.

We will continue to incur significantly increased costs and devote substantial management time as a result of operating as a public company.

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. For example, we are subject to the reporting requirements of the Exchange Act, and are required to comply with the applicable requirements of the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the JOBS Act, as well as rules and regulations subsequently implemented by the SEC and the stock exchange on which our common stock is listed, including the establishment and maintenance of effective disclosure and financial controls and changes in corporate governance practices. Compliance with these requirements has and may continue to increase our legal and financial compliance costs and will make some activities more time consuming and costly. In addition, from time to time, our management and other personnel need to divert attention from operational and other business matters to devote substantial time to these public company requirements. In particular, we have and will continue to incur significant expenses and devote substantial management effort toward ensuring compliance with the requirements of Section 404 of the Sarbanes-Oxley Act, which will continue to increase as the exemption from Section 404(b) of Sarbanes-Oxley Act allowed under the JOBS Act no longer applies to us. We cannot predict or estimate the amount of additional costs we may incur as a result of being a public company or the timing of such costs.

We are an emerging growth company and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies make our common stock less attractive to investors.

We are an emerging growth company and have taken advantage of certain exemptions from various reporting requirements that are applicable to other public companies including, but not limited to, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile. Starting January 1, 2019, and effective for our Annual Report on Form 10-K for 2018, we will no longer be an emerging growth company and after that date we will no longer be able to avail ourselves of these exemptions.

Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.

Generally accepted accounting principles in the United States are subject to interpretation by the Financial Accounting Standards Board, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results, could affect the reporting of transactions completed before the announcement of a change and could affect our compliance with financial debt covenants.

Risks Related to Ownership of Our Common Stock

Our actual operating results may differ significantly from our guidance.

From time to time we have released, and may continue to release, guidance in our quarterly earnings conference call, quarterly earnings releases, or otherwise, regarding our future performance that represents our management’s estimates as of the date of release. This guidance, which includes forward-looking statements, has been and will be based on projections prepared by our management. These projections are not prepared with a view toward compliance with published guidelines of the American Institute of Certified Public Accountants, and neither our registered public accountants nor any other independent expert or outside party compiles or examines the projections. Accordingly, no such person expresses any opinion or any other form of assurance with respect to the projections.

Projections are based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and are based upon specific assumptions with respect to future business decisions, some of which will change. We intend to state possible outcomes as high and low ranges which are intended to provide a sensitivity analysis as variables are changed but are not intended to imply that actual results could not fall outside of the suggested ranges. The principal reason that we release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such third parties.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results may vary from our guidance and the variations may be material. In light of the foregoing, investors are urged not to rely upon our guidance in making an investment decision regarding our common stock.

Any failure to successfully implement our operating strategy or the occurrence of any of the events or circumstances set forth in this report could result in the actual operating results being different from our guidance, and the differences may be adverse and material.

If securities or industry analysts do not publish research, or publish inaccurate or unfavorable research, about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the securities or industry analysts who publish research about us or our business downgrade our stock or publish inaccurate or unfavorable evaluations of our company or our stock, the price of our stock could decline. If one or more of these analysts cease coverage of our company, our stock may lose visibility in the market, which in turn could cause our stock price to decline.

The market price of our common stock has been and is likely to continue to be volatile, and you may be unable to sell your shares at or above the price at which you purchased them.

The market price of our common stock has been and is likely to continue to fluctuate widely. Factors affecting the market price of our common stock include:

- variations in our operating results, earnings per share, cash flows from operating activities, and key operating metrics, and how those results compare to analyst expectations;
- forward-looking guidance that we provide to the public and industry and financial analysts related to future revenue and profitability, and any change in that guidance or our failure to achieve the results reflected in that guidance;
- the net increases in the number of members, either independently or as compared with published expectations of industry, financial or other analysts that cover our company;
- changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;
- announcements of changes to our subscription, strategic alliances or significant agreements by us or by our competitors;
- announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;
- recruitment or departure of key personnel;
- the economy as a whole and market conditions in our industry;
- trading activity by a limited number of stockholders who together beneficially own a majority of our outstanding common stock;
- the number of shares of our stock trading on a regular basis; and
- any other factors discussed in these risk factors.

In addition, if the market for stock in our industry or the stock market in general experiences uneven investor confidence, the market price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The market price of our common stock might also decline in reaction to events that affect other companies within, or outside, our industry even if these events do not directly affect us. Some companies that have experienced volatility in the trading price of their stock have been the subject of securities class action litigation. If we are the subject of such litigation, it could result in substantial costs and a diversion of our management's attention and resources.

We do not intend to pay dividends on our common stock and, therefore, any returns will be limited to the value of our stock.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain all available funds and any future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. In addition, our ability to pay cash dividends on our common stock is limited by the terms of our credit agreement, APIC’s ability to pay dividends is limited by New York state insurance laws, and WICL Segregated Account AX's ability to pay dividends is limited by our agreements with WICL as well as WICL's regulatory requirements. Any return to stockholders will therefore be limited to the increase, if any, of our stock price.

Our directors and principal stockholders own a significant percentage of our stock and will be able to exert significant control over matters subject to stockholder approval.

Our directors, five percent or greater stockholders and their respective affiliates beneficially hold a significant amount of our outstanding voting stock. Therefore, these stockholders have the ability to influence us through this ownership position. These stockholders may be able to determine all matters requiring stockholder approval. For example, these stockholders may be able to control elections of directors, amendments of our organizational documents, or approval of any merger, sale of assets, or other major corporate transaction. This may prevent or discourage unsolicited acquisition proposals or offers for our common stock that you or other stockholders may feel are in your or their best interest as one of our stockholders.

Provisions in our restated certificate of incorporation, restated bylaws and Delaware law might discourage, delay or prevent a change in control of our company or changes in our management and, therefore, depress the market price of our common stock.

Our restated certificate of incorporation and restated bylaws contain provisions that could depress the market price of our common stock by acting to discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions, among other things:

- establish a classified board of directors so that not all members of our board are elected at one time;
- permit only the board of directors to establish the number of directors and fill vacancies on the board;
- provide that directors may only be removed “for cause” and only with the approval of two-thirds of our stockholders;
- require super-majority voting to amend some provisions in our restated certificate of incorporation and restated bylaws;
- authorize the issuance of “blank check” preferred stock that our board could use to implement a stockholder rights plan (also known as a “poison pill”);
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- prohibit cumulative voting; and
- establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company. Section 203 imposes certain restrictions on mergers, business combinations and other transactions between us and holders of 15% or more of our common stock.

Item 2. Unregistered Sale of Equity Securities and Use of Proceeds

In June 2018, we completed a follow-on public offering whereby we sold 2,090,909 shares of common stock (inclusive of 272,727 shares of common stock we sold pursuant to the full exercise of the underwriters' option to purchase additional shares) at a price to the public of $33.00 per share. We received aggregate net proceeds from the June 2018 follow-on public offering of $65.7 million, reflecting gross proceeds of $69.0 million, reduced by underwriting discounts and commissions and offering expenses payable by us. The shares sold in the follow-on public offering were registered under the Securities Act pursuant to a registration statement on Form S-3 (File No. 333-225760), which became effective immediately upon filing with the SEC on June 20, 2018 (the "Registration Statement"). The proceeds were primarily used to purchase real estate consisting of properties in use as corporate offices.

In August 2018, we sold 303,030 shares of common stock via a private placement under Section 4(a)(2) of the Securities Act to an accredited investor, the seller of the real estate acquired by the Company, such that the seller received aggregate consideration consisting of $55.0 million in cash and 303,030 shares of common stock with a fair value of $9.6 million for the real estate.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The list of exhibits included in the Exhibit Index immediately following this Quarterly Report on Form 10-Q is incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Seattle, State of Washington, on this 8th day of November 2018.

	TRUPANION, INC.
Date: November 8, 2018	/s/ Darryl Rawlings Darryl Rawlings Chief Executive Officer and President *(Principal Executive Officer)*
Date: November 8, 2018	/s/ Tricia Plouf Tricia Plouf Chief Financial Officer *(Principal Financial and Accounting Officer)*

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Exhibit Filing Date	Filed/Furnished Herewith
10.1	Amended Compensation Program for Non-Employee Directors of Trupanion, Inc. dated September 5, 2018					X
10.2	Joinder to Loan and Security Agreement and Amended and Restated Revolving Note, dated August 6, 2018, between Pacific Western Bank, Western Alliace Bank, Trupanion Managers USA, Inc. and Trupanion-APIC, LLC					X
31.1	Certification of Principal Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Principal Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1*	Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
32.2*	Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS	XBRL Instance Document - the instance does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document					X
101.SCH	XBRL Taxonomy Extension Schema Document.					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.					X
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.					X

* This certification is deemed not filed for purpose of Section 18 of the Exchange Act or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act.