TRUPANION INC.
Form 10-K
February 15, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016
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)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, $0.00001 par value per share	NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None.
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes x No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes x No
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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting 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

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

The aggregate market value of the registrant's common stock held by non-affiliates as of June 30, 2016, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $280,565,040 using the closing price on that day of $13.25.

As of February 8, 2017, there were approximately 29,509,841 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE Part III incorporates certain information by reference from the definitive proxy statement to be filed by the registrant in connection with the 2017 Annual Meeting of Stockholders (Proxy Statement). The Proxy Statement will be filed by the registrant with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the registrant's fiscal year ended December 31, 2016.

TRUPANION, INC.
Annual Report on Form 10-K
For the Fiscal Year Ended December 31, 2016
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Note About Forward-Looking Statements

This Annual Report on Form 10-K 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 Annual Report on Form 10-K 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 expressions that con 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 I. Item 1A. "Risk Factors" and elsewhere in this Annual Report on Form 10-K. 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 Annual Report on Form 10-K 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 "Trupanion," "we," "us," "our" and similar references refer to Trupanion, Inc. and its subsidiaries taken as a whole.

PART I

Item 1. Business

Our Mission

Our mission is to help the pets we all love receive the best veterinary care.

Our Company and Approach

We provide a medical insurance plan 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 plan 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 acquisition cost.

Our target market is large and underpenetrated. We have pioneered a unique solution that sits at the center of the pet medical ecosystem, meeting the needs of pets, pet owners and veterinarians, and we believe we are uniquely positioned to continue to drive market penetration. Our aggregate total pets enrolled grew from 31,207 pets on January 1, 2010 to 343,649 pets on December 31, 2016, which represents a compound annual growth rate of 41%.

Total Pets Enrolled

(in thousands)

Pet owners are often surprised by the cost of veterinary care and can be financially unprepared if their beloved pets become injured or ill. The costs of medical treatments for pets have become more onerous over time due to the availability and usage of increasingly advanced veterinary care. Consequently, pet owners without medical coverage may be forced to accept sub-standard care for their pets due to financial constraints.

To address these challenges, we offer a simple, fair and comprehensive medical plan that pays 90% of actual veterinary costs for injury and illness claims, has no payout limitations, has few exclusions and can be used to cover the costs incurred at any veterinary practice, emergency care center or specialty hospital in the United States, Canada and Puerto Rico. This approach aligns the interests of pet owners and veterinarians, which allows them to focus on providing the best care for pets rather than minimizing the cost of treatment. Some of our key differentiators include:

- Superior Value Proposition. Our vertically integrated infrastructure eliminates significant frictional costs that constrain most of our competitors, which allows us to provide superior value to our members.
- Proprietary Database and Technology Platform. Our custom-built technology platform and proprietary database contain 17 years of pet health records and give us unique insights into how to both manage our business and accurately price our medical plan subscriptions.
- Strong Relationship with Veterinary Community. We have invested significant time and energy communicating our value proposition to thousands of veterinarians. We partner with a nationwide sales force to communicate the benefits of our medical plan to veterinarians through in-person visits; we refer to these partners and their associates, collectively, as our Territory Partners.

- Trupanion Express™. Our software solution Trupanion Express™ enables us to pay veterinarian invoices directly, often in less than five minutes, without any paperwork. Trupanion Express™ integrates with veterinarians' practice management software, giving us access to more data, reducing our claims handling expense and giving us the ability to deliver a significantly better experience to our members compared to the traditional reimbursement model.

We believe that these differentiators serve as competitive advantages, making our business model difficult to replicate.

We generate revenue primarily from subscription fees for our medical plan. Our medical plan automatically renews on a monthly basis, and members pay the subscription fee at the beginning of each subscription period. Since 2010, at least 88% of our subscription business revenue every quarter has come from existing members who had active subscriptions at the beginning of the quarter. Due to our focus on providing a superior value proposition and member experience, our members are very loyal, as evidenced by our 98.5% average monthly retention rate since 2010. For more information regarding average monthly retention, including an explanation of how we calculate this metric, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Financial and Operating Metrics."

We enrolled our first pet in Canada in 2000 and our first pet in the United States in 2008. Our revenue for the year ended December 31, 2016 was $188.2 million, representing a compound annual growth rate of 46% from our revenue of $19.1 million for the year ended December 31, 2010. We have made and expect to continue to make substantial investments in member acquisition and in expanding our operations to support our expected growth. For the year ended December 31, 2016, we had a net loss of $6.9 million and our accumulated deficit was $81.3 million at December 31, 2016.

Our Solution

Benefits to Pet Owners

Predictability of costs and peace of mind. Our members can be confident that their pets will be covered in the event of an injury or illness. We pay 90% of the veterinary costs actually charged by the member's chosen veterinarian for all covered claims, less a member's chosen deductible, if any. Our members may obtain treatment from any licensed veterinarian that they select within the United States, Canada or Puerto Rico. Our coverage has no payout limits, is not subject to a lifetime maximum payout, and is not limited by the amount that a veterinarian charges or the treatment that a veterinarian recommends. Our injury and illness coverage is designed to be comprehensive and provide members with the highest value. Generally, the only costs not covered by our plan are those relating to conditions existing prior to the pet's enrollment, routine or preventative care, including examination fees and taxes.

Exceptional member experience. We are highly focused on providing an exceptional member experience. We offer a simple and easy to understand medical plan. We have designed our claims process to be fair, efficient and transparent. We strive to pay vet invoices directly, often in under five minutes.

Benefits to Veterinarians

Freedom to be the most effective advocate for pets. Our medical plan does not limit how much can be paid for an injury or illness. This provides veterinarians with the freedom to practice veterinary medicine at the highest level and be the most effective advocate for the health of the pets.

More loyal client base. Our members visit veterinarians more frequently, which can generate significantly more annual revenue for veterinarians. Furthermore, pet owners with medical coverage typically spend significantly more on their seriously injured or ill pet. The result is a client base that is more engaged, spends more money on care and has healthier cats and dogs.

Our Strategy

Our strategy is focused on attracting and retaining members by providing a best-in-class value and member experience. We are focused on building a successful long-term business by pursuing the following growth strategies:

Increase the number of referring veterinary practices. We intend to increase the number of veterinary practices that are actively introducing our medical plan to their clients.

Increase the number of referrals from active veterinary practices. We intend to continue increasing the number and quality of interactions that we have with veterinarians to accelerate the rate at which active veterinary practices refer us leads.

Increase the number of third-party referrals from members. We are focused on using innovative technologies to further enhance our member experience, which we believe will foster member referrals. For example, Trupanion Express™ is designed to facilitate the direct payment of invoices to veterinary practices. If widely adopted, Trupanion Express™ would transform the claims process and could increase referrals from pet owners and veterinarians acting as ambassadors for our brand.

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Improve online lead generation and conversion. We are investing in our online marketing capabilities, and intend to continue to do so in order to fully capture the online opportunity. Our online marketing initiatives have played an integral role in converting leads to enrolled pets and also generate new leads.
Explore other member acquisition channels. We regularly evaluate new member acquisition channels. We intend to aggressively pursue those channels that we believe could, over time, generate an attractive ratio of lifetime value relative to acquisition cost.
Expand internationally. While we are currently focused on capturing the large opportunity in the U.S. and Canadian markets, we may choose to explore international expansion in the future.
Pursue other revenue opportunities. We may opportunistically engage in other revenue opportunities. For example, American Pet Insurance Company, which we acquired in 2007, has written policies for unaffiliated general agents since the end of 2012. We believe we are well positioned to partner with other unaffiliated general agents offering pet insurance products over time.

Sales and Marketing

Marketing to Veterinarians

Veterinary practices represent our largest referral source. Forming long-term relationships with veterinarians is critical to our continued success, as we believe veterinary recommendations are highly persuasive to our existing and prospective members and key to increasing overall acceptance of our medical plan. To reach veterinarians effectively, we utilize a national independent referral network of Territory Partners. Territory Partners serve as a critical resource for us, as the market for veterinary services is highly fragmented and includes many sole-owner veterinary practices and small veterinary practices that are difficult to reach. Our Territory Partners are independent contractors who market our medical plan and are paid fees based on activity in their regions. We believe this compensation structure aligns our interests and provides a platform that we can leverage over time.

Sales and Marketing to Pet Owners

We generate leads through a diverse set of third-party referrals and online member acquisition channels, which we then convert into members through our website and contact center.

- Referrals from third-parties. We actively promote the value of our medical plan with veterinarians, veterinary affiliates (including purchasing groups and other veterinary membership organizations), corporate employee benefit providers, and shelters and breeders to introduce our medical plan to their clients.
- Referrals from existing members. For the year ended December 31, 2016, 24% of our new pet enrollments were generated from existing members adding a pet or referring their friends and family.
- Online. We believe most of our members spend some time researching pet medical coverage online as part of their decision-making process. A significant portion of the members we acquire from online leads come through our paid search marketing, email marketing, social media marketing and search engine optimization initiatives.

Our Platform and Technology

We are a data and technology-driven company that has devoted significant resources to developing scalable infrastructures that leverage state-of-the-art technology frameworks. We have a team of product and engineering professionals dedicated to enhancing our technology platform and developing new solutions for pet owners and veterinarians.
Our team has developed proprietary software that forms the backbone of our unique technology platform:
Analytics and pricing engine. Our dynamic analytics platform draws on our extensive library of proprietary data to effectively and accurately price subscriptions to our medical plan. We leverage a broad range of information, including species, breed, age, gender and pet location. As data collection is a key part of our research and development process, we are constantly looking for new and relevant data to collect and shape for this purpose.
Trupanion Express™. Our software solution for veterinarians facilitates our ability to pay their invoices directly to the veterinarian at the time of service, often in less than five minutes and without any paperwork. Trupanion Express™ integrates with veterinarians' practice management software, giving us access to more data, reducing our claims handling expense and giving us the ability to deliver a significantly better experience to our members compared to the traditional reimbursement model.

Trupanion.com. Our website provides a simple interface between Trupanion, consumer and business audiences, which removes the need for complex steps during the enrollment process. Built using digital asset management and customer relationship management system technologies, the site provides a custom-built user experience for each user based on who the user is and how the user arrived at the site.

Competition

We compete with consumers that self-fund veterinary costs with cash or credit, as well as traditional "pet insurance" providers and new entrants to our market. The vast majority of pet owners in the United States and Canada do not currently have medical coverage for their pets. We are primarily focused on expanding the overall size of the market by improving the value proposition for consumers. We view our primary competitive challenge as educating pet owners on why our medical plan is a better alternative to self-funding.

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. The largest of these traditional providers is Nationwide (formerly Veterinary Pet Insurance Company), a division of Nationwide Insurance. In addition, new entrants backed by large insurance companies with substantial financial resources have attempted to enter the market in the past and may do so again in the future. Further, traditional providers may consolidate, resulting in the emergence of new providers that are vertically integrated or able to create other operational efficiencies, which could lead to increased competition. We believe that we have competitive strengths that position us favorably related to existing and potential competitors. These include: a superior value proposition for pet owners due in part to our vertically integrated structure that reduces frictional costs, a unique member acquisition strategy using territory partners that has taken 17 years to develop, a proprietary database containing 17 years of historical data that provides actionable data insights, powerful technology infrastructure and an experienced management team.

Intellectual Property

We rely on federal, state, common law and international rights, as well as contractual restrictions, to protect our intellectual property. We control access to our proprietary technology, software and documentation by entering into confidentiality and invention assignment agreements with our employees and partners, and confidentiality agreements with third parties, such as service providers, vendors, individuals and entities that may be exploring a business relationship with us.

In addition to these contractual arrangements, we also rely on a combination of intellectual property rights, including trade secrets, patents, copyrights, trademarks and domain names, as well as contractual protections, to establish and protect our intellectual property. As of December 31, 2016, we had three pending patent applications in the United States, two pending patent applications in Canada, one pending patent application in Brazil, one pending patent application in Japan, one pending patent application in China, one pending patent application in Hong Kong, two pending Patent Cooperation Treaty patents, one pending patent application and one issued patent in Europe. We also had ten registered trademarks in the United States, including “Trupanion”. We had one registered trademark in Canada, and four pending trademarks. Many of our unregistered trademarks, however, contain words or terms having a common usage and, as a result, may not be protectable under applicable law. We also currently hold the “Trupanion.com” Internet domain name and numerous other related domain names.

Employees

As of December 31, 2016, we had 450 employees. We have not experienced any work stoppages, and we consider our relations with our employees to be good.

Regulation

Each U.S. state, the District of Columbia and U.S. territories and possessions, as well as all of the Canadian provinces, have insurance laws that apply to companies licensed to transact insurance business in the jurisdiction. The primary regulator of an insurance company, however, is located in its state of domicile. Our underwriting subsidiary American Pet Insurance Company (APIC) is domiciled in New York State and its primary regulator is therefore the New York Department of Financial Services (NY DFS). APIC is currently licensed to do business in all 50 states, Puerto Rico and the District of Columbia in the United States. As such, APIC is subject to comprehensive regulation and supervision under U.S. state and federal laws.

State insurance regulators have broad authority with respect to all aspects of the insurance industry, including the following:

- licensing of APIC to transact its line of business and approval and issuance of its certificate of authority;
- establishing minimum levels of capital and reserves required by APIC to operate as an ongoing insurance company;
- assessing the officers and directors of APIC to ensure a minimum level of competency and trustworthiness;

- licensing of individual producers and agents and business entities marketing and selling insurance products and of claims adjusters settling claims;
- admittance of assets to statutory surplus and regulating the type of investments in which APIC can invest;
- regulating premium rate levels for the insurance products APIC offers;
- approving policy forms APIC issues;
- regulating unfair trade and claims practices; and
- establishing reserve requirements and solvency standards.

Regulators also have broad authority to conduct on-site market conduct examinations of our management and operations, marketing and sales, underwriting, customer service, claims handling and licensing. Market conduct examinations can involve direct, on-site contact with a company to identify potential regulatory violations, discuss and correct an identified problem or obtain a better understanding of how the company is operating in the marketplace. Adverse state insurance regulatory actions could include limiting APIC's ability to write new policies, limiting APIC's ability to effect rate increases or to cancel, reduce or non-renew insurance coverage with respect to existing policies, disallowing premium increases or policy coverage amendments APIC seeks, reviewing the adequacy and appropriateness of our insurance products before they can be made available to our members and restricting marketing and sales by our referral sources, contact centers and producers.

State insurance laws and regulations in the United States require APIC to file financial statements with state insurance regulators everywhere it is licensed and its operations and accounts are subject to examination at any time. APIC's statutorily required financial statements are available to the public. APIC prepares statutory financial statements in accordance with accounting practices and procedures prescribed or permitted by these regulators. The National Association of Insurance Commissioners (NAIC) has approved a series of uniform statutory accounting principles (SAP) that have been adopted, in some cases with minor modifications, by all state insurance regulators. As a basis of accounting, SAP was developed to monitor and regulate the solvency of insurance companies. In developing SAP, insurance regulators were primarily concerned with assuring an insurer's ability to pay all its current and future obligations to policyholders. As a result, statutory accounting focuses on conservatively valuing the assets and liabilities of insurers, generally in accordance with standards specified by the insurer's domiciliary state. The values for assets, liabilities and equity reflected in financial statements prepared in accordance with U.S. generally accepted accounting principles are usually different from those reflected in financial statements prepared under SAP.

In Canada, our plan is written by an unaffiliated Canadian-licensed insurer, Omega General Insurance Company (Omega). Under the terms of our agreements with Omega, our subsidiary Trupanion Brokers Ontario acts as a general agent through a fronting and reinsurance agreement with Omega pursuant to which Trupanion retains any financial risk associated with our Canadian business. Effective January 1, 2015, this agreement was restructured to include our segregated cell business, Wyndham Segregated Account AX (WICL), located in Bermuda. These restructured agreements may be terminated by either party with one year's written notice until they terminate pursuant to their terms on December 31, 2018, at which time they will automatically renew for successive one-year periods and remain terminable by either party with one year's written notice. Omega's Canadian insurance operations are supervised and regulated by the Canadian federal, provincial and territorial governments. Omega is a fully licensed insurer in all of the Canadian provinces and territories in which we do business.

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 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 BMA the 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 of 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. Per our contractual agreements with WICL, the allowable dividend to be paid by WICL is equivalent to the positive undistributed profit attributable to the shares.

Insurance Holding Company Regulation

APIC is subject to laws governing insurance holding companies in New York, its state of domicile. These laws impact us in a number of ways, including the following:

- We must file periodic information reports with the NY DFS, including information concerning our capital structure, ownership, financial condition and general business operations.
- New York regulates certain transactions between APIC and our other affiliated entities, including the fee levels payable by APIC to affiliates that provide services to APIC.

- New York law restricts the ability of any one person to acquire certain levels of our voting securities without prior regulatory approval. State insurance holding company regulations generally provide that no person, corporation or other entity may acquire control of an insurance company, or a controlling interest in any parent company of an insurance company, without the prior approval of such insurance company's domiciliary state insurance regulator. Any person acquiring, directly or indirectly, 10% or more of the voting securities of an insurance company is presumed to have acquired "control" of the company. To obtain approval of any change in control, the proposed acquirer must file with the applicable insurance regulator an application disclosing, among other information, its background, financial condition, the financial condition of its affiliates, the source and amount of funds by which it will effect the acquisition, the criteria used in determining the nature and amount of consideration to be paid for the acquisition, proposed changes in the management and operations of the insurance company and other related matters. In considering an application to acquire control of an insurer, the insurance commissioner generally will consider such factors as the experience, competence and financial strength of the applicant, the integrity of the applicant's board of directors and executive officers, the acquirer's plans for the management and operation of the insurer and any anti-competitive results that may arise from the acquisition.
- New York law restricts the ability of APIC to pay dividends to its holding company parent. These restrictions are based in part on the prior year's statutory income and surplus. In general, dividends up to specified levels are considered ordinary and may be paid without prior approval, and dividends in larger amounts, or extraordinary dividends, are subject to approval by the NY DFS. An extraordinary dividend or distribution is defined as a dividend or distribution that, in the aggregate in any 12-month period, exceeds 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, not including realized capital gains.

Financial Regulation of Insurers

Risk-Based Capital Requirements

The NAIC has adopted risk-based capital requirements for life, health and property and casualty insurance companies. Refer to Item 1A. "Risk Factors" for details of these requirements.

NAIC Insurance Regulatory Information System Ratios

The NAIC has developed a set of financial relationships or tests known as the Insurance Regulatory Information System, or IRIS, to assist state regulators in monitoring the financial condition of U.S. insurance companies and identifying companies requiring special attention or action. IRIS consists of a statistical phase and an analytical phase whereby financial examiners review insurers' annual statements and financial ratios. The statistical phase consists of 12 key financial ratios based on year-end data that are generated from the NAIC database annually; each ratio has a "usual range" of results. For IRIS ratio purposes, APIC submits data annually to state insurance regulators who then analyze our data using prescribed financial data ratios. A ratio falling outside the prescribed "usual range" is not considered a failing result. Rather, unusual values are viewed as part of the regulatory early monitoring system. In many cases, it is not unusual for financially sound companies to have one or more ratios that fall outside the usual range. As of December 31, 2016, APIC had two such ratios outside the usual range, relating to net premiums written to surplus and investment yield.

Regulators may investigate or monitor an insurance company if its IRIS ratios fall outside the prescribed usual range. The inquiries made by state insurance regulators into an insurance company's IRIS ratios can take various forms. In some instances, regulators may require the insurance company to provide a written explanation as to the causes of the particular ratios being outside the usual range, management's actions to produce results that will be within the usual range in future years and what, if any, actions the insurance company's domiciliary state insurance regulators have taken. Regulators are not required to take action if an IRIS ratio is outside the usual range, but, depending on the nature and scope of the particular insurance company's exception, regulators may request additional information to monitor going forward and, as a consequence, may take additional regulatory action.

Insurance Guaranty Associations, Residual Markets, Wind Pools and State-specific Reinsurance Mechanisms

Most jurisdictions in which we operate have laws or regulations that require insurance companies doing business in the state to participate in various types of guaranty associations or other similar arrangements designed to protect policyholders from losses under insurance policies issued by insurance companies that become impaired or insolvent.

Typically, these associations levy assessments, up to prescribed limits, on member insurers on the basis of the member insurer's proportionate share of the business in the relevant jurisdiction in the lines of business in which the impaired or insolvent insurer is engaged. Some jurisdictions permit member insurers to recover assessments that they paid through full or partial premium tax offsets, usually over a period of years.

Some states in which APIC operates have residual markets, wind pools or state reinsurance mechanisms. The general intent behind these is to provide coverage to individuals and businesses that cannot find coverage in the private marketplace. The intent of state-specific reinsurance mechanisms generally is to stabilize the cost of, and ensure access to, reinsurance for admitted insurers writing business in the state. Historically, APIC has had minimal financial exposure to guaranty associations, residual markets, wind pools and state-specific reinsurance mechanisms; however there is no guarantee that these items will continue to be of low financial impact to APIC.

Licensing of Producers and Other Entities

Insurance agencies, producers, third-party administrators, claims adjusters, service providers and administrators are subject to licensing requirements and regulation by insurance regulators in various jurisdictions in which they conduct business. If any of our subsidiaries, referral sources, contact centers or service providers engage in these functions, they may be subject to licensing requirements and regulation by insurance regulators in various jurisdictions. If a subsidiary, referral source, contact center or service provider does not comply with licensing requirements and regulation by any insurance regulator, such insurance regulator could penalize such entity, including restricting certain activity of such entity.

Federal Initiatives

The U.S. federal government generally does not directly regulate the insurance business. From time to time, various regulatory and legislative changes have been proposed in the insurance industry. Among the proposals that have in the past been, or are at present being, considered are the possible introduction of federal regulation in addition to, or in lieu of, the current system of state regulation of insurers. There have also been proposals in various state legislatures (some of which have been enacted) to conform portions of their insurance laws and regulations to various model acts adopted by the NAIC. The NAIC has undertaken a Solvency Modernization Initiative focused on updating the U.S. insurance solvency regulation framework, including capital requirements, governance and risk management, group supervision, accounting and financial reporting and reinsurance. The NAIC Amendments are a result of these efforts. Additional requirements are also expected.

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) established a Federal Insurance Office within the U.S. Department of the Treasury. The Federal Insurance Office initially is charged with monitoring all aspects of the insurance industry (other than health insurance, certain long-term care insurance and crop insurance), gathering data and conducting a study on methods to modernize and improve the insurance regulatory system in the United States. It is not possible to predict whether, in what form or in what jurisdictions any of these proposals might be adopted, or the effect federal involvement in insurance will have, if any, on us.

Privacy and Data Collection Regulation

There are numerous federal, state and foreign laws regarding privacy and the protection of member data. The regulatory environment in this area for online businesses is very unsettled in the United States and internationally and new legislation is frequently being proposed and enacted.

In the area of information security and data protection, many states have passed laws requiring notification to users when there is a security breach for personal data or requiring the adoption of minimum information security standards. In addition, our operations subject us to certain payment card association operating rules, certification requirements and rules, including the Payment Card Industry Data Security Standard, a security standard for companies that collect, store or transmit certain data regarding credit and debit cards, credit and debit card holders and credit and debit card transactions.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or obtain and use our technology or data to develop products that may compete with our offerings. Policing unauthorized use of our technology or data is difficult. The laws of other countries in which we market our medical plan may offer little or no effective protection of our proprietary technology. Our competitors could also independently develop technologies equivalent to ours, and our intellectual property rights may not be broad enough for us to prevent competitors from selling products incorporating those technologies.

Companies in our industry and in other industries may own a large number of patents, copyrights and trademarks and may frequently request license agreements, threaten litigation or file suit against us based on allegations of infringement or other violations of intellectual property rights. From time to time, we face, and we expect to face in the future, allegations that we have infringed the trademarks, copyrights, patents and other intellectual property rights of third parties, including our competitors. As we face increasing competition and as our business grows, we will likely face more claims of infringement.

Information About Segments and Geographic Revenue

Information about segments and geographic revenue is set forth in Item 8. "Notes to Consolidated Financial Statements" under Note 13 of this Annual Report on Form 10-K. In addition, financial information regarding our operations, assets and liabilities, including our total revenue and net loss for the years ended December 31, 2016, 2015 and 2014 and our total assets as of December 31, 2016 and 2015, is included in Item 8. "Consolidated Financial Statements" of this Annual Report on Form 10-K.

Corporate Information

We were founded in Canada in 2000 as Vetinsurance Ltd. In 2006, we effected a business reorganization whereby Vetinsurance Ltd. became a consolidated subsidiary of Vetinsurance International, Inc., a Delaware corporation. In 2007, we began doing business as Trupanion. In 2013, we formally changed our name from Vetinsurance International, Inc. to Trupanion, Inc. Our principal executive offices are located at 6100 4th Avenue South, Seattle, Washington 98108, and our telephone number is (855) 727-9079. Our website address is www.trupanion.com. Information contained on, or that can be accessed through, our website is not incorporated by reference into this prospectus, and you should not consider information on our website to be part of this Annual Report on Form 10-K.

Available Information

We are required to file annual, quarterly and other reports, proxy statements and other information with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934, as amended (Exchange Act). We also make available, free of charge on the investor relations portion of our website at investors.trupanion.com, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after they are filed electronically with the SEC. You can inspect and copy our reports, proxy statements and other information filed with the SEC at the offices of the SEC's Public Reference Room located at 100 F Street, NE, Washington D.C 20549 on official business days during the hours of 10 a.m. to 3 p.m. Eastern time. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Rooms. The SEC also maintains an Internet website at www.sec.gov where you can obtain our SEC filings. You can also obtain paper copies of these reports, without charge, by contacting Investor Relations at InvestorRelations@Trupanion.com.

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 net losses since our inception and may not be able to achieve or maintain profitability in the future.

We have incurred significant net losses since our inception. We had a net loss of $6.9 million for the year ended December 31, 2016. Additionally, as of December 31, 2016, our accumulated deficit was $81.3 million. 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. 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 spent $15.2 million on sales and marketing to acquire new members for the year ended December 31, 2016. 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 medical plan 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 medical plan. 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 financial and operating metrics described in “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Financial and 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 was 98.6% in 2016. If our efforts to satisfy our existing members are not successful, 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 medical plan 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 medical plan subscription for a variety of reasons, including increased subscription fees, perceived or actual lack of value, delays or other unsatisfactory experiences in claims administration, unsatisfactory member service, an economic downturn, loss of a pet, a more attractive offer from a competitor, changes in our medical plan or other reasons, including reasons that are outside of our control. When a member terminates his or her medical plan subscription, we no longer receive the related revenue and may not be able to recover the member acquisition cost or other expenses, including claims expenses, related to that member. 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 medical plan subscription 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 medical plan 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 medical plan 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 medical plan subscriptions reflect expected claim payment patterns 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 medical plan 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 in our medical plan, and is subject to variability as actual results may differ from pricing assumptions. If the subscription fees we collect are insufficient to cover actual claim costs, 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 medical plan subscriptions to cover claims expenses, 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 medical plan subscriptions. The assumptions we make about breeds and other factors in pricing medical plan subscriptions may prove to be inaccurate and, accordingly, these pricing analytics may not accurately reflect the claims expense that we will ultimately incur. Furthermore, if any of our competitors developed similar or better data systems, adopted similar or better underwriting criteria and pricing models or received our data, our competitive advantage could decline or be lost.

Our actual claims expenses may exceed our current reserve established for claims and may adversely affect our operating results and financial condition.

As of December 31, 2016, our claims reserve was $9.5 million. During 2016, claims exceeded our claims reserve and this may happen again in the future. Our recorded claims reserve is based on our best estimates of claims, both reported and incurred but not reported, after considering known facts and interpretations of circumstances. We consider internal factors, including data from our proprietary data analytics platform, experience with similar cases, actual claims paid, historical trends involving claim payment patterns, pending levels of unpaid claims, claims management 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 the unpaid portion of claims that have occurred, including claims incurred but not reported, 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 claims may vary materially from recorded reserves, and such variance may result in adjustments to the claims reserve, which could have a material effect on our operating results.

We rely significantly on Territory Partners, veterinarians and other third parties to recommend our medical plan.

We rely significantly on Territory Partners and other third parties to cultivate direct veterinary relationships and build awareness of the benefits that our medical plan offers veterinarians and their clients. In turn, we rely on veterinarians to introduce and refer our medical plan to their clients. We also rely significantly on other third parties, such as existing members, online and offline businesses, animal shelters, breeders and veterinary affiliates, including veterinarian purchasing groups and associations, to help generate leads for our medical plan subscriptions. Veterinary practices represent our largest member acquisition channel, accounting for approximately 71% of our enrollments excluding existing members adding pets and referring their friends and family in the year ended December 31, 2016. 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 the medical plan we offer;
- 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 in a medical plan 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.

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 medical plan or be able to maintain any relationships they may have developed with veterinarians within their territories. 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 our medical plan can provide to veterinarians. If the scope of our medical plan coverage is perceived to be inadequate or our claims settlement process is unsatisfactory to the veterinarians' clients because, for example, our coverage is insufficient, member requests for reimbursement are denied or we fail to timely settle and pay veterinary invoices, veterinarians may be unwilling to recommend our medical plan to their clients and they may encourage their existing clients who have subscribed to our medical plan to stop subscribing to our medical plan or to purchase a competing product. If veterinarians determine our medical plan 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. Territory Partners may decide not to participate in our marketing initiatives or training opportunities, accept our introduction of new solutions or comply with our policies and procedures applicable to the Territory Partners, 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. In addition, termination of these contracts may trigger termination penalties that obligate us to pay significantly more than the amounts that otherwise would have been paid to the terminated Territory Partner.

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. For the year ended December 31, 2016, we generated 92% of our revenue from medical plan subscriptions. In order to continue to increase our membership, we must continue to offer a medical plan that provides 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 medical plan;
- maintain positive relationships with and increase the number and efficiency of Territory Partners;
- continue to offer a superior value medical plan with competitive features and rates;
- accurately price our medical plan subscriptions in relation to actual membership claims costs and operating expenses and achieve required regulatory approval for pricing changes;

- provide our members with superior member service, including a timely and efficient claims experience and by recruiting, integrating and retaining skilled and experienced claims personnel who can appropriately and efficiently adjudicate member claims;
- 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, which was $25.8 million as of December 31, 2016. 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 the Company's reinsurance agreement with Omega. Under this agreement, the Company is required to fund a Canadian Trust account in accordance with Canadian regulations. As of December 31, 2016, the account held CAD $2.1 million.

Unexpected increases in the severity or frequency of claims may negatively impact our operating results.

Unexpected changes in the severity or frequency of claims may negatively impact our operating results. Changes in claims severity are driven primarily by inflation in the cost of veterinary care and the increasing availability and usage of expensive, technologically advanced medical treatments. Increases in claims severity also 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 claim frequency from time to time, and short-term trends may not continue over the longer term. The frequency of claims 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 more frequent claims and other new member acquisition activities. A significant increase in claim severity or frequency could increase our cost of revenue and have a material adverse effect on our financial condition.

Changes in the Canadian currency exchange rate may adversely affect our revenue and operating results.

We offer our medical plan in Canada, which exposes us to the risk of changes in the Canadian currency exchange rates. As of December 31, 2016, approximately 20% of our total revenue was generated in Canada. Fluctuations in the relative strength of the Canadian economy and the Canadian dollar has in the past and could in the future adversely affect our revenue and operating results.

Our success depends on our ability to adjust member claims timely and accurately.

We must accurately evaluate and timely pay member claims in a manner that gives our members high satisfaction. Many factors can affect our ability to pay member claims accurately, and in a timely manner that gives our members high satisfaction, including the training, experience and skill of our personnel, our ability to reduce the number of claims requests made for non-covered conditions and ineligible invoice items, the department's culture and the effectiveness of its management, our ability to develop or select and implement appropriate procedures, technologies and systems to support our member claims functions and changes in our policy coverage. Our failure to pay claims requests fairly, 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 claim submissions.

It is possible that a member, or a third-party on behalf of the member, could submit a claim for reimbursement 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 claims 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.

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 coverage for their pets. We are focused primarily on expanding the overall size of the market, and we view our primary competitive challenge as educating pet owners on why our medical plan 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. The largest of these traditional "pet insurance" providers is Nationwide Pet (formerly Veterinary Pet Insurance Company), a division of Nationwide Insurance. They are now offering a product designed to appear similar to ours. 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, resulting in the emergence of new providers that are vertically integrated or able to 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 the service at our contact center and claims department, 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, medical plan 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 seeking to enroll in our medical plan 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 the medical plan we offer, including its perceived value, coverage, 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 a pet medical plan;
- the quality of and changes to the consumer experience, including on our website or with our contact center or claims department;
- regulatory requirements, including those that make the experience on our website cumbersome or difficult to navigate or that hinder our call center or claims department’s 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 online member 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 medical plan on our website or telephonically through 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 medical plan;
- quality of service provided by our contact center and claims professionals, including the fairness, ease and timeliness of our claims administration process;
- 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, claims management systems, customer relationship management system, contact center phone system and website. We use these technology frameworks to price our medical plan subscriptions, enroll members, engage with current members and administer member claims under our medical plan. Additionally, our members review and purchase subscriptions to our medical plan and submit reimbursement requests through our website and contact center. 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 recognize 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 the frequency or severity of claims costs) generated by our new business, which could prevent us from becoming profitable and could impair our ability to compete effectively for pet medical plan business. Additionally, we have in the past, and may in the future, experience increases in medical plan subscription 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 medical plan;
- the timing, volume and severity of our claims and the adequacy of our claims reserve;
- our ability to accurately price our medical plans 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 the cost of our medical plan subscriptions or those of our competitors;
- fluctuations in applicable foreign currency exchange rates;
- the perceived value of our medical plan to veterinarians and pet owners;
- spending decisions by our members and prospective members;
- our costs and expenses, including pet acquisition costs and claims expenses;
- our ability to expand the scope and efficiency of our Territory Partner network;
- 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 medical plan 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 writing our medical plan, implementing our own national independent referral network of Territory Partners, pricing our medical plan subscriptions with our in-house actuarial team, administering claims made with respect to our medical plan, 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 coverage 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 coverage will grow over time if consumers are offered a high-value product, the market for medical coverage for cats and dogs in North America has been historically growing slowly or stagnant 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 coverage for cats and dogs in North America has been highly competitive and may become even more competitive 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;
- 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 provide different coverage and are subject to materially different terms and conditions than the Trupanion medical plan. Further, the unaffiliated general agents administer these policies and market them to consumers. For the year ended December 31, 2016, premiums from these policies accounted for 5.8% of our total revenue. 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 (Omega). 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 claims through an agency agreement and a fronting and administration agreement. These agreements will remain in effect until December 31, 2017 but 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 medical plan, 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 to the extent we no longer qualify for the exemption provided to an emerging growth company, as defined by The Jumpstart Our Business Startups Act of 2012 (JOBS Act).

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, are unable to comply with the requirements of Section 404 in a timely manner, 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 claims data 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 medical plan, including information relating to subscription fees, coverage, benefits, exclusions, limitations, availability and medical plan comparisons. A significant amount of both automated and manual effort is required to maintain the medical plan 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 medical plan. 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 to our medical plan, 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 the subscription fees for our medical plan, 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. 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.

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, copyrights, trademarks and domain names, as well as contractual restrictions, to establish and protect our intellectual property. As of December 31, 2016, we had three pending patent applications in the United States, two pending patent applications in Canada, one pending patent application in Brazil, one pending patent application in Japan, one pending patent application in China, one pending patent application in Hong Kong, two pending patents filed under the Patent Cooperation Treaty, and one pending patent application and one issued patent in Europe. 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.

As of December 31, 2016, we had ten registered trademarks in the United States, including “Trupanion”. We had one registered trademark in Canada, and four pending trademarks. Many of our unregistered trademarks, however, contain words or terms having a common usage and, as a result, may not be protectable under applicable law. Trademark protection may also not be available, or sought by us, in every country in which our medical plan may become 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 medical plan, 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 to our medical plan 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.

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 financial covenants, including having APIC maintain statutory capital and surplus at all times of not less than the greater of $0.5 million or 110% of the highest amount of statutory capital and surplus required in any state in which APIC is licensed, maintaining a minimum unrestricted cash balance of $0.6 million in our accounts at Western Alliance Bank (WAB) and/or one or more WAB affiliates, maintaining all of our depository and operating accounts at WAB and/or one or more WAB affiliates, maintaining all of our depository and operating accounts at WAB, achieving certain monthly revenue and remaining within certain maximum EBITDA loss levels. 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.
As of December 31, 2016, we had $5.0 million outstanding indebtedness. We 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 borrow additional funds to support risk-based capital requirements related to 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 in our medical plan 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 in our medical plan or intercompany services, could result in substantial tax liabilities. Our voluntary disclosure of tax obligations and any future assertions by any jurisdiction that we should be paying taxes may create increased administrative burdens or costs, require payment of substantial fines and penalties, discourage consumers from enrolling in our medical plan, reduce our operational efficiencies, decrease our ability to compete or otherwise substantially harm our business and operating results.

If consumer acceptance of the Internet as an acceptable marketplace for a pet medical plan 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 a pet medical plan. Internet use may not continue to develop at historical rates, and consumers may not continue to use the Internet to research, select and purchase a pet medical plan. 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. Pet medical plans are a discretionary purchase, and members may reduce or eliminate their discretionary spending during an economic downturn, resulting in an increase in medical plan subscription terminations and a reduction in the number of new member enrollments. We may experience a material increase in medical plan subscription 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 a pet medical plan 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 acquire other companies or technologies, which could divert our management's attention, result in additional dilution to our stockholders and otherwise disrupt our operations and harm our operating results.

We may decide to acquire businesses, products and technologies. Our ability to successfully make and integrate acquisitions is unproven. The pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated. Further, even if we successfully acquire additional businesses or technologies, we may not be able to migrate the policyholders to our medical plan, integrate the acquired personnel, operations and technologies successfully, or effectively manage the combined business following the acquisition. We also may not achieve the anticipated benefits from the acquired business or technology. In addition, we may unknowingly inherit liabilities from future acquisitions that arise after the acquisition and are not adequately covered by indemnities. Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. If an acquired business or technology 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, 2016, we had U.S. federal net operating loss carryforwards of approximately $79.0 million that will begin to expire in 2027. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, 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 and 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 Internal Revenue Code, annual use of the Company's net operating loss carryforwards and credit carryforwards may be limited if the Company experiences an ownership change. As of December 31, 2016, we believe the utilization of approximately $0.5 million of net operating losses are subject to limitation as a result of prior ownership changes however subsequent ownership changes may further affect the limitation in future years.

We may explore opportunities to expand our operations globally, and we may therefore become subject to a number of risks associated with international expansion and operations.

As part of our growth plan, we expect to explore opportunities to expand our operations globally. We have no history of marketing, selling, administrating and supporting our medical plan to consumers outside of the United States, Canada and Puerto Rico. International sales and operations are 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 medical plan in non-English speaking countries;
- the costs and resources required to modify our medical plan 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 to our medical plan 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 medical plan, 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 medical plan, 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, 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. medical plan 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.
- 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.

As of December 31, 2016, APIC was required to maintain at least $25.8 million of risk-based capital to satisfy the No Action Level (the highest of the above levels). As of December 31, 2016, APIC maintained $30.5 million of risk-based capital. 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 claims 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 a pet medical plan, our business and operating results could be harmed.

The sale of a pet medical plan, 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;
- approve which entities can be paid commissions from carriers and the circumstances under which they may be paid;
- 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, brokers, and adjusters, 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 to our medical plan 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 to our medical plan, 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 to our medical plan and the manner in which we write policies for any unaffiliated general agent. Any modification of our marketing or business practices in response to regulatory inquiries could harm our business, operating results or financial condition.

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 insurance coverage with respect to 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 medical plan 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 claims 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 pet insurance to be licensed may be interpreted to apply to our business, which could require us to modify our business practices.

Insurance regulators generally require that each individual who transacts pet insurance business on our behalf must maintain a valid license in one or more jurisdictions. 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 may in the future determine that any of our personnel or referral sources were selling subscriptions to our medical plan on our behalf and need to be licensed in a particular jurisdictions. 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 and would likely be required to modify our business practices and 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 medical plan 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 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 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 in our medical plan, 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.

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 in our medical plan. 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 medical plan advertisements and transactions may prompt calls for more stringent consumer protection laws that may impose additional burdens on companies conducting business and selling subscriptions to a pet medical plan 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. On July 1, 2014, legislation became effective in Canada that, among other things, prohibits the sending of commercial electronic messages without the express or implied consent of the recipient, subject to certain exceptions. Failure to abide by this new legislation could lead to significant administrative monetary penalties and, as of July 1, 2017, civil liability exposure, including through class actions. 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 service providers, email service providers and others attempt to block the transmission of unsolicited email, commonly known as "spam." Many Internet and email 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 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 increase when we are no longer an emerging growth company, as defined by the JOBS Act. 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 will make our common stock less attractive to investors.
We are an emerging growth company. Under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, we will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.
For as long as we continue to be an emerging growth company, we intend to take 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. We cannot predict if investors will find our common stock less attractive because we will rely on these exemptions. 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.
We generally will remain an emerging growth company until the earliest of (i) the end of the fiscal year in which the market value of our common stock that is held by non-affiliates exceeds $700 million as of June 30, (ii) the end of the fiscal year in which we have total annual gross revenue of $1 billion or more during such fiscal year, (iii) the date on which we issue more than $1 billion in non-convertible debt in a three-year period or (iv) the end of the fiscal year in which the fifth anniversary of our IPO occurred, July 18, 2014.
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 financial and operational 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 medical plan, 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 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our principal executive offices are located at 6100 4th Avenue South, Seattle, Washington. The lease for our principal office is for 72,157 square feet and expires in July 2026. This lease includes provisions which increase our principal office space to a total of 90,385 square feet in 2017 and then to a total of 108,218 square feet in 2018. We also occupy 1,600 square feet of office space in Vancouver, British Columbia pursuant to a lease that expires in March 2017 which we plan to renew.

Item 3. Legal Proceedings

From time to time, we may be subject to various legal proceedings and claims in the ordinary course of business activities, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights; employment claims; coverage disputes with policyholders; and general contract or other claims. We may, from time to time, also be subject to various other legal or government claims, disputes or investigations.

The outcomes of our legal proceedings are inherently unpredictable, subject to significant uncertainties, and could be material to our operating results for a particular period. We make a provision for a liability relating to legal matters when it is both probable that a liability beyond previously accrued amounts has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter.

Item 4. Mine Safety Disclosures

None.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Market for our Common Stock

Our common stock began trading on the New York Stock Exchange (NYSE) under the symbol "TRUP" on July 18, 2014. Prior to that time, there was no public market for our common stock. On June 17, 2016, we voluntarily transferred the listing of our common stock from the NYSE to the NASDAQ Global Market of the NASDAQ Stock Market LLC (NASDAQ) where our common stock continues to be traded under the symbol "TRUP". The following table sets forth the high and low intra-day sales prices per share for our common stock on the NASDAQ and NYSE.

	Fiscal Year 2016		Fiscal Year 2015	
	High	Low	High	Low
1st Quarter	$9.85	$7.82	$8.47	$6.70
2nd Quarter	$15.92	$9.54	$8.50	$7.41
3rd Quarter	$16.93	$13.52	$8.63	$6.83
4th Quarter	$17.18	$14.75	$9.90	$6.40

Dividend Policy

We have never declared or paid cash dividends on our capital stock. Under our credit agreement, we are restricted from paying any dividends or making any distributions on account of our capital stock. We currently intend to retain any future earnings for use in the operation of our business and do not intend to declare or pay any cash dividends in the foreseeable future. Any further determination to pay dividends on our capital stock will be at the discretion of our board of directors, subject to applicable laws and restrictions in our outstanding credit agreement, and will depend on our financial condition, results of operations, capital requirements, general business conditions and other factors that our board of directors considers relevant.

Holders of Record

As of February 8, 2017, there were 46 stockholders of record of our common stock. The actual number of stockholders is greater than this number of record holders, and includes stockholders who are beneficial owners, whose shares are held of record by banks, brokers, and other financial institutions.

Securities Authorized for Issuance under Equity Compensation Plans

The information called for by this item is incorporated by reference to our Proxy Statement for the Annual Meeting of Stockholders to be held in 2017. See Part III, Item 12 "Security Ownership of Certain Beneficial Owners and Management."

Stock Performance Graph

The following shall not be deemed "filed" for purposes of Section 18 of the Exchange Act, or incorporated by reference into any of our other filings under the Exchange Act or the Securities Act, except to the extent we specifically incorporate it by reference into such filing.

This chart compares the cumulative total return on our common stock with that of the S&P Small Cap 600 Index and the NASDAQ-100 Technology Sector Index. The chart assumes $100 was invested at the close of market on July 18, 2014, in our common stock and the S&P Small Cap 600 Index, and assumes the reinvestment of any dividends. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

Company/Index	7/18/2014	9/30/2014	12/31/2014	3/31/2015	6/30/2015	9/30/2015	12/31/2015	3/31/2016	6/30/2016	9/30/2016	12/31/2016
Trupanion Inc.	$100.00	$74.57	$60.82	$70.19	$72.28	$66.23	$85.61	$86.40	$116.23	$148.25	$136.14
S&P Small Cap 600	100.00	95.62	104.65	108.46	108.31	97.91	101.16	103.45	106.67	113.98	126.19
NASDAQ- 100 Technology Sector Index	100.00	101.85	108.79	108.08	105.62	98.09	106.25	107.61	108.77	127.51	131.81

Issuer Purchases of Equity Securities

Not applicable.

Item 6. Selected Consolidated Financial Data

The following selected consolidated financial and other data should be read with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. The selected consolidated statements of operations data for the years ended December 31, 2016, 2015 and 2014 and the consolidated balance sheet data as of December 31, 2016 and 2015 are derived from our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The selected consolidated statements of operations data for the years ended December 31, 2013 and 2012 and the consolidated balance sheet data as of December 31, 2014, and 2013 and 2012 are derived from our audited consolidated financial statements not included in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of the results to be expected in any future period.

	Years Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands, except share and per share data)				
Consolidated Statements of Operations Data:					
Revenue:					
Subscription business	$173,356	$133,406	$103,502	$76,413	$55,352
Other business	14,874	13,557	12,408	7,416	178
Total revenue	188,230	146,963	115,910	83,829	55,530
Cost of revenue:					
Subscription business[1]	141,321	109,428	85,169	61,394	44,185
Other business	13,621	12,306	10,867	6,791	134
Total cost of revenue	154,942	121,734	96,036	68,185	44,319
Gross profit:					
Subscription business	32,035	23,978	18,333	15,019	11,167
Other business	1,253	1,251	1,541	625	44
Total gross profit	33,288	25,229	19,874	15,644	11,211
Operating expenses:					
Sales and marketing[1]	15,247	15,231	11,608	9,091	7,149
Technology and development[1]	9,534	11,215	9,899	4,888	3,406
General and administrative[1]	15,205	15,558	14,312	8,652	6,195
Total operating expenses	39,986	42,004	35,819	22,631	16,750
Operating loss	(6,698)	(16,775)	(15,945)	(6,987)	(5,539)
Interest expense	218	325	6,726	609	535
Other (income) expense, net	(58)	(9)	(1,487)	671	252
Loss before income taxes	(6,858)	(17,091)	(21,184)	(8,267)	(6,326)
Income tax expense (benefit)	38	114	(7)	(92)	84
Net loss	$(6,896)	$(17,205)	$(21,177)	$(8,175)	$(6,410)
Net loss attributable to common stockholders	$(6,896)	$(17,205)	$(21,177)	$(8,175)	$(8,147)
Net loss per share attributable to common stockholders—basic and diluted[2]	$(0.24)	$(0.62)	$(1.64)	$(6.23)	$(9.76)
Weighted average number of shares outstanding used to compute net loss per share attributable to common stockholders—basic and diluted[2]	28,527,602	27,638,443	12,934,477	1,312,019	834,648

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	Years Ended December 31, 2016	2015	2014	2013	2012
Other Financial and Operational Data[3]:					
Total pets enrolled	343,649	291,818	232,450	182,497	127,704
Total subscription pets enrolled	323,233	272,636	215,491	168,405	125,387
Monthly average revenue per pet	$47.82	$45.04	$44.14	$42.56	$41.99
Lifetime value of a pet	$631	$591	$591	$619	$557
Average pet acquisition cost[4]	$123	$132	$121	$104	$100
Average monthly retention	98.60 %	98.64 %	98.69 %	98.65 %	98.51 %
Adjusted EBITDA (in thousands)[5]	$62	$(11,297)	$(10,349)	$(4,351)	$(3,904)

	As of December 31, 2016	2015	2014	2013	2012
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$23,637	$17,956	$53,098	$14,939	$4,234
Short-term investments	29,570	25,288	22,371	16,088	10,809
Working capital	34,729	30,016	62,111	13,710	7,746
Total assets	82,345	70,917	98,306	51,653	27,666
Warrant liabilities	—	—	—	4,900	551
Current and long-term debt	4,767	—	14,900	26,099	9,900
Total liabilities	37,630	25,561	39,031	52,928	23,015
Convertible preferred stock	—	—	—	31,724	31,724
Stockholders' equity (deficit)	44,715	45,356	59,275	(32,999)	(27,073)

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

	Years Ended December 31, 2016	2015	2014	2013	2012
	(in thousands)				
Cost of revenue	$275	$263	$315	$230	$109
Sales and marketing	532	446	553	677	428
Technology and development	246	404	461	351	268
General and administrative	1,893	1,889	2,755	680	629
Total stock-based compensation expense	$2,946	$3,002	$4,084	$1,938	$1,434

(2) See note 2 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K for a description of the method used to compute basic and diluted net loss per share attributable to common stockholders.

(3) For more information about how we calculate total pets enrolled, total subscription pets enrolled, monthly average revenue per pet, lifetime value of a pet, average pet acquisition cost and average monthly retention, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Financial and Operating Metrics."

(4) Average pet acquisition cost is calculated in part based on acquisition cost and net acquisition cost, non-GAAP financial measures. Acquisition cost is defined as sales and marketing expenses, excluding stock-based compensation expense. Net acquisition cost is defined as acquisition cost, net of sign-up fee revenue and other business segment sales and marketing expense. For more information about acquisition cost, net acquisition cost and a reconciliation of sales and marketing expenses to acquisition cost and net acquisition cost, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Non-GAAP Financial Measures."

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(5) Adjusted EBITDA is a non-GAAP financial measure that we define as net loss excluding stock-based compensation expense, depreciation and amortization expense, interest income, interest expense, change in fair value of warrant liabilities, income tax expense (benefit) and loss (income) from equity method investment. For more information about Adjusted EBITDA, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Non-GAAP Financial Measures.”

Item 7. Management's Discussion and Analysis of Financial Conditions and Results of Operations

Overview

We provide a medical insurance plan 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 plan 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.

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 plan, which we market to consumers. Our medical plan automatically renews on a monthly basis and members pay the subscription fee at the beginning of each subscription period, in most cases by authorizing 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. 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 provide different coverage and may have materially different terms and conditions than our subscription medical plan.

We generate leads for our subscription business through both third-party referrals and online member 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 network of partners who are paid fees based on activity in their regions, which we refer to as our Territory Partners. Our Territory Partners are dedicated to cultivating direct veterinary relationships and building awareness of the benefits that our medical plan offers 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, our medical plan. Our online member acquisition channels serve as important resources for pet owner education and drive new member leads and conversion. We also receive a significant number of new leads from existing members adding pets and referring their friends and family members. 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.

Our revenue increased from $147.0 million for the year ended December 31, 2015 to $188.2 million for the year ended December 31, 2016, representing 28% year-over-year growth. We have made and expect to continue to make substantial investments in member acquisition and in expanding our operations. For the years ended December 31, 2016, 2015, and 2014, we had a net loss of $6.9 million, $17.2 million and $21.2 million, respectively. As of December 31, 2016, our accumulated deficit was $81.3 million.

Key Financial and Operating Metrics

The following tables set forth our key financial and operating metrics for our subscription business for the periods ended December 31, 2016, 2015 and 2014 and for each of the last eight fiscal quarters.

	Years Ended December 31,		
	2016	2015	2014
Total pets enrolled (at period end)	343,649	291,818	232,450
Total subscription pets enrolled (at period end)	323,233	272,636	215,491
Monthly average revenue per pet	$47.82	$45.04	$44.14
Lifetime value of a pet (LVP)	$631	$591	$591
Average pet acquisition cost (PAC)	$123	$132	$121
Average monthly retention	98.60 %	98.64 %	98.69 %
Adjusted EBITDA (in thousands)	$62	$(11,297)	$(10,349)

	Period Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
Total pets enrolled (at period end)	343,649	334,070	320,896	307,298	291,818	276,988	259,948	246,106
Total subscription pets enrolled (at period end)	323,233	312,282	299,856	287,123	272,636	258,546	241,808	228,409
Monthly average revenue per pet	$49.17	$48.37	$47.39	$46.12	$45.48	$45.15	$45.10	$44.34
Lifetime value of a pet (LVP)	$631	$624	$622	$603	$591	$591	$570	$567
Average pet acquisition cost (PAC)	$133	$120	$118	$123	$132	$129	$133	$134
Average monthly retention	98.60 %	98.61 %	98.64 %	98.65 %	98.64 %	98.66 %	98.67 %	98.66 %
Adjusted EBITDA (in thousands)	$302	$304	$522	$(1,066)	$(1,588)	$(3,211)	$(3,165)	$(3,333)

Total pets enrolled. Total pets enrolled reflects the number of pets subscribed to either our plan or 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 subscribed to the plan marketed by Trupanion to consumers 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 calculated in part 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 expenses, excluding stock-based compensation expense, offset by sign-up fee revenue and other business segment sales and marketing expenses. We offset sales and marketing expenses with sign-up fee revenue since it is a one-time charge to new members used to partially offset initial setup costs, which are included in sales and marketing expenses. 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.

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 December 31, 2016 is an average of each month's retention from January 1, 2016 through December 31, 2016. 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.

Adjusted EBITDA. Adjusted EBITDA is a non-GAAP financial measure that we define as net loss excluding stock-based compensation expense, depreciation and amortization expense, interest income, interest expense, change in fair value of warrant liabilities, income tax expense (benefit) and loss (income) from equity method investment. For more information about adjusted EBITDA and a reconciliation of net loss to adjusted EBITDA, see "Non-GAAP Financial Measures" below.

Non-GAAP Financial Measures

We believe that using acquisition cost, net acquisition cost and adjusted EBITDA to calculate and present certain of our other key metrics is helpful to our investors. These measures, which are non-GAAP financial measures, are not prepared in accordance with U.S. GAAP. We define acquisition cost as sales and marketing expenses, excluding stock-based compensation expense. We define net acquisition cost as acquisition cost net of sign-up fee revenue and other business segment sales and marketing expenses. We define adjusted EBITDA as net loss excluding stock-based compensation expense, depreciation and amortization expense, interest income, interest expense, change in fair value of warrant liabilities, income tax expense (benefit) and loss (income) from equity method investment.

Our non-GAAP financial measures may not provide information that is directly comparable to that provided by other companies in our industry as other companies in our industry may calculate or use non-GAAP financial measures differently. In addition, there are limitations in using non-GAAP financial measures because the non-GAAP financial measures are not prepared in accordance with GAAP, may be different from non-GAAP financial measures used by other companies and exclude expenses that may have a material impact on our reported financial results. Further, stock-based compensation expense and other items used in the calculation of adjusted EBITDA have been and will continue to be for the foreseeable future significant recurring expenses in our business. 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. We urge our investors to review the reconciliation of our non-GAAP financial measures to the most directly comparable GAAP financial measures in our consolidated financial statements that is included below, and not to rely on any single financial or operating measure to evaluate our business.

Because of varying available valuation methodologies, subjective assumptions and the variety of equity instruments that can impact a company’s non-cash expenses, we believe that providing non-GAAP financial measures such as acquisition cost, net acquisition cost and adjusted EBITDA that exclude stock-based compensation expense and, in the case of adjusted EBITDA, the change in fair value of warrant liabilities and loss (income) from equity method investments allows for more meaningful comparisons between our operating results from period to period. We net sign-up fees with sales and marketing expenses in our calculation of net acquisition cost because we collect it from new members at the time of enrollment and consider it to be an offset to a portion of our sales and marketing expenses. We exclude the change in fair value of warrant liabilities from our calculation of adjusted EBITDA in order to eliminate fluctuations caused by changes in our stock price. We believe this allows us to calculate and present acquisition cost, net acquisition cost and the related financial measures we derive from them, as well as adjusted EBITDA, in a consistent manner across periods. Our non-GAAP financial measures and the related financial measures we derive from them are important tools for financial and operational decision-making and for evaluating our own operating results over different periods of time.

The following table reflects the reconciliation of acquisition cost and net acquisition cost to sales and marketing expenses:

	Years Ended December 31,		
	2016	2015	2014
	(in thousands)		
Sales and marketing expenses	$15,247	$15,231	$11,608
Excluding:			
Stock-based compensation expense	(532)	(446)	(553)
Acquisition cost	14,715	14,785	11,055
Net of:			
Sign-up fee revenue	(2,073)	(1,983)	(1,572)
Other business segment sales and marketing expense	(218)	(80)	(124)
Net acquisition cost	$12,424	$12,722	$9,359

	Three Months Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands)							
Sales and marketing expenses	$3,951	$3,892	$3,564	$3,840	$3,919	$4,128	$3,533	$3,651
Excluding:								
Stock-based compensation expense	(113)	(172)	(165)	(82)	(104)	(102)	(110)	(130)
Acquisition cost	3,838	3,720	3,399	3,758	3,815	4,026	3,423	3,521
Net of:								
Sign-up fee revenue	(526)	(525)	(495)	(527)	(506)	(542)	(451)	(484)
Other business segment sales and marketing expense	(62)	(63)	(55)	(38)	(8)	(16)	(30)	(26)
Net acquisition cost	$3,250	$3,132	$2,849	$3,193	$3,301	$3,468	$2,942	$3,011

The following table reflects the reconciliation of adjusted EBITDA to net loss:

	Years Ended December 31,		
	2016	2015	2014
	(in thousands)		
Net loss	$(6,896)	$(17,205)	$(21,177)
Excluding:			
Stock-based compensation expense	2,946	3,002	4,084
Depreciation and amortization expense	3,846	2,542	1,675
Interest income	(119)	(75)	(74)
Interest expense	218	325	6,726
Change in fair value of warrant liabilities	—	—	(1,575)
Income tax expense (benefit)	38	114	(8)
Loss (income) from equity method investment	29	—	—
Adjusted EBITDA	$62	$(11,297)	$(10,349)

	Three Months Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands)							
Net loss	$(1,723)	$(1,637)	$(964)	$(2,572)	$(3,001)	$(4,643)	$(4,625)	$(4,936)
Excluding:								
Stock-based compensation expense	731	776	743	696	653	749	897	703
Depreciation and amortization expense	1,229	1,093	739	785	741	672	563	566
Interest income	(41)	(29)	(26)	(23)	(19)	(19)	(18)	(19)
Interest expense	81	66	41	30	26	14	40	245
Income tax expense(benefit)	7	13	4	14	12	16	(22)	108
Loss (income) from equity method investment	18	22	(15)	4	—	—	—	—
Adjusted EBITDA	$302	$304	$522	$(1,066)	$(1,588)	$(3,211)	$(3,165)	$(3,333)

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 maintain the retention rate of enrolled pets may be affected by a number of factors, including the actual and perceived value of our services and the quality of our member experience, our claims payment process and the competitive environment. In addition, 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, 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. For example, the timing of our Territory Partner conference may increase our average pet acquisition cost in a given period (historically, during the fourth quarter of each year). We also regularly test new member acquisition channels and marketing initiatives, which may be more expensive than our traditional marketing channels and increase our average acquisition costs. We plan to expand the number of Territory Partners which is likely to increase our average pet acquisition cost. We continually assess our sales and marketing activities by monitoring the ratio of LVP to PAC.

Timing of initiatives. Over time we plan to implement new initiatives to improve our member experience, make modifications to our medical 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. As our revenue has grown faster in the United States compared to Canada, this geographic shift in the mix of business has reduced the growth in our monthly average revenue per pet. In addition, as our mix of revenue changes between the United States and Canada, our exposure to foreign exchange fluctuations will be impacted.

Other business segment. Our other business segment includes revenue and expenses related to policies written on behalf of third parties where we do not undertake the direct consumer marketing. This segment includes the writing of policies that provide different coverage and may have materially different terms and conditions than our subscription medical plan. Our relationships in our other business segment are generally subject to termination provisions and are non-exclusive. Accordingly we cannot control how much business is written with us, 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 - 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.

Basis of Presentation

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 our medical plan, which we market to consumers. Our other business segment includes revenue and expenses related to our other operations that are not directly marketed to consumers. We report our financial information in accordance with U.S. GAAP.

Revenue

We generate revenue in our subscription business segment primarily from subscription fees for our medical plan. Our medical plan automatically renews on a monthly basis, and members pay the subscription fee at the beginning of each subscription period, in most cases by authorizing 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 provide different coverage and may have materially different terms and conditions than our subscription medical plan.

Cost of Revenue

Cost of revenue in each of our segments is comprised of claims expenses and other cost of revenue.

Claims expenses

Claims expenses include claims incurred, the cost of personnel administering the claims and providing member service relating to claims, and other operating expenses directly or indirectly related to claims administration. Claims incurred are the claims approved for payment plus an accrual for claims incurred that have not yet been submitted or approved for payment. This accrual is based on our historical experience and developments in claims frequency and severity and the cost of veterinary care, and also includes the cost of administering such claims.

Other cost of revenue

Other cost of revenue for the subscription business segment includes direct and indirect member service expenses, renewal fees, credit card transaction fees and premium tax expenses. Other cost of revenue for the other business segment includes the commission the Company pays to the unaffiliated general agent and premium taxes on other policies in this segment.

For both our subscription business and our other business segments, we generally expect our cost of revenue to remain relatively constant as a percentage of revenue, although there may be some periodic variability due to a number of factors including the rate of claims occurrences during such periods. Claims expenses as a percentage of our subscription business revenue may increase over time as part of our strategy to return more value to our members to further enhance our member experience, retention rates and lifetime value of a pet. We currently expect that, in the long-term, such increases generally would be offset by economies of scale in our other cost of revenue.

Gross Profit

Gross profit is total revenue less cost of revenue. We expect gross profit as a percentage of revenue in our subscription segment to remain relatively consistent in the long-term, although there has been and may be in the future some periodic variability due to a number of factors, including the rate of claims occurrences during such periods and in the timing and significance of our pricing adjustments. The timing of our implementation of various initiatives to improve the experience of our members also may affect gross profit in the short-term. Further, as the mix of subscription business and other business changes and as we add or modify relationships in our other business segment, this may impact our total gross profit as a percentage of revenue.

Operating Expenses

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

Sales and Marketing

Sales and marketing expenses primarily consist of lead generation costs, converting leads to enrolled pets, print, online and promotional advertising costs, strategic partnership fees and personnel costs and related expenses. Sales and marketing expenses are driven primarily by investments to acquire new members. We plan to continue to invest in existing and new member acquisition channels and marketing initiatives to grow our business. Investments in new member acquisition channels and marketing initiatives are generally more expensive than our traditional marketing channels and increase our average pet acquisition cost. We manage our sales and marketing expense on a per pet basis. As such, we expect sales and marketing expenses to fluctuate in absolute values and as a percentage of revenue based on how many new pets are enrolled in a period as well as the average pet acquisition cost. We generally target a ratio of lifetime value of a pet to average pet acquisition cost of 5 to 1.

Technology and Development

Technology and development expenses primarily consist of personnel costs and related expenses for our operations staff, which includes information technology development and infrastructure support, third-party services and depreciation of hardware and capitalized software and amortization of intangible assets. We expect technology and development expenses to decrease as a percentage of revenue in the near term as we continue to experience scale in our technology expenses.

General and Administrative

General and administrative expenses consist primarily of personnel costs and related expenses for our finance, actuarial, human resources, regulatory, legal, general management functions, as well as facilities and professional services. We expect general and administrative expenses to decrease as a percentage of revenue as we continue to experience scale in our general and administrative expenses.

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 our revenue for those periods. The period-to-period comparison of financial results is not necessarily indicative of future results.

	Years Ended December 31,		
	2016	2015	2014
	(in thousands)		
Consolidated Statements of Operations Data:			
Revenue:			
Subscription business	$173,356	$133,406	$103,502
Other business	14,874	13,557	12,408
Total revenue	188,230	146,963	115,910
Cost of revenue:			
Subscription business[(1)]	141,321	109,428	85,169
Other business	13,621	12,306	10,867
Total cost of revenue	154,942	121,734	96,036
Gross profit:			
Subscription business	32,035	23,978	18,333
Other business	1,253	1,251	1,541
Total gross profit	33,288	25,229	19,874
Operating expenses:			
Sales and marketing[(1)]	15,247	15,231	11,608
Technology and development[(1)]	9,534	11,215	9,899
General and administrative[(1)]	15,205	15,558	14,312
Total operating expenses	39,986	42,004	35,819
Operating loss	(6,698)	(16,775)	(15,945)
Interest expense	218	325	6,726
Other income, net	(58)	(9)	(1,487)
Loss before income taxes	(6,858)	(17,091)	(21,184)
Income tax expense (benefit)	38	114	(7)
Net loss	$(6,896)	$(17,205)	$(21,177)

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

	Years Ended December 31,		
	2016	2015	2014
	(in thousands)		
Cost of revenue	$275	$263	$315
Sales and marketing	532	446	553
Technology and development	246	404	461
General and administrative	1,893	1,889	2,755
Total stock-based compensation expense	$2,946	$3,002	$4,084

	Years Ended December 31,		
	2016	2015	2014
Revenue	100 %	100 %	100 %
Cost of revenue	82	83	83
Gross profit	18	17	17
Operating expenses:			
Sales and marketing	8	10	10
Technology and development	5	8	9
General and administrative	8	11	12
Total operating expenses	21	29	31
Operating loss	(4)	(12)	(14)
Interest expense	—	—	5
Other income, net	—	—	(1)
Loss before income taxes	(4)	(12)	(18)
Income tax expense (benefit)	—	—	—
Net loss	(4)%	(12)%	(18)%

	Years Ended December 31,		
	2016	2015	2014
Subscription business revenue	100%	100%	100%
Subscription business cost of revenue	82	82	82
Subscription business gross profit	18 %	18 %	18 %

Comparison of the years ended December 31, 2016, 2015 and 2014

Revenue

	Years Ended December 31, 2016	2015	2014	2015 to 2016 % Change	2014 to 2015 % Change
	(in thousands, except percentages, pet and per pet data)				
Revenue:					
Subscription business	$173,356	$133,406	$103,502	30%	29%
Other business	14,874	13,557	12,408	10	9
Total revenue	$188,230	$146,963	$115,910	28	27
Percentage of Revenue by Segment:					
Subscription business	92 %	91 %	89 %		
Other business	8	9	11		
Total revenue	100 %	100 %	100 %		
Total pets enrolled (at period end)	343,649	291,818	232,450	18	26
Total subscription pets enrolled (at period end)	323,233	272,636	215,491	19	27
Monthly average revenue per pet	$47.82	$45.04	$44.14	6	2
Average monthly retention	98.60 %	98.64 %	98.69 %		

Year ended December 31, 2016 compared to year ended December 31, 2015. Total revenue increased by $41.3 million to $188.2 million for the year ended December 31, 2016, or 28%. Revenue from our subscription business segment increased by $40.0 million to $173.4 million for the year ended December 31, 2016, or 30%. This increase in subscription business revenue was primarily due to a 19% increase in total subscription pets enrolled as of December 31, 2016 compared to December 31, 2015, and increased average revenue per pet of 6% for the same period due to increases in pricing to cover the increased cost of veterinary care. The impact of the increase was partially offset by an approximate $1.2 million negative impact on our Canadian revenue due to changes in foreign exchange rates when compared to 2015. Revenue from our other business segment increased $1.3 million to $14.9 million for the year ended December 31, 2016, or 10%, due to an increase in enrolled pets in this segment.

Year ended December 31, 2015 compared to year ended December 31, 2014. Total revenue increased by $31.1 million to $147.0 million for the year ended December 31, 2015, or 27%. Revenue for our subscription business segment increased by $29.9 million to $133.4 million for the year ended December 31, 2015, or 29%. This increase in subscription business revenue was primarily due to a 27% increase in total subscription pets enrolled as of December 31, 2015 compared to December 31, 2014. Average revenue per pet increased from $44.14 to $45.04, or 2%, for the same period due to increases in pricing to cover the increased cost of veterinary care. The impact of the increase was partially offset by an approximate $4.8 million impact of foreign exchange rates on our Canadian revenue. Revenue from our other business segment increased $1.2 million to $13.6 million for the year ended December 31, 2015, or 9%, due to an increase in enrolled pets in this segment.

Cost of Revenue

	Years Ended December 31, 2016	2015	2014	2015 to 2016 % Change	2014 to 2015 % Change
	(in thousands, except percentages)				
Cost of Revenue:					
Subscription business:					
Claims expenses	$124,636	$95,420	$74,206	31%	29%
Other cost of revenue	16,685	14,008	10,963	19	28
Total cost of revenue	141,321	109,428	85,169	29	28
Gross profit	32,035	23,978	18,333	34	31
Other business:					
Claims expenses	8,898	7,904	5,707	13	38
Other cost of revenue	4,723	4,402	5,160	7	(15)
Total cost of revenue	13,621	12,306	10,867	11	13
Gross profit	1,253	1,251	1,541	—	(19)
Total pets enrolled (at period end)	343,649	291,818	232,450	18	26
Total subscription pets enrolled (at period end)	323,233	272,636	215,491	19	27
Percentage of Revenue by Segment:					
Subscription business:					
Claims expenses	72 %	72 %	72 %		
Other cost of revenue	10	10	10		
Total cost of revenue	82	82	82		
Gross profit	18	18	18		
Other business:					
Claims expenses	60	58	46		
Other cost of revenue	32	32	42		
Total cost of revenue	92	91	88		
Gross profit	8	9	12		

Year ended December 31, 2016 compared to year ended December 31, 2015. Cost of revenue for our subscription business segment was $141.3 million, or 82% of revenue, for the year ended December 31, 2016, compared to $109.4 million, or 82%, of revenue for the year ended December 31, 2015. This $31.9 million increase in subscription cost of revenue was primarily the result of a 19% increase in subscription pets enrolled. Compensation expense and related costs increased by $2.1 million, or 17%, due to an increase in employee headcount to service our growth and improve our member experience. This was offset by a $1.0 million benefit of foreign exchange rates on our Canadian costs.

Cost of revenue for our other business segment increased $1.3 million to $13.6 million for the year ended December 31, 2016, due to an increase in enrolled pets in this segment.

Year ended December 31, 2015 compared to year ended December 31, 2014. Cost of revenue for our subscription business segment was $109.4 million, or 82% of revenue, for the year ended December 31, 2015, compared to $85.2 million, or 82% of revenue, for the year ended December 31, 2014. This $24.3 million increase in subscription cost of revenue was primarily the result of a 27% increase in enrolled pets and a 29% increase in claims expense for our subscription business. Compensation expense and related costs increased by $1.8 million due to a 12% increase in employee headcount to service our growth and improve our member experience. There was an additional $3.5 million benefit of foreign exchange rates on our Canadian costs.

Cost of revenue for our other business segment increased $1.4 million to $12.3 million for the year ended December 31, 2015, due to an increase in enrolled pets in this segment. Our employer paid pets in this segment have historically been at a lower margin than other pets in this segment and they have increased 14% from 2014 to 2015, decreasing our other business segment gross margin from 12% to 9%.

Sales and Marketing Expenses

	Years Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
	(in thousands, except percentages and per pet data)				
Sales and marketing	$15,247	$15,231	$11,608	—%	31%
Percentage of total revenue	8 %	10 %	10 %		
Subscription Business:					
Total subscription pets enrolled (at period end)	323,233	272,636	215,491	19	27
Average pet acquisition cost (PAC)	$123	$132	$121	(7)	9
Lifetime Value of a Pet (LVP)	$631	$591	$591	7	—

Year ended December 31, 2016 compared to year ended December 31, 2015. Sales and marketing expenses remained consistent at $15.2 million for the year ended December 31, 2016 and decreased as a percentage of revenue from 10% to 8%. Headcount increased 30% in the sales and marketing department, offset by a decrease in the use of third-party vendors. Our core sales and marketing initiatives remained consistent between years. During 2016 we continued to focus on disciplined spending and increased our LVP to PAC ratio from 4.5:1 at December 31, 2015 to 5.1:1 at December 31, 2016.

Year ended December 31, 2015 compared to year ended December 31, 2014. Sales and marketing expenses increased $3.6 million to $15.2 million for the year ended December 31, 2015, or 31%. The increase in sales and marketing expenses was primarily due to an increase of $0.5 million in expenditures related to new and expanded online marketing initiatives and public relations, a $0.8 million increase in print advertising and brand development and a $1.1 million increase related to developing our territory partner network and support functions. Additionally, there was a $1.1 million increase in compensation and related costs and recruiting due to increased headcount in the sales and marketing department. Fees to our territory partners increased $0.3 million based on increased enrollments.

Technology and Development Expenses

	Years Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
	(in thousands, except percentages)				
Technology and development	$9,534	$11,215	$9,899	(15)%	13%
Percentage of total revenue	5 %	8 %	9 %		

Year ended December 31, 2016 compared to year ended December 31, 2015. Technology and development expenses decreased $1.7 million to $9.5 million for the year ended December 31, 2016, or 15%. This decrease was partially due to a $2.7 million decrease in professional services and compensation expense and related costs as headcount decreased 36% in this department. This was partially offset by a $1.2 million increase in depreciation expense, driven by several projects being placed into service during 2016.

Year ended December 31, 2015 compared to year ended December 31, 2014. Technology and development expenses increased $1.3 million to $11.2 million for the year ended December 31, 2015, or 13%. The increase was primarily due to a $0.4 million increase related to infrastructure growth to support our growing business. Depreciation and amortization expense increased by $0.6 million as new projects relating to prior years were placed into service in 2015. Additionally, there was a $0.2 million increase in costs related to our direct pay initiative. Total expenses, net of capitalization, in technology related to our direct pay claims processing initiative were $4.3 million in 2015 and $4.4 million in 2014. Of these amounts, depreciation expense comprised $0.8 million in 2015 and $0.6 million in 2014.

General and Administrative Expenses

	Years Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
	(in thousands, except percentages)				
General and administrative	$15,205	$15,558	$14,312	(2)%	9%
Percentage of total revenue	8 %	11 %	12 %		

Year ended December 31, 2016 compared to year ended December 31, 2015. General and administrative expenses decreased $0.4 million to $15.2 million for the year ended December 31, 2016, or 2%. This was primarily due to a decrease in personnel costs and related expenses of $0.6 million resulting from lower incentive compensation while headcount remained consistent. General and administrative expenses decreased from 11% to 8% as a percentage of revenue for the year ended December 31, 2016, as we experienced scale in our support functions.

Year ended December 31, 2015 compared to year ended December 31, 2014. General and administrative expenses increased $1.2 million to $15.6 million for the year ended December 31, 2015, or 9%. The increase in general and administrative expenses was primarily due to an increase in salaries and related expenses of $0.5 million resulting from increases in headcount. Regulatory fees incurred in our normal course of business increased $0.4 million, and depreciation and amortization increased $0.3 million due to property and equipment additions placed into service late in 2014.

Other Expense, Net

	Years Ended December 31,		
	2016	2015	2014
	(in thousands)		
Interest expense	$218	$325	$6,726
Other income, net	(58)	(9)	(1,487)
Total other expense, net	$160	$316	$5,239

Year ended December 31, 2016 compared to year ended December 31, 2015. Other expense, net for the year ended December 31, 2016 decreased $0.1 million to $0.2 million. This was primarily due to a $0.1 million decrease in interest expense resulting from a lower outstanding average loan balance compared to the prior year.

Year ended December 31, 2015 compared to year ended December 31, 2014. Other expense, net for the year ended December 31, 2015 decreased $4.9 million to $0.3 million. This was primarily due to a decrease in interest expense associated with the repayment of debt and the expensing of unamortized debt discounts associated with the repayment of debt in 2014, partially offset by the revaluation of warrants classified as liabilities which resulted in other income in 2014.

Quarterly Results of Operations

The following tables set forth selected unaudited quarterly statements of operations data for the last eight fiscal quarters. The unaudited interim financial statements for each of these quarters have been prepared on the same basis as the audited financial statements included elsewhere in this prospectus and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present a fair statement of our results of operations and financial position for these periods. This data should be read in conjunction with the audited consolidated financial statements and accompanying notes included elsewhere in this prospectus. These quarterly operating results are not necessarily indicative of our operating results for any future period.

	Three Months Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands)							
Consolidated Statements of Operations Data:								
Revenue:								
Subscription business	$47,422	$44,629	$42,162	$39,143	$36,722	$34,420	$32,208	$30,056
Other business	3,918	3,730	3,670	3,556	3,479	3,445	3,379	3,254
Total revenue	51,340	48,359	45,832	42,699	40,201	37,865	35,587	33,310
Cost of revenue:								
Subscription business(1)	38,528	36,432	34,158	32,203	29,856	28,146	26,661	24,766
Other business	3,594	3,427	3,408	3,192	3,075	3,128	3,140	2,962
Total cost of revenue	42,122	39,859	37,566	35,395	32,931	31,274	29,801	27,728
Gross profit:								
Subscription business	8,894	8,197	8,004	6,940	6,866	6,274	5,547	5,290
Other business	324	303	262	364	404	317	239	292
Total gross profit	9,218	8,500	8,266	7,304	7,270	6,591	5,786	5,582
Operating expenses:								
Sales and marketing(1)	3,951	3,892	3,564	3,840	3,919	4,128	3,533	3,651
Technology and development(1)	2,744	2,339	2,164	2,287	2,533	3,005	2,879	2,798
General and administrative(1)	4,177	3,811	3,495	3,722	3,798	4,067	3,996	3,697
Total operating expenses	10,872	10,042	9,223	9,849	10,250	11,200	10,408	10,146
Operating loss	(1,654)	(1,542)	(957)	(2,545)	(2,980)	(4,609)	(4,622)	(4,564)
Interest expense	81	66	41	30	26	14	40	245
Other (income) expense, net	(19)	16	(38)	(17)	(17)	4	(15)	19
Loss before income taxes	(1,716)	(1,624)	(960)	(2,558)	(2,989)	(4,627)	(4,647)	(4,828)
Income tax expense (benefit)	7	13	4	14	12	16	(22)	108
Net loss	$(1,723)	$(1,637)	$(964)	$(2,572)	$(3,001)	$(4,643)	$(4,625)	$(4,936)

	Period Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
Other Financial and Operational Data[2]:								
Total pets enrolled	343,649	334,070	320,896	307,298	291,818	276,988	259,948	246,106
Total subscription pets enrolled	323,233	312,282	299,856	287,123	272,636	258,546	241,808	228,409
Monthly average revenue per pet	$49.17	$48.37	$47.39	$46.12	$45.48	$45.15	$45.10	$44.34
Lifetime value of a pet	$631	$624	$622	$603	$591	$591	$570	$567
Average pet acquisition cost[3]	$133	$120	$118	$123	$132	$129	$133	$134
Average monthly retention	98.60 %	98.61 %	98.64 %	98.65 %	98.64 %	98.66 %	98.67 %	98.66 %
Adjusted EBITDA (in thousands)[4]	$302	$304	$522	$(1,066)	$(1,588)	$(3,211)	$(3,165)	$(3,333)

(1) Includes stock-based compensation as follows:

	Three Months Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands)							
Cost of revenue	$60	$ 83	$ 66	$ 66	$ 68	$ 68	$ 58	$ 69
Sales and marketing	113	172	165	82	104	102	110	130
Technology and development	88	67	36	55	93	97	93	121
General and administrative	470	454	476	493	388	482	636	383

(2) For more information about how we calculate total pets enrolled, total subscription pets enrolled, monthly average revenue per pet, lifetime value of a pet, average pet acquisition cost and average monthly retention, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Financial and Operating Metrics.”

(3) Average pet acquisition cost is calculated in part based on acquisition cost and net acquisition cost, non-GAAP financial measures. Acquisition cost is defined as sales and marketing expenses, excluding stock-based compensation expense. Net acquisition cost is defined as acquisition cost, net of sign-up fee revenue and other business segment sales and marketing expense. For more information about acquisition cost, net acquisition cost and a reconciliation of sales and marketing expenses to acquisition cost and net acquisition cost, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Non-GAAP Financial Measures.”

(4) Adjusted EBITDA is a non-GAAP financial measure that we define as net loss excluding stock-based compensation expense, depreciation and amortization expense, interest income, interest expense, change in fair value of warrant liabilities, income tax expense (benefit) and loss (income) from equity method investment. For more information about Adjusted EBITDA, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Non-GAAP Financial Measures.”

	Three Months Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(as a percentage of revenue)							
Revenue	100 %	100 %	100 %	100 %	100 %	100 %	100 %	100 %
Cost of revenue	82	82	82	83	82	83	84	83
Gross profit	18	18	18	17	18	17	16	17
Operating expenses:								
Sales and marketing	8	8	8	9	10	11	10	11
Technology and development	5	5	5	5	6	8	8	8
General and administrative	8	8	8	9	9	11	11	11
Total operating expenses	21	21	20	23	25	30	29	30
Operating loss	(3)	(3)	(2)	(6)	(7)	(12)	(13)	(14)
Interest expense	—	—	—	—	—	—	—	(1)
Other (income) expense, net	—	—	—	—	—	—	—	—
Loss before income taxes	(3)	(3)	(2)	(6)	(7)	(12)	(13)	(15)
Income tax expense (benefit)	—	—	—	—	—	—	—	—
Net loss	(3)%	(3)%	(2)%	(6)%	(7)%	(12)%	(13)%	(15)%

	Three Months Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(as a percentage of subscription revenue)							
Subscription business revenue	100%	100%	100%	100%	100%	100%	100%	100%
Subscription business cost of revenue	81	82	81	82	81	82	83	82
Subscription business gross profit	19 %	18 %	19 %	18 %	19 %	18 %	17 %	18 %

Liquidity and Capital Resources

Since inception, we have financed our operations and met capital requirements primarily through the sale of equity securities and from borrowings. Our principal uses of cash are paying claims, funding operations and capital requirements, investing in new member acquisition, enhancements to our member experience and servicing debt. In July 2014, we closed our IPO, pursuant to which we sold 8,193,750 shares of common stock at an offering price of $10.00 per share. We received net proceeds of approximately $72.8 million.

Sources of Funds

As of December 31, 2016, we had $53.2 million of cash and cash equivalents and short-term investments and $21.6 million available under our line of credit which excludes $1.6 million reserved under the credit agreement for an outstanding letter of credit and other ancillary services. We believe that our existing cash and cash equivalents, short-term investments and line of credit will be sufficient to fund our operations and statutory capital requirements for at least the next 12 months. From time to time, we may explore additional financing, which could include equity, equity-linked and debt financing. However, there can be no assurance that any additional financing will be available to us on acceptable terms, or at all.

Cash and investments held by our insurance subsidiaries, American Pet Insurance Company (APIC) and Wyndham Insurance Company (SAC) Limited (WICL) Segregated Account AX, are subject to certain capital and dividend rules and regulations as applicable within the jurisdictions in which they are authorized to operate. For more information on this change, see "—Regulation".

Long-Term Debt

Pacific Western Bank Loan and Security Agreement

In April 2007, we entered into a loan and security agreement with Pacific Western Bank (PWB), formerly with Square 1 Bank, a division of PWB, which we amended and restated in August 2012 and June 2016. In December 2016, we replaced this agreement and entered into a syndicated loan agreement with PWB and Western Alliance Bank (WAB) that increased our facility from $20.0 million to $30.0 million. We refer to this amended and restated loan and security agreement as our PWB credit facility. The PWB credit facility provides for a revolving line of credit, under which we may take advances up to $30.0 million. 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 $30.0 million and the total amount of cash and securities held by our insurance subsidiaries (APIC and WICL), less up to $0.5 million for obligations we may have outstanding from PWB and/or WAB for other ancillary services and our $1.1 million letter of credit. 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. The PWB credit facility matures in December 2018 or December 2019 if the revolving line of credit is automatically renewed. The PWB credit facility automatically renews in January 2018 unless canceled by PWB and/or WAB.

The PWB credit facility requires us to maintain certain financial covenants, including having APIC maintain statutory capital and surplus at all times of not less than the greater of $0.5 million or 110% of the highest amount of statutory capital and surplus required in any state in which APIC is licensed, maintaining a minimum unrestricted cash balance of $0.6 million in our accounts at WAB and/or one or more WAB affiliates, maintaining all of our depository and operating accounts at PWB and/or WAB, achieving certain quarterly revenue and remaining within certain monthly maximum EBITDA loss levels. EBITDA is defined for such purposes 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 compensation expense, plus (v) loss from equity method investments, and minus gain from equity method investments.

The PWB credit facility also requires us to maintain certain non-financial covenants, including those that restrict 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. As of December 31, 2016, 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 December 31, 2016, we had $5.0 million aggregate borrowings outstanding under the PWB credit facility.

Regulation

As of December 31, 2016, our insurance entities, APIC and Wyndham Insurance Company (SAC) Limited (WICL) Segregated Account AX, held $29.5 million in short-term investments and $13.0 million in other current assets, including $4.4 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. As of December 31, 2016, total assets and liabilities held outside our insurance entities totaled $37.3 million and $14.4 million, respectively, including $14.8 million of cash and cash equivalents that are segregated from other operating funds and are held in trust for the payment of claims on behalf of our insurance subsidiaries.

To comply with these 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.

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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, 2016, APIC was required to maintain at least $25.8 million of risk-based capital to avoid this additional regulatory oversight. As of that date, APIC maintained $30.5 million of risk-based capital. 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.

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. In general, 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, 2016, $0.1 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. Our agreements with WICL do not allow dividends to be paid to our parent company until 2017. Subsequent to December 31, 2016, our parent entity received a dividend of $2.7 million from Wyndham Insurance Company (SAC) Limited (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 million or 115% of unearned Canadian premium plus 15% of outstanding Canadian claims, including all incurred but not reported claims.

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 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 of 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.

Investments
As of December 31, 2016, we had $32.1 million of short-term and long-term investments in our insurance entities. These investments are held to satisfy statutory requirements and support operating needs. The majority of our investments are highly rated U.S. treasury securities, certificates of deposit, and U.S. government funds. In addition we have one investment in a municipal bond which is insured by a third-party insurance company with a rating of “A2” with Moody’s.

Historical Cash Flow Trends
The following table shows a summary of our cash flows for the periods indicated (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Net cash provided by (used in) operating activities	$5,006	$(10,425)	$(10,801)
Net cash used in investing activities	(6,508)	(9,923)	(11,926)
Net cash provided by (used in) financing activities	7,672	(14,208)	57,863
Effect of exchange rates on cash	111	(586)	23
Net change in cash, cash equivalents, and restricted cash	$6,281	$(35,142)	$35,159

Operating Cash Flows
We derive operating cash flows from cash collected from the sale of subscriptions to our medical plan, which is used to pay claims and other cost of revenue. Additionally, cash is used to support the growth of our business by reinvesting to acquire new pets and projects to improve member experience.
Net cash provided by operating activities for the year ended December 31, 2016 consisted of our net loss of $6.9 million reduced by non-cash expenses, including stock-based compensation of $2.9 million and depreciation and amortization of $3.8 million and a $5.0 million change in operating assets and liabilities. The change in cash provided by (used in) operating activities was primarily related to the $10.3 million improvement in net loss, driven by higher revenue and decreased operating expenses as a percentage of revenue as we experienced efficiencies in our claims and customer service departments and experienced scale in our technology and development and general and administrative departments. Additionally, we reduced spend as a percentage of revenue in our sales and marketing department.
Net cash used in operating activities for 2015 consisted of our net loss of $17.2 million reduced by non-cash expenses, including stock-based compensation of $3.0 million and the amortization of $2.5 million and a $1.3 million change in operating assets, which were primarily driven by an increase in claims paid, increased spend on marketing and technology initiatives, increased payables due to timing of payments, as well as an increase in prepaid assets due to prepayments for benefits and a new billing system. These increases in cash used in operating activities were partially offset by increased revenue due to enrollment growth and higher average revenue per pet.
Net cash used in operating activities for 2014 consisted of our net loss of $21.2 million reduced by non-cash expenses, including stock-based compensation of $4.1 million and the amortization of the debt discount of $5.0 million as well as changes in our operating assets and liabilities of $1.1 million, which were primarily driven by an increase in claims paid, increased spend on marketing and technology initiatives, as well as an increase in prepaid assets due to advance payment insurance. These increases in cash used in operating activities were partially offset by increased revenue due to enrollment growth and higher average revenue per pet.
Investing Cash Flows
Net cash used in investing activities for each of the periods presented was primarily related to the net purchase of investments to increase our statutory capital. We expect to continue increasing our statutory capital as we expand our operations. In addition, purchases of property and equipment decreased from the year ended December 31, 2015 to the year ended December 31, 2016 due to decreased spending related to internally developed software projects including our direct pay initiative.
Financing Cash Flows
Historically, we have funded our operations through the issuance of common and preferred stock and the incurrence of indebtedness. In July 2014, we completed our IPO, pursuant to which we sold 8,193,750 shares of common stock at

an offering price of $10.00 per share.

For the year ended December 31, 2016, net cash provided by financing activities primarily consisted of borrowings under our line of credit of $5.0 million and proceeds from the exercise of stock options of $3.7 million, partially offset by $0.7 million for tax withholding on restricted stock.

For 2015, net cash used in financing activities primarily consisted of debt repayments of $14.9 million. In addition, we received $1.3 million in proceeds from the exercise of stock options.

For 2014, net cash provided by financing activities included the net proceeds from our IPO of $72.8 million and debt financing of $17.0 million. Net cash used in financing activities consisted primarily of debt repayments of $32.0 million.

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. Our contractual cash obligations as of December 31, 2016 are set forth below (in thousands):

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt obligations	$5,450	$ 225	$ 5,225	$ —	$ —
Capital lease obligations	581	374	207	—	—
Operating lease obligations	20,702	1,510	3,880	4,283	11,029
Strategic marketing and service provider agreements	2,450	1,269	1,114	67	—
Other obligations	3,755	2,355	1,331	69	—

Critical Accounting Policies and Significant Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and related disclosure of contingent assets and liabilities, revenue and expenses at the date of the financial statements. Generally, we base our estimates on historical experience and on various other assumptions in accordance with GAAP that we believe to be reasonable under the circumstances. Actual results may differ from these estimates.

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. Our critical accounting policies and estimates include those related to:

- stock-based compensation;
- income taxes; and
- claims reserve.

Stock-Based Compensation

Compensation expense related to stock-based transactions, including employee and non-employee stock option awards, and restricted stock awards and units, is measured and recognized in the financial statements based on fair value. The fair value of each option award is estimated on the grant date using the Black-Scholes-Merton option-pricing model. All of our stock-based awards have been for instruments tied to our common stock. The stock-based compensation expense, net of estimated forfeitures, is recognized on a straight-line basis over the requisite service periods of the awards, which are generally four years. Many factors are considered when estimating forfeitures, including types of awards, employee class and historical experience.

Key assumptions. Our Black-Scholes-Merton option-pricing model requires the input of highly subjective assumptions, including the fair value of the underlying stock, the expected volatility of the price of our stock, the expected term of the option, risk-free interest rates and the expected dividend yield of our stock. These estimates involve inherent uncertainties and the application of management’s judgment. If factors change and different assumptions are used, our stock-based compensation expense could be materially different in the future. These assumptions are estimated as follows:

- Expected volatility—As we do not have a significant trading history for our common stock, the expected stock price volatility for our common stock was estimated by taking the average historic price volatility for identified peers based on daily price observations over a period equivalent to the expected term of the stock option grants and warrant

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issuances. We did not rely on implied volatilities of traded options or warrants in our industry peers' common stock because the volume of activity was relatively low. We intend to continue to consistently apply this process using the same or similar public companies until a sufficient amount of historical information regarding the volatility of our own share price becomes available.

- Expected term—The expected term represents the period that our stock-based awards are expected to be outstanding. As we do not have sufficient historical experience for determining the expected term of the stock-based awards granted, we have based our expected term for awards issued to employees on the simplified method, which represents the average period from vesting to the expiration of the stock option.
- Risk-free interest rate—The risk-free interest rate is based on the yields of U.S. Treasury securities with maturities similar to the expected term of the options.
- Expected dividend yield—We have never declared or paid any cash dividends and do not presently plan to pay cash dividends in the foreseeable future. Consequently, we used an expected dividend yield of zero.

In addition to the assumptions used in the Black-Scholes-Merton option-pricing model, the amount of stock option expense we recognize in our consolidated statements of operations includes an estimate of stock option forfeitures. Estimated forfeitures did not have a material impact on our assumptions in 2016, 2015 or 2014.

Income Taxes

We use the liability method of accounting for income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to be in effect when such assets and liabilities are recovered or settled. We determine deferred tax assets, including net operating losses (NOLs) and liabilities, based on temporary differences between the book and tax bases of assets and liabilities. We believe that it is currently more likely than not that our deferred tax assets will not be realized, and as such, a full valuation allowance is required. In addition, annual use of our net operating loss carryforwards and credit carryforwards may be limited if we experience an ownership change. As of December 31, 2016, the utilization of approximately $0.5 million of net operating losses are subject to limitation as a result of prior ownership changes; however, subsequent ownership changes may further affect the limitation in future years.

Claims Reserve

Our claims reserve represents estimated claims and claim settlement costs with respect to covered claims that have occurred as of the balance sheet date. The liabilities for claims and claim adjustment expenses are recorded at the estimated ultimate payment amounts. Estimated ultimate payment amounts are based upon a number of factors, including claims information received from members and estimates of incurred but not reported claims. Historical claims data as well as expected developments in the industry, internal claims adjustment expense forecasts, and the economy as a whole are considered by our team of pet medical insurance actuaries when developing our claims reserve.

In establishing estimates for these factors, we must make various assumptions regarding frequency and severity of claims, length of time to achieve ultimate settlement of claims, estimated deductible applicable to incurred claims, and changes in the cost of veterinary care. Due to the inherent uncertainty associated with these estimates, and the cost of incurred but unreported claims, our actual liabilities may be different from our original estimates. On a monthly basis, we review our reserve for claims and claims settlement costs to determine whether further adjustments are required. Any resulting adjustments are included in the current period's results.

As of December 31, 2016 and 2015, our reserve for claims incurred but not yet reported was $9.5 million and $6.3 million, respectively. We believe the amount of our claims reserve as of December 31, 2016 is adequate and we do not believe that there are any reasonably likely changes in the facts or circumstances underlying key assumptions that would result in the reserve for claims being insufficient in an amount that would have a material impact on our reported results, financial position or liquidity. The ultimate liability, however, may be in excess of or less than the amount we have reserved. During 2016, we experienced actual claims that were greater than our estimate for prior year reserves by $0.7 million. During 2015 and 2014, we experienced actual claims that were below our estimate for prior year reserves by less than $0.1 million and $0.5 million, respectively. Historically, approximately 95% of claims have been settled within three months of the claim date.

Item 7A. Quantitative and Qualitative Disclosures About Market Risks

We are exposed to various market risks, including the risks inherent in our insurance business and changes in interest rates. Market risk is the potential loss arising from adverse changes in market rates and prices.

Interest Rate Risk

The principal market risk we face is interest rate risk. We had cash and cash equivalents of $23.6 million and $32.1 million in investments as of December 31, 2016, which consisted of both highly-liquid investments with an original maturity of twelve months or less and long-term low-risk investments. We believe that we do not have significant exposure to changes in the fair value of these assets as a result of changes in interest rates due to the short-term nature of most of our investments coupled with the security behind our long-term investments. Historically, our investment income has not been a material part of our operations.

As of December 31, 2016, our aggregate outstanding indebtedness was $5.0 million, which was borrowed pursuant to our revolving line of credit with Pacific Western Bank (PWB) and Western Alliance Bank (WAB). This PWB credit facility bears interest at the rate of greater of 4.5% or 1.25% plus the prime rate and matures in December 2018 or December 2019 if the PWB credit facility is automatically renewed. Interest on any borrowings under the PWB credit facility would accrue at a rate based on a formula tied to certain market rates at the time of incurrence. However, we do not expect that any change in prevailing interest rates will have a material impact on our results of operations or cash flows. For more information regarding this credit agreement, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Long-Term Debt."

Foreign Currency Exchange Risk

We generate a significant portion of our revenue in Canada. In 2016, our Canadian operations accounted for 20% of our revenue. Our revenue and expenses are generally denominated in the currencies in which our operations are located, which are the United States and Canada. As our operations in Canada or the United States grow on an absolute basis and/or relative to one another, our results of operations and cash flows will be subject to fluctuations due to changes in foreign currency exchange rates.

Upon consolidation, as exchange rates vary, revenues and other operating results may differ materially from expectations. For example, had the average 2015 Canadian currency exchange rate remained consistent into 2016, Canadian revenues would have been $1.3 million higher after the foreign currency conversion. Our analysis of operating results transacted in Canadian currency indicated that a hypothetical 10% change in the Canadian currency exchange rate could have increased or decreased our total revenues by approximately $3.7 million for the year ended December 31, 2016. To date, we have not entered into any material foreign currency hedging contracts although we may do so in the future.

Item 8. Financial Statements and Supplementary Data

Trupanion Inc.
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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Trupanion, Inc.

We have audited the accompanying consolidated balance sheets of Trupanion, Inc. as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive loss, changes in redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2016. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Trupanion, Inc. at December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Seattle, Washington
February 15, 2017

Trupanion, Inc.
Consolidated Statements of Operations
(in thousands, except for share and per share data)

	Years Ended December 31,		
	2016	2015	2014
Revenue	$188,230	$146,963	$115,910
Cost of revenue:			
Claims expenses	133,534	103,324	79,913
Other cost of revenue	21,408	18,410	16,123
Gross profit	33,288	25,229	19,874
Operating expenses:			
Sales and marketing	15,247	15,231	11,608
Technology and development	9,534	11,215	9,899
General and administrative	15,205	15,558	14,312
Total operating expenses	39,986	42,004	35,819
Operating loss	(6,698)	(16,775)	(15,945)
Interest expense	218	325	6,726
Other income, net	(58)	(9)	(1,487)
Loss before income taxes	(6,858)	(17,091)	(21,184)
Income tax expense (benefit)	38	114	(7)
Net loss	$(6,896)	$(17,205)	$(21,177)
Net loss per share attributable to common stockholders:			
Basic and diluted	$(0.24)	$(0.62)	$(1.64)
Weighted average shares used to compute net loss per share attributable to common stockholders:			
Basic and diluted	28,527,602	27,638,443	12,934,477

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Trupanion, Inc.
Consolidated Statements of Comprehensive Loss
(in thousands)

	Years Ended December 31,		
	2016	2015	2014
Net loss	$(6,896)	$(17,205)	$(21,177)
Other comprehensive income (loss):			
Foreign currency translation adjustments	79	(517)	65
Change in unrealized losses on available-for-sale securities	46	4	110
Other comprehensive income (loss), net of taxes	125	(513)	175
Comprehensive loss	$(6,771)	$(17,718)	$(21,002)

Trupanion, Inc.
Consolidated Balance Sheets
(in thousands, except for share data)

	Years Ended December 31,	
	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	$23,637	$17,956
Short-term investments	29,570	25,288
Accounts and other receivables	10,118	8,196
Prepaid expenses and other assets	2,062	2,193
Total current assets	65,387	53,633
Restricted cash	600	—
Long-term investments, at fair value	2,579	2,388
Equity method investment	271	300
Property and equipment, net	8,464	9,719
Intangible assets, net	4,910	4,854
Other long term assets	134	23
Total assets	$82,345	$70,917
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$2,006	$1,289
Accrued liabilities	4,322	4,189
Claims reserve	9,521	6,274
Deferred revenue	13,463	11,042
Deferred tax liabilities	251	169
Other payables	1,094	654
Total current liabilities	30,657	23,617
Long-term debt	4,767	—
Deferred tax liabilities	1,372	1,433
Other liabilities	834	511
Total liabilities	37,630	25,561
Stockholders' equity:		
Common stock, $0.00001 par value per share, 100,000,000 shares authorized at December 31, 2016 and 200,000,000 shares authorized at December 31, 2015, 30,156,247 and 29,498,947 shares issued and outstanding at December 31, 2016; 29,017,168 and 28,396,189 shares issued and outstanding at December 31, 2015.	—	—
Preferred stock: $0.00001 par value per share, 10,000,000 shares authorized at December 31, 2016 and December 31, 2015, and 0 shares issued and outstanding at December 31, 2016 and December 31, 2015.	—	—
Additional paid-in capital	129,574	122,844
Accumulated other comprehensive loss	(377)	(502)
Accumulated deficit	(81,281)	(74,385)
Treasury stock, at cost: 657,300 shares at December 31, 2016, and 620,979 shares at December 31, 2015.	(3,201)	(2,601)
Total stockholders' equity	44,715	45,356
Total liabilities and stockholders' equity	$82,345	$70,917

Trupanion, Inc.
Consolidated Statements of Changes in Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit)
(in thousands, except share amounts)

	Redeemable Convertible Preferred Stock		Common Stock		Special Voting Shares		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' (Deficit) Equity
	Shares	Amount	Shares	Amount	Shares	Amount					
Balance at December 31, 2013	14,857,989	31,722	2,236,641	—	2,247,130	—	5,769	(36,003)	(164)	(2,601)	(32,999)
Conversion of special voting shares to common stock	—	—	2,247,130	—	(2,247,130)	—	—	—	—	—	—
Conversion of preferred stock to common stock	(14,944,945)	(32,724)	14,944,945	—	—	—	32,724	—	—	—	32,724
Exercise of warrants	86,956	1,002	25,170	—	—	—	270	—	—	—	270
Proceeds from IPO, net of issuance costs	—	—	8,193,750	—	—	—	72,722	—	—	—	72,722
Reclassification of warrant liabilities	—	—	—	—	—	—	3,180	—	—	—	3,180
Issuance of common stock upon exercise of stock options and vesting of restricted stock units	—	—	183,305	—	—	—	181	—	—	—	181
Stock-based compensation expense	—	—	—	—	—	—	4,199	—	—	—	4,199
Other comprehensive income (loss)	—	—	—	—	—	—	—	—	175	—	175
Net loss	—	—	—	—	—	—	—	(21,177)	—	—	(21,177)
Balance at December 31, 2014	—	—	27,830,941	—	—	—	119,045	(57,180)	11	(2,601)	59,275
Issuance of restricted stock	—	—	4,616	—	—	—	—	—	—	—	—
Tax withholding on restricted stock	—	—	(72,197)	—	—	—	(643)	—	—	—	(643)
	—	—	632,829	—	—	—	1,335	—	—	—	1,335

Exercise of stock options											
Stock-based compensation expense	—	—	—	—	—	—	3,107	—	—	—	3,107
Other comprehensive income (loss)	—	—	—	—	—	—	—	—	(513)	—	(513)
Net loss	—	—	—	—	—	—	—	(17,205)	—	—	(17,205)
Balance at December 31, 2015	—	—	28,396,189	—	—	—	122,844	(74,385)	(502)	(2,601)	45,356
Issuance of restricted stock	—	—	2,511	—	—	—	—	—	—	—	—
Tax withholding on restricted stock	—	—	(42,798)	—	—	—	(662)	—	—	—	(662)
Exercise of stock options	—	—	1,119,367	—	—	—	3,745	—	—	—	3,745
Exercise of warrants	—	—	59,999	—	—	—	600	—	—	—	600
Purchase of treasury stock	—	—	(36,321)	—	—	—	—	—	—	(600)	(600)
Stock-based compensation expense	—	—	—	—	—	—	3,047	—	—	—	3,047
Other comprehensive income (loss)	—	—	—	—	—	—	—	—	125	—	125
Net loss	—	—	—	—	—	—	—	(6,896)	—	—	(6,896)
Balance at December 31, 2016	—	$ —	29,498,947	$	—	$ —	$129,574	$(81,281)	$ (377)	$(3,201)	$ 44,715

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Trupanion, Inc.
Consolidated Statements of Cash Flows
(in thousands)

	Years Ended December 31,		
	2016	2015	2014
Operating activities			
Net loss	$(6,896)	$(17,205)	$(21,177)
Adjustments to reconcile net loss to cash used in operating activities:			
Depreciation and amortization	3,846	2,542	1,674
Amortization of debt discount and prepaid loan fees	58	21	5,033
Warrant income	—	—	(1,574)
Stock-based compensation expense	2,946	3,002	4,084
Other, net	46	(89)	57
Changes in operating assets and liabilities:			
Accounts and other receivable	(1,830)	(328)	(126)
Prepaid expenses and other current assets	48	(905)	(369)
Accounts payable	652	(347)	449
Accrued liabilities	175	51	551
Claims reserve	3,226	1,241	(505)
Deferred revenue	2,398	1,779	877
Other payables	337	(187)	225
Net cash provided by (used in) operating activities	5,006	(10,425)	(10,801)
Investing activities			
Purchases of investment securities	(31,616)	(24,800)	(34,894)
Maturities of investment securities	27,247	20,180	28,601
Equity method investment	—	(300)	—
Purchases of property and equipment	(1,941)	(4,894)	(5,633)
Other	(198)	(109)	—
Net cash used in investing activities	(6,508)	(9,923)	(11,926)
Financing activities			
Tax withholding on restricted stock	(662)	(643)	—
Proceeds from exercise of stock options	3,745	1,335	211
Proceeds from (repayment of) debt financing	4,988	(14,900)	(15,000)
Payments on capital lease obligations	(204)	—	—
Other financing costs	(195)	—	(103)
Net proceeds from IPO	—	—	72,755
Net cash provided by (used in) financing activities	7,672	(14,208)	57,863
Effect of foreign exchange rates on cash, net	111	(586)	23
Net change in cash, cash equivalents, and restricted cash	6,281	(35,142)	35,159
Cash, cash equivalents, and restricted cash at beginning of period	17,956	53,098	17,939
Cash, cash equivalents, and restricted cash at end of period	$24,237	$17,956	$53,098
Supplemental disclosures			
Income taxes paid	19	139	9
Interest paid	153	155	1,494
Noncash investing and financing activities:			
Warrants issued in conjunction with debt issuance	—	—	1,124
Increase in payables for property and equipment	104	98	911
Cashless exercise of preferred stock warrants	—	—	1,270

Cashless exercise of common stock warrants	600	—	—
Common stock warrant reclassification to equity	—	—	3,180
Property and equipment acquired under capital lease	559	—	—

Trupanion, Inc.
Notes to Consolidated Financial Statements

1. Nature of Operations and Summary of Significant Accounting Policies
Description of Business
The Company provides medical insurance plans for cats and dogs throughout the United States, Canada and Puerto Rico. The Company's data-driven, vertically-integrated approach enables us to provide pet owners with what the Company believes is the highest value medical plan for their pets, priced specifically for each pet's unique characteristics. The Company strives to operate the 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.
Reclassifications
Certain prior year amounts have been reclassified within the Company's consolidated financial statements from their original presentation to conform to the current period presentation.

Principles of Consolidation
The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.
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 reported amounts of assets and liabilities and disclosure of contingencies and the reported amounts of revenue and expenses. Significant items subject to such estimates and assumptions include the valuation of deferred tax assets, stock-based compensation, claims reserve, useful lives of software developed for internal use, allowance for doubtful accounts, and income tax uncertainties. Actual results could differ from the estimates used in preparing the consolidated financial statements.
Cash, Cash Equivalents and Restricted Cash
Cash, cash equivalents and restricted cash totaled $24.2 million at December 31, 2016 and was comprised of $23.6 million cash and cash equivalents and $0.6 million restricted cash. There was no restricted cash as of December 31, 2015 and 2014.
The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. At times, cash on deposit may be in excess of the applicable federal deposit insurance corporation limits.
The Company considers any cash account that is restricted to withdrawal or use under the terms of certain financing agreements as restricted cash. Cash will be considered restricted for so long as the line of credit it relates to is open. Restricted cash pledged as collateral for its credit facility totaled $0.6 million at December 31, 2016.
Accounts and Other Receivable
Receivables are comprised of trade receivables and other miscellaneous receivables. As of December 31, 2016 and 2015, receivables included $8.0 million and $7.2 million, respectively, for one-year policies written by an unaffiliated general agent. Accounts and other receivable are carried at their estimated collectible amounts.
No single customer made up more than 5% of accounts receivable as of December 31, 2016 or 2015.

Deferred Acquisition Costs

The Company incurs certain costs related to the successful acquisition of new and renewal customer contracts, which are capitalized. These costs include premium taxes, fees and enrollment-based bonuses, and referral fees that directly relate to the successful acquisition of new or renewal customer contracts. Deferred acquisition costs are included in prepaid expenses and other assets on the consolidated balance sheet and are amortized over the related policy term to the applicable financial statement line item, including sales and marketing expenses and other cost of revenue. Total deferred acquisition costs for the years ended December 31, 2016, 2015 and 2014 are summarized below (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Deferred acquisition costs capitalized	$12,251	$10,184	$7,995
Deferred acquisition costs amortized:			
Sales and marketing	1,401	1,490	858
Other cost of revenue	10,743	8,606	7,052
Total amortization	12,144	10,096	7,910
Balance at December 31,	$664	$557	$469

Investments

The Company recognizes the following classifications of investments:

Short-term-investments—Investments with an initial maturity of less than one year are reported at amortized cost, which approximates fair value.

Available-for-Sale—Investments in fixed maturities not classified as short-term-investments are reported at fair value, and the temporary declines or increases from amortized cost are included as a component of other comprehensive income.

Available-for-sale securities are classified based upon the availability to be used in current operations.

Premiums and discounts on fixed maturity securities are amortized or accreted over the life of the security. Such amortization expense and accretion is included in interest income. Interest income is recognized in other income, net when earned.

A decline in the fair value of any available-for-sale security below amortized cost that is deemed to be other than temporary results in an impairment to reduce the amortized cost to fair value or recovery value. To determine whether an impairment is other than temporary, the Company considers its intent to sell the security, intent and ability to hold the security, as well as all available information relevant to the collectability of the security, including past events, current conditions, and reasonable and supportable forecasts, when developing estimates of cash flows expected to be collected. Realized capital gains and losses are determined on a specific identification basis and recorded as a part of other expense, net in the statement of operations.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from three to five years. Leasehold improvements are depreciated over the less of their expected useful life or the remaining term of the related lease. Fixed assets under capital lease are depreciated over the lesser of their expected useful life or the remaining term of the related lease.

Costs related to software developed for internal use are primarily related to the Company’s website, internal support systems, and proprietary billing and claims systems. Costs are capitalized during the application development stage of the project and depreciated on a straight-line basis over the estimated useful lives of the related assets, estimated to be three years, once the software is placed into service.

Intangible Assets

Indefinite-lived intangible assets, which are not amortized, are assessed for impairment at least annually and more frequently if circumstances indicate a possible impairment. The Company first performs a qualitative analysis to assess whether it is more likely than not the asset is impaired and, if necessary, a quantitative analysis is performed to measure impairment.

Assets with finite lives are amortized over their estimated remaining useful life.

Asset Impairment

Long-lived assets, such as property and equipment and definite-lived intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, the Company first compares undiscounted cash flows expected to be generated by the asset or asset group to its carrying amount. If the carrying amount of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, impairment is recognized to the extent that the carrying amount exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values, and third-party independent appraisals, as considered necessary.

Claims Reserve

The claims reserve includes unpaid claims and claims adjustment expenses, which includes an estimate, based on past experience, for claims incurred but not reported. Such liabilities are necessarily based on assumptions and estimates, and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in the period in which they become known.

Warrants

The Company issued warrants to purchase common or convertible preferred stock to third parties as a part of certain business and financing transactions. The Company values warrants using the Black-Scholes-Merton option-pricing model. Certain warrants were considered liability awards and were remeasured each reporting period until exercised, settled or reclassified to stockholders' equity. See Note 12 for additional information.

Revenue Recognition

The Company generates revenue primarily from subscription fees for its medical insurance plan and other policies the Company writes, which is earned pro rata over the terms of the customer contracts.

No single customer accounted for more than 5% of the Company's revenue in 2016, 2015 or 2014.

Claims Expense

Claims expenses include claims incurred, the cost of personnel administering the claims and providing member service relating to claims, and other operating expenses directly or indirectly related to claims administration.

Other Cost of Revenue

Other cost of revenue for the subscription business segment includes direct and indirect member service expenses, renewal fees, credit card transaction fees and premium tax expenses. Other cost of revenue for the other business segment includes the commission the Company pays to the unaffiliated general agent and premium taxes on other policies in this segment.

Sales and Marketing

Sales and marketing expenses consist of costs to educate veterinarians and policy holders about the Company's policy, converting leads to enrolled pets, print, online and promotional advertising costs and employee compensation and related costs.

Technology and Development

Technology and development expenses consist primarily of personnel costs and related expenses for the Company's operations staff, which includes information technology development and infrastructure support, third-party services and depreciation of hardware and capitalized software and amortization of intangible assets.

General and Administrative

General and administrative expenses consist primarily of personnel costs and related expenses for the Company's finance, actuarial, human resources, legal and general management functions, as well as facilities and professional services.

Other Income, Net

Other income, net was comprised of the following (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Interest income	$ (119)	$ (75)	$ (73)
Foreign exchange loss	—	36	41
Loss on disposal of fixed assets	24	20	111
Warrant remeasurement	—	—	(1,574)
Other	37	10	8
Other income, net	$ (58)	$ (9)	$ (1,487)

Insurance Operations

Effective January 1, 2015, the Company formed a segregated account in Bermuda as part of Wyndham Insurance Company (SAC) Limited (WICL), and entered into a revised fronting and reinsurance arrangement with Omega General Insurance Company (Omega) to include its newly formed segregated account. The Company maintains all risk with the business written in Canada and consolidates the entity in its financial statements. Contractual requirements restrict dividends from this entity until after 2016, at which time dividends will be allowed subject to the Segregated Accounts Company Act of 2000, which allows for dividends only to the extent that the entity 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.

For the Company’s Canadian business, all plans are written by Omega General Insurance Company (Omega) and the risk is assumed by the Company through a fronting and reinsurance agreement. Premiums are recognized and earned pro rata over the terms of the related customer contracts. Premiums recognized from the agreement in 2016, 2015 and 2014 were $36.5 million, $30.9 million and $29.1 million, respectively and deferred revenue relating to this arrangement at December 31, 2016 and 2015 was $1.3 million and $0.9 million, respectively. Reinsurance revenue was 19%, 21% and 25% of total revenue in 2016, 2015 and 2014, respectively. Cash designated for the purpose of paying claims related to this reinsurance agreement was $2.1 million and $2.0 million at December 31, 2016 and 2015, respectively. In addition, as required by the Office of the Superintendent of Financial institutions regulations related to the Company’s reinsurance agreement with Omega, the Company is required to fund 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, 2016, the Company was in compliance with all requirements.

The Company has not transferred any risk to third-party reinsurers.

In November 2012, the Company began writing one-year pet insurance policies for an unaffiliated general agent. Revenue during 2016, 2015 and 2014 totaled $10.8 million, $9.9 million and $10.0 million, respectively, and deferred revenue relating to this arrangement at December 31, 2016 and 2015 was $6.1 million and $5.5 million, respectively.

Advertising

Advertising costs are expensed as incurred, with the exception of television advertisements, which are expensed the first time each advertisement is aired. Advertising costs amounted to $4.0 million, $5.3 million and $3.2 million, in 2016, 2015 and 2014, respectively.

Stock-Based Compensation

The Company measures compensation expense for stock-based transactions to employees at fair value on the date of grant and recognizes such cost, on a straight-line basis over the requisite service period (generally four years) net of estimated forfeitures, except for the restricted stock with a performance condition which is measured on a graded vesting schedule. Many factors are considered when estimating forfeitures, including types of awards, employee class and historical experience. Stock options are valued using the Black-Scholes-Merton option-pricing model. The fair value of restricted stock units (RSUs) and restricted stock awards is based on the fair value of the Company’s stock on the date of the grant.

The Company measures compensation cost for stock-based compensation to non-employees at fair value and remeasures the award each period until the award vests.

Income Taxes

Income taxes are accounted for under the liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. Valuation allowances are provided for when it is considered more likely than not that deferred tax assets will not be realized.

The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than a 50% likelihood of being realized. Penalties and interest are classified as a component of income taxes.

Foreign Currency

The Company’s consolidated financial statements are reported in U.S. dollars. Assets and liabilities of international subsidiaries with non-U.S. dollar functional currencies are translated to U.S. dollars at the exchange rates in effect on the balance sheet date. Revenue and expenses for each subsidiary are translated to U.S. dollars using a weighted-average rate for the relevant reporting period. Translation adjustments resulting from this process are included in accumulated other comprehensive loss, and totaled $0.4 million, $0.4 million and $0.1 million as of December 31, 2016, 2015 and 2014, respectively. Gains and losses that arise from exchange rate fluctuations for monetary asset and liability balances that are not denominated in an entity’s functional currency are included within other income.

Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentration of credit risk consist primarily of cash and cash equivalents, investments and accounts receivable. The Company manages its risk by investing cash equivalents and investment securities in money market instruments and securities of the U.S. government, U.S. government agencies and high-credit-quality issuers of debt securities.

Credit risk with respect to accounts receivable is dispersed due to the large number of customers. In addition, the Company’s credit risk is mitigated by the relatively short collection period.

Accounting Pronouncements Adopted during Period

In May 2015, the FASB issued an ASU amending short-term insurance contract disclosures and requiring more detailed disclosures to enable users of financial statements to understand information relating to liabilities for unpaid claims and claims adjustment expenses. Additionally, the amendments will also require insurance entities to disclose information about significant changes in methodologies and assumptions used to calculate these liabilities. The Company adopted this ASU as of December 31, 2016 and has provided the required disclosures in Note 9.

In November 2016, the FASB issued an ASU which requires amounts determined to be restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. This ASU is effective for fiscal periods beginning after December 15, 2018 including interim periods within that reporting period, with early adoption permitted. The Company adopted this ASU as of December 31, 2016 and has retrospectively applied all provisions by providing comparative disclosures for each period presented.

Recent Accounting Pronouncements

In November 2015, the FASB issued an ASU amending the accounting for income taxes and requiring all deferred tax assets and liabilities to be classified as non-current on the consolidated balance sheet. The ASU is effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The ASU may be adopted either prospectively or retrospectively. The Company adopted this guidance retrospectively as of January 1, 2017. The Company anticipates that this guidance will not have a material impact on the financial statements resulting from the reclassification of deferred taxes to non-current.

In February 2016, the FASB issued an ASU amending the lease presentation guidance. The ASU requires organizations that lease assets to recognize the rights and obligations created by those leases on the balance sheet. 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. The Company has determined this guidance will require recognition of a lease liability and corresponding asset on the balance sheet equal to the present value of minimum lease payments. The carrying amount of the asset is derived from the amount of the lease liability at the end of each reporting period.

In March 2016, the FASB issued an ASU amending the accounting for employee share-based payments, including income tax recognition and classification. The entity may make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur. Additionally, tax withholding of shares will be allowed up to the employees' maximum individual tax rate in the relevant jurisdiction without resulting in liability classification of the award. Finally, under the new guidance, companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital on the balance sheet. Instead, companies will record all excess tax benefits and deficiencies as income tax expense or benefit in the income statement. This ASU is effective for fiscal years beginning after December 15, 2016 including interim periods within that reporting period, with early adoption permitted. The Company adopted this guidance as of January 1, 2017. The Company has determined the guidance for estimating forfeitures does not currently have a material impact to the financial statements. The guidance for tax withholding on RSU's may have a material impact on cash flow from financing activities to the extent individual employees elect to withhold shares at rates higher than the statutory minimum. The guidance related to the accounting for excess tax benefits and deficiencies will result in an initial adjustment as of January 1, 2017 to the Company's net operating loss deferred tax asset to eliminate the Company's existing APIC pool amounting to $4.3 million, which will be offset by an adjustment to the company's valuation allowance.

In August 2016, the FASB issued an ASU which addresses eight specific cash flow issues intended to reduce diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This ASU is effective for fiscal periods beginning after December 15, 2017 including interim periods within that reporting period, with early adoption permitted. The Company plans to adopt this guidance as of January 1, 2018. The Company is in the process of assessing the impact of this guidance.

2. Net Loss per Share

Basic net loss per share is calculated by dividing the net loss by the weighted-average number of shares of common stock outstanding for the period. Excluded from the weighted-average number of shares outstanding are shares that have been issued and are subject to future vesting and unvested restricted stock. Diluted net loss per share is calculated by dividing the net loss by the weighted-average number of common stock equivalents outstanding for the period determined using the treasury-stock method. Potentially dilutive common stock equivalents are comprised of unvested restricted stock, stock options and warrants. For all periods presented, there is no difference in the number of shares used to calculate basic and diluted shares outstanding due to the Company’s net loss position.

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

	As of December 31,		
	2016	2015	2014
Stock options	4,123,023	4,871,949	5,112,556
Restricted stock awards and units	352,996	472,384	592,625
Warrants	810,000	869,999	869,999

3. Property and Equipment, Net

Property and equipment, along with their useful lives, were as follows for the years ended December 31, 2016 and 2015 (in thousands):

	Years Ended December 31,					
	2016			2015		
Office and telephone equipment (5 years)	$	129		$	127	
PC and networking hardware (3–4 years)	1,191			1,177		
Software (3–5 years)	14,340			12,547		
Furniture and fixtures (5 years)	618			711		
Vehicles (5 years)	54			54		
Fixed assets under capital lease (over less of expected useful life or life of lease)	478			—		
Leasehold improvement (over less of expected useful life or life of lease)	—			621		
Property and equipment	16,810			15,237		
Accumulated depreciation	(8,346		)	(5,518		)
Property and equipment, net	$	8,464		$	9,719	

Depreciation expense for property and equipment was $3.8 million, $2.5 million and $1.6 million for 2016, 2015 and 2014, respectively.

The Company capitalized interest of $0.2 million in 2016, 2015 and 2014 related to software developed for internal use.

4. Intangible Assets

The Company acquired an insurance company in 2007, which originally included licenses in 23 states. These licenses were valued at $4.8 million. The Company is currently licensed in all 50 states, the District of Columbia and Puerto Rico. Most licenses are renewed annually upon payment of various fees assessed by the issuing state. Renewal costs are expensed as incurred. This is considered an indefinite-lived intangible asset given the planned renewal of the certificates of authority and applicable licenses for the foreseeable future. No impairments have been recorded on this asset as of December 31, 2016.

5. Investment Securities

The amortized cost, gross unrealized holding losses, and fair value of available-for-sale and short-term investments by major security type and class of security were as follows as of December 31, 2016 and 2015 (in thousands):

	Amortized Cost	Gross Unrealized Holding Losses	Fair Value
As of December 31, 2016			
Available-for-sale:			
Foreign deposits	$ 1,587	$ —	$1,587
Municipal bond	1,000	(8)	$992
	$ 2,587	$ (8)	$2,579
Short-term investments:			
U.S. Treasury securities	$ 5,791	$ —	$5,791
Certificates of deposit	707	—	707
U.S. government funds	23,072	—	23,072
	$ 29,570	$ —	$29,570

	Amortized Cost	Gross Unrealized Holding Losses	Fair Value
As of December 31, 2015			
Available-for-sale:			
Foreign deposits	$ 1,442	$ —	$1,442
Municipal bond	1,000	(54)	946
	$ 2,442	$ (54)	$2,388
Short-term investments:			
U.S. Treasury securities	$ 5,683	$ —	$5,683
Certificates of deposit	1,551	—	$1,551
U.S. government funds	18,054	—	$18,054
	$ 25,288	$ —	$25,288

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

	December 31, 2016	
	Amortized Cost	Fair Value
Available-for-sale:		
Due under one year	$—	$—
Due after one year through five years	1,587	1,587

Due after five years through ten years	1,000	992
Due after ten years	—	—
	$2,587	$2,579

The Company had one investment with an unrealized loss of less than $0.1 million and a fair value of $1.0 million at December 31, 2016 and an unrealized loss of $0.1 million and a fair value of $0.9 million at December 31, 2015. This investment has been in an unrealized loss position for more than 12 months. The Company assessed the bond for credit impairment and determined that there is no intent to sell this bond and it is likely that it will hold the investment for a period of time sufficient to allow for recovery. Furthermore, future payments on this bond are insured by a financial guarantee insurer. Therefore, the Company believes that the unrealized loss on this bond constitutes a temporary impairment.

6. Fair Value

The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible.

When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.
- Level 2 inputs: Valuations based on observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.
- Level 3 inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date.

The following table presents the placement in the fair value hierarchy of assets and liabilities that are measured at fair value on a recurring basis (in thousands):

	As of December 31, 2016			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	$600	$600	$ —	$ —
Foreign deposits	1,587	1,587	—	—
Municipal bond	992	—	992	—
Money market funds	7,033	7,033	—	—
Total	$10,212	$9,220	$ 992	$ —

	As of December 31, 2015			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Foreign deposits	$1,442	$1,442	$ —	$ —
Municipal bond	946	—	946	—
Money market funds	7,545	7,545	—	—
Total	$9,933	$8,987	$ 946	$ —

Long-term investments classified as available-for-sale are measured using quoted market prices when quoted market prices are available. If quoted market prices in active markets for identical assets are not available to determine fair value, then the Company uses quoted prices of similar instruments and other significant inputs derived from observable market data obtained from third-party data providers. Short-term investments are carried at amortized cost and the fair value is disclosed in Note 3. Fair value is determined in the same manner as available-for-sale securities and is considered a Level 1 measurement.

The Company estimates fair value for 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 December 31, 2016.

The Company's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers between levels for the twelve months ended December 31, 2016 and 2015.

7. Equity Method Investments

During 2015, the Company invested $0.3 million in a software development company in exchange for 300,000 units of Series A preferred stock resulting in a 13% equity interest. This agreement was amended and restated on September 12, 2016 to increase Series A preferred stock from 300,000 units to 750,000 units resulting in a 20% equity interest. The Company's equity interest is accounted for under the equity method as the Company has the ability to exert significant influence. The equity method investment balance is adjusted each period on a one quarter lag to recognize the proportionate share of net income or loss, including adjustments to recognize certain differences between the carrying value and the equity in net assets.

8. Commitments and Contingencies

During the third quarter of 2015, the Company entered into a lease agreement for a building located in Seattle, Washington. The initial 10-year term of the lease commenced in the third quarter of 2016.

The Company has operating leases, related to equipment and office facilities, which expire over the next three years with various renewal options. Minimum rent payments under operating leases are recognized on a straight-line basis over the term of the lease. Rental expense for operating leases was $1.2 million, $1.0 million and $0.8 million during 2016, 2015 and 2014, respectively.

Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of December 31, 2016, are as follows (in thousands):

Year ending December 31:	
2017	$1,510
2018	1,860
2019	2,020
2020	2,101
2021	2,182
Thereafter	11,029
Total minimum lease payments	$20,702

The Company has entered into agreements for strategic marketing initiatives, as well as with independent contractors to provide services for a period of time. Future commitments related to these contracts are as follows (in thousands):

Year ending December 31:	
2017	$3,624
2018	1,681
2019	764
2020	119
2021	17
Thereafter	—
Total minimum commitment	$6,205

During 2016, the Company entered into a capital lease agreement. As of December 31, 2016, this agreement resulted in an increase in future commitments of $0.4 million for 2017 and $0.2 million in 2018.

From time to time, the Company may be subject to various legal proceedings and claims in the ordinary course of business activities, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights; employment claims; coverage disputes with policyholders; and general contract or other claims. The Company may, from time to time, also be subject to various other legal or government claims, disputes or investigations.

The outcomes of the Company's legal proceedings are inherently unpredictable, subject to significant uncertainties, and could be material to the Company's operating results and cash flows for a particular period. The Company makes a provision for a liability relating to legal matters when it is both probable that a liability beyond previously accrued amounts has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter.

9. Claims Reserve

The Company provides a reserve for claims incurred but not reported (IBNR). This liability is primarily based on, but not limited to, patterns of claims being paid, patterns of claims being received, seasonality patterns and historical experience. As the Company grows, the IBNR claim liability is expected to increase. Additionally, if expected claims paying completion patterns extend, the IBNR claim liability further increases. The Company reviews estimates for reported but unpaid claims and IBNR claims quarterly. Any necessary adjustments are reflected in earnings.

The Company has two segments: subscription business and other business. The subscription business segment includes monthly subscriptions related to the Company's medical plan which are marketed directly to consumers, while the other business segment includes all other business that is not directly marketed to consumers.

Claims Reserve

Activity in the subscription business claims reserve is summarized as follows (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Claims reserve at beginning of year - subscription business	$ 5,384	$ 4,278	$ 4,573
Claims incurred during the year related to:			
Current year - subscription business	123,823	95,390	74,471
Prior years - subscription business	813	30	(132)
Total claims incurred	124,636	95,420	74,339
Claims paid during year related to:			
Current year - subscription business	115,314	89,768	69,956
Prior years - subscription business	5,832	4,239	4,442
Total claims paid	121,146	94,007	74,398
Non-cash claims expense - subscription business	336	307	236
Claims reserve at end of year - subscription business	$ 8,538	$ 5,384	$ 4,278

The increase in subscription business claims for prior years in the years ended December 31, 2016 and December 31, 2015 is primarily due to more claims incurred than expected relating to prior year claims. The decrease in subscription business claims for prior years in the year ended December 31, 2014 is primarily due to less incurred claims than expected relating to prior year claims.

Activity in the other business claims reserve is summarized as follows (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Claims reserve at beginning of year - other business	$ 890	$ 829	$ 1,039
Claims incurred during the year related to:			
Current year - other business	9,027	7,983	5,967
Prior years - other business	(129)	(79)	(393)
Total claims incurred	8,898	7,904	5,574
Claims paid during year related to:			
Current year - other business	8,048	7,095	5,138
Prior years - other business	757	748	646
Total claims paid	8,805	7,843	5,784
Non-cash claims expense - other business	—	—	—
Claims reserve at end of year - other business	$ 983	$ 890	$ 829

The decrease in other business claims for prior years in the years ended December 31, 2016, December 31, 2015 and December 31, 2014 is primarily due to less claims incurred than expected relating to prior year claims.

Incurred claims and claim adjustment expenses

The Company measures claims frequency using individual claims submissions at the claim event level. A certain claim event may result in multiple reported claims if it involves multiple visits to the veterinarian resulting in multiple invoices. At the end of each reporting period, the cumulative number of claims reported includes all claims submitted (excluding those included in the reserve for incurred but not reported claims), regardless of whether it resulted in an incurred loss. The following table summarizes the activity for incurred claims and claim adjustment expenses for the Company's subscription business segment (in thousands, except for cumulative number of claims data; includes non-cash expenses incurred during the period).

	Years Ended December 31,				As of December 31, 2016	
	Incurred claims and claim adjustment expenses					
Year Incurred	2013	2014	2015	2016	Total of IBNR plus expected development on reported claims	Cumulative number of reported claims
	(unaudited)	(unaudited)	(unaudited)			
2013	$49,595	$ 49,475	$ 49,593	$49,629	$8	269,849
2014		$ 71,008	$ 70,954	$71,118	$71	377,083
2015			$ 94,354	$94,908	$286	469,815
2016				$123,478	$8,173	538,427
				$339,133		

The following table summarizes the activity for incurred claims and claim adjustment expenses for the Company's other business segment (in thousands, except for cumulative number of claims data; includes non-cash expenses incurred during the period):

	Years Ended December 31,				As of December 31, 2016	
	Incurred claims and claim adjustment expenses					
Year Incurred	2013	2014	2015	2016	Total of IBNR plus expected development on reported claims	Cumulative number of reported claims
	(unaudited)	(unaudited)	(unaudited)			
2013	$3,294	$ 2,841	$ 2,849	$2,849	$—	18,169
2014		$ 5,966	$ 5,888	$5,887	$1	34,535
2015			$ 7,973	$7,845	$3	46,713
2016				$9,027	$979	53,723
				$25,608		

Cumulative paid claims and claim adjustment expenses

The following table summarizes the activity for cumulative claims paid and claim adjustment expenses (CAE) for the Company's subscription business segment (in thousands; includes non-cash expenses incurred during the period):

	Years Ended December 31,			
Year Incurred	2013	2014	2015	2016
	(unaudited)	(unaudited)	(unaudited)	
2013	$45,276	$ 49,475	$ 49,593	$49,621
2014		$ 66,845	$ 70,885	$71,047
2015			$ 89,012	$94,622
2016				$115,305
Total				$330,595
Total outstanding liabilities for unpaid claims and CAE				$8,538

The following table summarizes the activity for cumulative claims paid and claim adjustment expenses for the Company's other business segment (in thousands; includes non-cash expenses incurred during the period):

	Years Ended December 31,			
Year Incurred	2013	2014	2015	2016
	(unaudited)	(unaudited)	(unaudited)	
2013	$2,196	$ 2,841	$ 2,849	$2,850
2014		$ 5,137	$ 5,886	$5,886
2015			$ 7,085	$7,841
2016				$8,048
Total				$24,625
Total outstanding liabilities for unpaid claims and CAE				$983

10. Debt

The Company has a revolving line of credit with a bank, which is secured by any and all interest the Company has in assets that are not otherwise restricted. On December 16, 2016, the Company replaced its previous line of credit agreement and entered into a syndicated loan agreement with Pacific Western Bank and Western Alliance Bank increasing its facility from $20.0 million to $30.0 million. The revolving line of credit bore a variable interest rate as of December 31, 2016 equal to the greater of 4.5% or 1.25% plus the prime rate, and as of December 31, 2015 equal to the greater of 5.0% or 1.5% plus the prime rate. Interest expense is due monthly on the outstanding principal amount with all amounts outstanding under the revolving line of credit due upon maturity in December 2018, or December 2019 if the revolving line of credit is renewed. The revolving line of credit automatically renews January 2018 unless canceled by the bank. The credit agreement requires the Company to comply with various financial and non-financial covenants. As of December 31, 2016 and December 31, 2015, the Company was in compliance with all covenants. This facility had a requirement that $0.6 million be held as restricted cash with the bank as of December 31, 2016. This facility also had a compensating balance requirement of $0.5 million as of December 31, 2016 and December 31, 2015.

Borrowings on the revolving line of credit were limited to the lesser of $30.0 million in 2016 and $20.0 million in 2015, and the total amount of cash and securities held by the Company's insurance subsidiaries (APIC and WICL), less up to $3.0 million, for obligations the Company may have outstanding for other ancillary services in the future. As of December 31, 2016, the Company's outstanding borrowings under this facility were $5.0 million. During 2015, the Company repaid its borrowings under this facility, and as of December 31, 2015, the Company had no outstanding borrowings under this facility.

The Company entered into a lease agreement during 2015 which required the Company to issue a security deposit in the form of an irrevocable standby letter of credit totaling $1.1 million which expires in August 2017 and renews annually thereafter. This amount reduces the Company’s available revolving line of credit. As of December 31, 2016 and 2015, the Company had $21.6 million and $18.4 million, respectively, available under its revolving line of credit.

Interest expense during 2016, 2015 and 2014 related to all loans was \$0.2 million, \$0.3 million and \$6.7 million, respectively.

11. Stock-Based Compensation

In June 2014, the Company’s Board of Directors adopted the 2014 Equity Incentive Plan (2014 Plan), which succeeded the 2007 Equity Compensation Plan upon the Company’s IPO. The 2014 Plan authorizes the award of stock options or restricted stock to directors, officers, employees, and non-employees. All awards have 10-year contractual terms. At December 31, 2016, there were 3,901,594 additional shares available for the Company to grant under the 2014 Plan.
Stock Options
The grant date fair value of stock option awards are estimated on the date of grant using the Black-Scholes-Merton option-pricing model. Valuation assumptions for the years ended December 31, 2016, 2015 and 2014 are presented in the following table:

	Years Ended December 31,		
	2016	2015	2014
Valuation assumptions:			
Expected term (in years)	5.04-6.25	3.0-6.25	6.25
Expected volatility	37.6%-42.1%	37.2%–49.4%	54.3%–59.3%
Risk-free interest rate	1.1%-2.0%	1.1%–2.0%	1.8%–2.0%
Expected dividend yield	—%	—%	—%

Expected term: The expected term represents the period that the Company’s stock-based awards are expected to be outstanding. As the Company does not have sufficient historical experience for determining the expected term of stock-based awards granted, the expected term for awards issued to employees is based on the simplified method, which represents the average period from vesting to the expiration of the stock option.
Expected volatility: As the Company does not have significant trading history for common stock, the expected stock price volatility for common stock is estimated by taking the average historical price volatility for identified peers based on daily price observations over a period equivalent to the expected term of the stock option grants. The Company does not rely on implied volatilities of traded options in identified peers’ common stock because the volume of activity is relatively low. The Company intends to continue to consistently apply this process using these or similar public companies until a sufficient amount of historical information regarding the volatility of the Company’s common stock price becomes available.
Risk-free interest rate: The risk-free interest rate for the expected term of the stock option is based on the U.S. Treasury yield curve at the date of grant.
Expected dividend yield: The Company does not expect to pay any dividends in the foreseeable future.

Stock option activity for the years ended December 31, 2016, 2015 and 2014 was as follows:

	Number of Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
December 31, 2013	4,663,445	2.12	30,406
Granted	754,200	9.64	—
Exercised	(176,595)	1.20	1,428
Forfeited	(128,494)	5.40	—
December 31, 2014	5,112,556	3.19	21,116
Granted	698,764	7.84	—
Exercised	(632,829)	2.12	3,703
Forfeited	(306,542)	7.65	—
December 31, 2015	4,871,949	3.71	29,644
Granted	666,664	13.37	—
Exercised	(1,119,367)	3.35	11,980
Forfeited	(296,223)	8.14	—
December 31, 2016	4,123,023	5.06	43,185
Vested and exercisable at December 31, 2016	3,119,438	$ 3.06	$ 38,856

As of December 31, 2016, stock options outstanding had a weighted average remaining contractual life of 5.7 years and vested and exercisable options had a weighted average remaining contractual life of 4.6 years.

The weighted-average grant date fair value of stock options granted and the fair value of options vested were as follows for the years ending December 31, 2016, 2015, and 2014:

	Weighted-Average Grant Date Fair Value	Fair Value of Options Vested
	(per share)	(in thousands)
Year:		
2014	$ 5.33	$ 2,203
2015	$ 3.46	$ 3,796
2016	$ 5.64	$ 6,688

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Restricted Stock Awards and Restricted Stock Units

The below table summarizes the Company's restricted stock award activity for the years ending December 31, 2016, 2015 and 2014:

	Number of Shares	Weighted-Average Grant Date Fair Value Per Restricted Stock
Nonvested stock award balance at December 31, 2013	722,226	$ 4.77
Restricted stock awards granted	6,126	5.79
Awards upon which restrictions lapsed	(143,967)	4.81
Restricted stock awards forfeited	—	—
Nonvested stock award balance at December 31, 2014	584,385	4.77
Restricted stock awards granted	2,385	7.26
Awards upon which restrictions lapsed	(119,262)	4.80
Restricted stock awards forfeited	—	—
Nonvested stock award balance at December 31, 2015	467,508	4.77
Restricted stock awards granted	—	—
Awards upon which restrictions lapsed	(116,877)	4.77
Restricted stock awards forfeited	—	—
Nonvested stock award balance at December 31, 2016	350,631	4.77

During the third quarters of 2016, 2015 and 2014, 116,877 shares of restricted stock, which were subject to a performance condition relating to the Company's IPO, vested and resulted in $0.5 million, $0.9 million and $1.6 million of expense, respectively, included in general and administrative expense in the consolidated statement of operations. The fair value of these vested shares was approximately $1.8 million, $0.9 million and $1.2 million, respectively. The remaining 350,631 shares of unvested restricted stock related to this agreement are expected to vest over the remaining service term of approximately 3.0 years.

Stock-based compensation expense includes stock options, restricted stock units and restricted stock awards granted to employees and non-employees, and is reported in the Company's consolidated statement of operations in claims expenses, other cost of revenue, sales and marketing, technology and development, and general and administrative expenses depending on the function performed by the employee or non-employee. Stock-based compensation expense recognized in each category of the consolidated statement of operations for the years ended December 31, 2016, 2015 and 2014 was as follows (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Claims expenses	$234	$219	$236
Other cost of revenue	41	44	79
Sales and marketing	532	446	553
Technology and development	246	404	461
General and administrative	1,893	1,889	2,755
Total stock-based compensation	$2,946	$3,002	$4,084

As of December 31, 2016, the Company had unrecognized stock-based compensation expense of $5.2 million, which is expected to vest over a weighted-average period of approximately 2.7 years. As of December 31, 2016, the Company had 953,406 unvested stock options and 352,996 restricted stock awards and units that are expected to vest. No net tax benefits related to the stock-based compensation costs have been recognized since the Company's inception.

12. Stockholders' Equity

On July 23, 2014 the Company completed an IPO pursuant to which 8,193,750 shares of common stock were sold to the public at a price of $10.00 per share. The Company received net proceeds of approximately $72.8 million from the IPO. Upon the closing of the IPO, all shares of outstanding convertible preferred stock and exchangeable shares automatically converted into 14,944,945 and 2,247,130 shares of common stock, respectively. If this transaction had taken place on January 1, 2014, the Company's weighted-average shares outstanding for the twelve months ended December 31, 2014 would have been 27,067,167.

As of December 31, 2016, the Company had 100,000,000 shares of common stock authorized and 29,498,947 shares of common stock outstanding. Holders of common stock are entitled to one vote on each matter properly submitted to the stockholders of the Company except those related to matters concerning possible outstanding preferred stock. At December 31, 2016, the Company had 10,000,000 shares of undesignated shares of preferred stock authorized for future issuance and did not have any outstanding shares of preferred stock. The holders of common stock are also entitled to receive dividends as and when declared by the board of directors of the Company, whenever funds are legally available. These rights are subordinate to the dividend rights of holders of all classes of stock outstanding at the time. The Company is unable to pay dividends to stockholders as of December 31, 2016 due to restrictions in its credit agreements.

Warrants

At December 31, 2016 and 2015, the Company had warrants to purchase 810,000 shares and 869,999 shares of common stock, respectively, at $10.00 per share, which begin to expire in 2018. At the end of each reporting period prior to the July 23, 2014, warrants were subject to contractual modification provisions and the Company adjusted the fair value of the warrants. For periods subsequent to July 23, 2014, these warrants were no longer subject to contractual modification provisions and were reclassified from a liability classification to an equity classification on the consolidated balance sheet.

13. Segments

The Company has two segments: subscription business and other business. The subscription business segment includes monthly subscriptions related to the Company's medical plan which are 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):

	Years Ended December 31,		
	2016	2015	2014
Revenue:			
Subscription business	$173,356	$133,406	$103,502
Other business	14,874	13,557	12,408
	188,230	146,963	115,910
Claims expenses:			
Subscription business	124,636	95,420	74,206
Other business	8,898	7,904	5,707
	133,534	103,324	79,913
Other cost of revenue:			
Subscription business	16,685	14,008	10,963
Other business	4,723	4,402	5,160
	21,408	18,410	16,123
Gross profit:			
Subscription business	32,035	23,978	18,333
Other business	1,253	1,251	1,541
	33,288	25,229	19,874
Sales and marketing:			
Subscription business	15,029	15,151	11,484
Other business	218	80	124
	15,247	15,231	11,608
Technology and development	9,534	11,215	9,899
General and administrative	15,205	15,558	14,312
Operating loss	$(6,698)	$(16,775)	$(15,945)

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

	Years Ended December 31,		
	2016	2015	2014
United States	$151,361	$116,585	$86,494
Canada	36,869	30,378	29,416
Total revenue	$188,230	$146,963	$115,910

Substantially all of the Company's long-lived assets were located in the United States as of December 31, 2016 and 2015.

14. Dividend Restrictions and Statutory Surplus

The Company’s business operations are conducted through subsidiaries, one of which is an insurance company domiciled in New York, and one which is a segregated cell business, Wyndham Segregated Account AX, located in Bermuda. In addition to general state law restrictions on payments of dividends and other distributions to stockholders applicable to all corporations, insurance companies are subject to further regulations that, among other things, may require such companies to maintain certain levels of equity and restrict the amount of dividends and other distributions that may be paid to their parent corporations.

Under regulatory requirements at December 31, 2016, the amount of dividends that may be paid by the Company’s insurance subsidiary in New York to the Company without prior approval by regulatory authorities was $0.1 million. During 2016, 2015 and 2014, the Company’s insurance subsidiaries did not pay any dividends to the Company. Subsequent to December 31, 2016, the Company received a dividend of $2.7 million from Wyndham Insurance Company (SAC) Limited (WICL) Segregated Account AX as allowed under the Company's agreements with WICL. The statutory net income for 2016, 2015 and 2014 and statutory capital and surplus at December 31, 2016, 2015 and 2014, for the Company’s insurance subsidiary were as follows (in thousands):

	As of December 31,		
	2016	2015	2014
Statutory net income	$4,081	$1,386	$ 990
Statutory capital and surplus	30,451	26,068	23,661

As of December 31, 2016, the Company’s insurance subsidiary (American Pet Insurance Company) maintained $30.5 million of statutory capital and surplus which was above the required amount of $25.8 million of statutory capital and surplus to avoid additional regulatory oversight. As of December 31, 2016 and 2015, the Company had $6.5 million on deposit with various states in which it writes policies.

15. Related Parties

The Company is party to arrangements with the father of the Company’s Chief Executive Officer, who serves as an independent contractor to develop veterinary relationships and build referrals. The terms of the independent contractor agreement are consistent with the terms of other similar independent contractors that do business with the Company. Total amounts paid to the related party were less than $0.1 million, $0.3 million and $0.3 million in 2016, 2015 and 2014, respectively.

16. Income Taxes

Loss before income taxes was as follows for the years ended December 31, 2016, 2015 and 2014 (in thousands):

	Years Ended December 31,		
	2016	2015	2014
United States	$(6,906)	$(17,222)	$(21,371)
Foreign	48	131	187
	$(6,858)	$(17,091)	$(21,184)

The components of income tax expense (benefit) were as follows (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Current:			
U.S. federal & state	$ 25	$ 31	$ 26
Foreign	13	84	(30)
	38	115	(4)
Deferred:			
U.S. federal & state	—	—	—
Foreign	—	(1)	(3)
	—	(1)	(3)
Income tax expense (benefit)	$ 38	$ 114	$ (7)

A reconciliation of income tax expense at the statutory federal income tax rate and income taxes as reflected in the financial statements is presented below:

	Years Ended December 31,		
	2016	2015	2014
Federal income taxes at statutory rate	34.0 %	34.0 %	34.0 %
Equity compensation	7.7	(1.2)	(0.9)
Change in valuation allowance	(41.1)	(34.9)	(32.5)
Other, net	(1.2)	1.4	(0.5)
Effective income tax rate	(0.6)%	(0.7)%	0.1 %

The principal components of the Company's deferred tax assets and liabilities were as follows (in thousands):

	Years Ended December 31,	
	2016	2015
Deferred tax assets:		
Current:		
Unearned premium reserves	$ 918	$ 745
Loss reserves	27	167
Other	782	690
Noncurrent:		
Net operating loss carryforwards	22,632	20,514
Depreciation and amortization	535	451
Equity compensation	1,137	713
Other	156	96
Total deferred tax assets	26,187	23,376
Deferred tax liabilities:		
Current:		
Deferred costs	(226)	(189)
Noncurrent:		
Intangible assets	(1,623)	(1,623)
Other	(77)	(72)
Total deferred tax liabilities	(1,926)	(1,884)
Total deferred taxes	24,261	21,492
Less deferred tax asset valuation allowance	(25,879)	(23,110)

Net deferred taxes	$ (1,618)	$ (1,618)

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At December 31, 2016, the Company had federal net operating loss carryforwards of $79.0 million. Use of the carryforwards is limited based on the future income of the Company. The federal net operating loss carryforwards will begin to expire in 2027. Approximately $12.7 million of the net operating loss (NOL) carryforwards relate to tax deductible stock-based compensation in excess of amounts recognized for financial statement purposes. Pursuant to Sections 382 and 383 of the Internal Revenue Code, annual use of the Company’s net operating loss carryforwards and credit carryforwards may be limited if the Company experiences an ownership change. As of December 31, 2016, the utilization of approximately $0.5 million of net operating losses are subject to limitation as a result of prior ownership changes; however, subsequent ownership changes may further affect the limitation in future years.

A valuation allowance is required to reduce the deferred tax assets reported if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all the evidence, both positive and negative, the Company has recorded a full valuation allowance against its deferred tax assets at December 31, 2016 and 2015, because the Company’s management has determined that it is more likely than not that these assets will not be fully realized.

The Company is open to examination by the U.S. federal tax jurisdiction for the years ended December 31, 2013 through 2016. The Company is also open to examination for 2007 and forward with respect to net operating loss carryforwards generated and carried forward from those years in the United States. The Company is open to examination by the Canada Revenue Agency for the years ended December 31, 2012 through 2016 for all corporate tax matters, and open for the years ended December 31, 2009 through 2016 for transactions with non-arm’s length non-Canadian residents.

The Company accounts for uncertain tax positions based on a two-step process of evaluating recognition and measurement criteria. The first step assesses whether the tax position is more likely than not to be sustained upon examination by the taxing authority, including resolution of any appeals or litigation, on the basis of the technical merits of the position. If the tax position meets the more-likely-than-not criteria, the portion of the tax benefit greater than 50% likely to be realized upon settlement with the relevant tax authority is recognized in the financial statements. Net unrecognized tax benefits, interest, and penalties not expected to be settled within one year are included in other long-term liabilities on the consolidated balance sheets. No significant changes in uncertain tax positions are expected in the next twelve months.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits is as follows (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Balance, beginning of year	$80	$ 65	$390
Decreases to tax positions related to prior periods	—	—	(346)
Increases to tax positions related to the current year	40	15	21
Balance, end of year	$120	$ 80	$65

17. Employee Benefits

The Company has a 401(k) plan for its U.S. employees. The plan allows employees to contribute a percentage of their pretax earnings annually, subject to limitations imposed by the Internal Revenue Service. The plan also allows the Company to make a matching contribution, subject to certain limitations. To date, the Company has made no contributions to the 401(k) plan.

18. Quarterly Financial Information (Unaudited)

The following table contains selected unaudited financial data for each quarter of 2016 and 2015. The unaudited information should be read in conjunction with the Company's financial statements and related notes included elsewhere in this report. The Company believes that the following unaudited information reflects all normal recurring adjustments necessary for a fair presentation of the information for the periods presented. The operating results for any quarter are not necessarily indicative of results for any future period.

	Three Months Ended							
	Dec. 31, 2016	Sept. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands, except share amounts)							
Total revenues	$ 51,340	$ 48,359	$ 45,832	$ 42,699	$ 40,201	$ 37,865	$ 35,587	$ 33,310
Gross profit	9,218	8,500	8,266	7,304	7,270	6,591	5,786	5,582
Net loss	(1,723)	(1,637)	(964)	(2,572)	(3,001)	(4,643)	(4,625)	(4,936)
Net loss per share attributable to common stockholders:								
Basic and diluted	(0.06)	(0.06)	(0.03)	(0.09)	(0.11)	(0.17)	(0.17)	(0.18)
Weighted average shares used to compute net loss per share attributable to common stockholders:								
Basic and diluted	29,020,559	28,732,417	28,348,348	27,999,248	27,856,450	27,755,310	27,597,721	27,337,302

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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 Annual Report on Form 10-K. 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.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined under Rule 13a-15(f) and 15d-15(f) under the Exchange Act. Management has assessed the effectiveness of its internal control over financial reporting as of December 31, 2016 based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework). As a result of this assessment, management concluded that, as of December 31, 2016, its internal control over financial reporting was effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

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 quarter ended December 31, 2016 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.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information required by this Item is incorporated herein by reference to our Proxy Statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the end of the fiscal year covered by this Annual Report.

Item 11. Executive Compensation

Information required by this Item is incorporated herein by reference to our Proxy Statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the end of the fiscal year covered by this Annual Report.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required by this Item is incorporated herein by reference to our Proxy Statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the end of the fiscal year covered by this Annual Report.

Item 13. Certain Relationships and Related Transactions and Director Independence

Information required by this Item is incorporated herein by reference to our Proxy Statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the end of the fiscal year covered by this Annual Report.

Item 14. Principal Accountant Fees and Services

Information required by this Item is incorporated herein by reference to our Proxy Statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements

We have filed the financial statements listed in the Index to Financial Statements as a part of this Annual Report on Form 10-K.

(a)(2) Financial Statement Schedules

Schedule I Condensed Financial Information of Registrant

No other financial statement schedules have been provided because the information called for is not required or is shown either in the financial statements or notes thereto.

(a)(3) Exhibits

The list of exhibits included in the Exhibit Index to this Annual Report on Form 10-K is incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of Seattle, state of Washington, on this 15th day of February, 2017.

TRUPANION, INC.

By: /s/ Darryl Rawlings
Darryl Rawlings
Chief Executive Officer and President

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints Darryl Rawlings, Tricia Plouf and Asher Bearman, and each of them, as his or her true and lawful attorneys-in-fact, proxies and agents, each with full power of substitution, for him or her in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact, proxies and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully for all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact, proxies and agents, or their or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: February 15, 2017	/s/ Darryl Rawlings Darryl Rawlings Chief Executive Officer and President (Principal Executive Officer)
Date: February 15, 2017	/s/ Tricia Plouf Tricia Plouf Chief Financial Officer(Principal Financial and Accounting Officer)
Date: February 15, 2017	/s/ Murray Low Murray Low Chairman of the Board of Directors
Date: February 15, 2017	/s/ Chad Cohen Chad Cohen Director
Date: February 15, 2017	/s/ Michael Doak Michael Doak Director
Date: February 15, 2017	/s/ Robin Ferracone Robin Ferracone Director
Date: February 15, 2017	/s/ Dan Levitan Dan Levitan Director
Date: February 15, 2017	/s/ H. Hays Lindsley H. Hays Lindsley Director
Date: February 15, 2017	/s/ Glenn Novotny Glenn Novotny Director
Date: February 15, 2017	/s/ Howard Rubin Howard Rubin Director

EXHIBIT INDEX

The following exhibits are filed as part of this Annual Report on Form 10-K or are incorporated herein by reference. Where an exhibit is incorporated by reference, the number in parentheses indicates the document to which cross-reference is made. See the end of this exhibit index for a listing of cross-reference documents.

Exhibit		Incorporated by Reference				Filed/Furnished
Number	Exhibit Description	Form	File No.	Exhibit	Exhibit Filing Date	Herewith
3.1	Restated Certificate of Incorporation of the Registrant.	10-Q	001-36537	3.1	8/28/2014	
3.2	Certificate of Amendment to the Restated Certificated of Incorporation of Trupanion Inc.	8-K	001-36537	3.1	6/3/2016	
3.3	Restated Bylaws of the Registrant.	10-Q	001-36537	3.2	8/28/2014	
4.1	Form of Common Stock Certificate.	S-1	333-196814	4.1	6/16/2014	
4.2	Third Amended and Restated Registration Rights Agreement, dated October 25, 2011, by and among the Registrant and certain of its stockholders, as amended.	S-1	333-196814	4.4	6/16/2014	
10.1+	Form of Indemnity Agreement.	S-1	333-196814	10.1	6/16/2014	
10.2+	2007 Equity Compensation Plan and forms of stock option agreements and exercise notices, restricted stock notice agreement and restricted stock agreement thereunder.	S-1	333-196814	10.2	6/16/2014	
10.3+	2014 Equity Incentive Plan and forms of stock option award agreement, restricted stock agreement and restricted stock unit award agreement thereunder.	S-1	333-196814	10.3	6/16/2014	
10.4+	2014 Employee Stock Purchase Plan.	S-1	333-196814	10.4	6/16/2014	
10.5+	Amended and Restated Employment Agreement, dated April 20, 2007, by and between the Registrant and Darryl Rawlings.	S-1	333-196814	10.6	6/16/2014	
10.6+	Employment Agreement, dated June 13, 2012, by and between the Registrant and Michael Banks.	S-1	333-196814	10.7	6/16/2014	
10.7+	Consulting Agreement, dated May 5, 2014, by and between the Registrant and Howard Rubin.	S-1	333-196814	10.8	6/16/2014	

10.8+	Agency Agreement between Omega General Insurance Company and Trupanion Brokers Ontario, Inc., effective January 1, 2015.	10-K	001-36537	10.13	2/24/2015
10.9+	Fronting and Administration Agreement between Wyndham Insurance Company (SAC) Limited and Omega General Insurance Company, effective January 1, 2015.	10-K	001-36537	10.14	2/24/2015
10.10†	Quota Share Reinsurance Agreement between Wyndham Insurance Company (SAC) Limited and Omega General Insurance Company, effective January 1, 2015.	10-K	001-36537	10.15	2/24/2015
10.11+	First Amendment to Consulting Agreement, dated January 1, 2016, by and between the Registrant and Howard Rubin.	10-Q	001-36537	10.2	5/5/2016
10.12+	Amendment to Lease Agreement, dated December 7, 2015, by and between American Pet Insurance Company and Selig Real Estate Holdings XXXIV, LLC, as amended.	10-K	001-36537	10.16	2/16/2016

10.13+	Second Amendment to Consulting Agreement, dated January 1, 2017 by and between the Registrant and Howard Rubin.	X
10.14+	Employment Agreement, dated January 13, 2017, by and between the Registrant and Tim Graff.	X
10.15+	Senior Credit Facility Loan and Security Agreement, entered into as of December 16, 2016 between Pacific Western Bank, Western Alliance Bank and Trupanion, Inc.	X
10.16+	Quota Share Reinsurance Agreement between Wyndham Insurance Company (SAC) Limited and Omega General Insurance Company, effective January 1, 2016.	X
10.17+	Quota Share Reinsurance Agreement between Wyndham Insurance Company (SAC) Limited and Omega General Insurance Company, effective January 1, 2017.	X
21.1	Subsidiaries of the Registrant.	X
23.1	Consent of independent registered public accounting firm.	X
24.1	Power of Attorney (reference is made to the signature page hereto)	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.	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 Label Linkbase Document.	X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.	X

+ Indicates a management contract or compensatory plan or arrangement.

† Registrant has omitted portions of the referenced exhibit pursuant to a request for confidential treatment under Rule 24b-2 promulgated under the Exchange Act. The omitted portions of this exhibit have been filed separately with the SEC.

* 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.

Schedule I - Condensed Financial Information of Registrant
Trupanion, Inc.
Condensed Statements of Comprehensive Loss
(Parent Company Only)
(In thousands)

	Years Ended December 31,		
	2016	2015	2014
Expenses:			
Claims expenses	$269	$226	$240
Other costs of revenue	41	44	79
Sales and marketing	871	621	553
Technology and development	531	628	528
General and administrative	3,627	3,852	4,108
Total expenses	5,339	5,371	5,508
Operating loss	(5,339)	(5,371)	(5,508)
Interest expense	218	325	6,725
Other expense (income)	23	(2)	(1,575)
Loss before equity in undistributed earnings of subsidiaries	(5,580)	(5,694)	(10,658)
Equity in undistributed earnings of subsidiaries	(1,316)	(11,511)	(10,519)
Net loss	$(6,896)	$(17,205)	$(21,177)
Other comprehensive (loss) income, net of taxes:			
Other comprehensive (loss) income of subsidiaries	125	(513)	175
Other comprehensive (loss) income	125	(513)	175
Comprehensive loss	$(6,771)	$(17,718)	$(21,002)

Trupanion, Inc.
Condensed Balance Sheets
(Parent Company Only)
(In thousands, except for share and per share data)

	As of December 31,	
	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	$3,401	$6,040
Accounts and other receivable	1,492	517
Prepaid expenses and other assets	106	364
Total current assets	4,999	6,921
Restricted cash	600	—
Equity method investment	271	300
Property and equipment, net	1,070	641
Intangible assets, net	4,773	4,784
Advances to and investments in subsidiaries	40,086	34,488
Total assets	$51,799	$47,134
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$19	$11
Accrued liabilities	145	144
Deferred tax liabilities	250	169
Other liabilities	328	—
Total current liabilities	742	324
Long-term debt	4,767	—
Deferred tax liabilities	1,372	1,454
Other liabilities	203	—
Total liabilities	7,084	1,778
Stockholders' equity:		
Common stock, $0.00001 par value per share, 100,000,000 shares authorized at December 31, 2016 and 200,000,000 shares authorized at December 31, 2015, 30,156,247 and 29,498,947 shares issued and outstanding at December 31, 2016; 29,017,168 and 28,396,189 shares issued and outstanding at December 31, 2015.	—	—
Preferred stock: $0.00001 par value per share, 10,000,000 shares authorized at December 31, 2016 and December 31, 2015, and 0 shares issued and outstanding at December 31, 2016 and December 31, 2015.	—	—
Additional paid-in capital	129,574	122,844
Accumulated other comprehensive (loss) income	(377)	(502)
Accumulated deficit	(81,281)	(74,385)
Treasury stock, at cost: 657,300 shares at December 31, 2016, and 620,979 shares at December 31, 2015.	(3,201)	(2,601)
Total stockholders' equity	44,715	45,356

Total liabilities and stockholders’ equity	$51,799	$47,134

Trupanion, Inc.
Condensed Statements of Cash Flows
(Parent Company Only)
(In thousands)

	Years Ended December 31,		
	2016	2015	2014
Operating activities			
Net loss	$(6,896)	$(17,205)	(21,177)
Adjustments to reconcile net loss to cash (used in) provided by operating activities:			
Loss attributable to equity method investments	1,316	11,511	10,519
Depreciation and amortization	251	126	67
Amortization of debt discount and prepaid loan fees	58	21	5,033
Warrant expense	—	—	(1,574)
Stock-based compensation expense	2,946	3,002	4,084
Changes in operating assets and liabilities	1,742	(1,383)	465
Net cash (used in) provided by operating activities	(583)	(3,928)	(2,583)
Investing activities			
Purchases of property and equipment	1	(149)	(243)
Equity method investment	—	(300)	—
Advances to and investments in subsidiaries	(9,333)	(19,900)	(22,209)
Net cash used in investing activities	(9,332)	(20,349)	(22,452)
Financing activities			
Tax withholding on restricted stock	(662)	(643)	—
Proceeds from exercise of stock options	3,745	1,335	211
Proceeds from (repayment of) debt financing	4,988	(14,900)	(15,000)
Other financing costs	(195)	—	(103)
Net Proceeds from IPO	—	—	72,755
Net cash (used in) provided by financing activities	7,876	(14,208)	57,863
Effect of foreign exchange rates on cash, net	—	(517)	175
Net (decrease) increase in cash, cash equivalents, and restricted cash	(2,039)	(39,002)	33,003
Cash, cash equivalents, and restricted cash at beginning of year	6,040	45,042	12,039
Cash, cash equivalents, and restricted cash at end of year	$4,001	$6,040	45,042
Supplemental disclosures			
Interest paid	(153)	(155)	(1,494)
Noncash investing and financing activities:			
Warrants issued in conjunction with debt issuance	—	—	1,124
Cashless exercise of preferred stock warrants	—	—	1,270
Cashless exercise of common stock warrants	600	—	—
Common stock warrant reclassification to equity	—	—	3,180

1. Organization and Presentation

The accompanying condensed financial statements present the financial position, results of operations and cash flows for Trupanion, Inc. These condensed unconsolidated financial statements should be read in conjunction with the consolidated financial statements of Trupanion, Inc. and its subsidiaries and the notes thereto (the Consolidated Financial Statements). Investments in subsidiaries are accounted for using the equity method of accounting. Certain prior year amounts have been reclassified within the accompanying condensed financial statements from their original presentation to conform to the current period presentation.

Additional information about Trupanion, Inc.'s accounting policies pertaining to intangible assets, commitments and contingencies, debt financing, stock-based compensation, and stockholders' equity are set forth in Notes 4, 8, 10, 11 and 12, respectively, to the Consolidated Financial Statements.