

TRUPANION INC.

Form 10-Q

May 02, 2018

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2018

**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**

(State or other jurisdiction of incorporation or organization)

**83-0480694**

(I.R.S. Employer Identification Number)

**6100 4th Avenue S, Suite 200**

**Seattle, Washington 98108**

**(855) 727 - 9079**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  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

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(§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).  Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if smaller reporting company)

Smaller reporting company

Emerging growth company

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

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

As of April 25, 2018, there were approximately 31,186,900 shares of the registrant's common stock outstanding.

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**TRUPANION, INC.**  
**Quarterly Report on Form 10-Q**  
**For the Period Ended March 31, 2018**  
**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I - FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements (unaudited)</u>	<u>1</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>12</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>25</u>
Item 4. <u>Controls and Procedures</u>	<u>26</u>
<b><u>PART II - OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	<u>27</u>
Item 1A. <u>Risk Factors</u>	<u>27</u>
Item 2. <u>Unregistered Sale of Equity Securities and Use of Proceeds</u>	<u>52</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>52</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>52</u>
Item 5. <u>Other Information</u>	<u>52</u>
Item 6. <u>Exhibits</u>	<u>52</u>
<u>Exhibit Index</u>	<u>53</u>
<u>Signatures</u>	<u>54</u>

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**Note About Forward-Looking Statements**

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

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

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

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

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
Revenue	\$69,760	\$ 54,729
Cost of revenue:		
Veterinary invoice expense	50,113	39,187
Other cost of revenue	8,583	6,387
Gross profit	11,064	9,155
Operating expenses:		
Technology and development	2,164	2,403
General and administrative	4,458	4,012
Sales and marketing	5,938	4,089
Total operating expenses	12,560	10,504
Operating loss	(1,496 )	(1,349 )
Interest expense	219	137
Other (income) expense, net	(140 )	(28 )
Loss before income taxes	(1,575 )	(1,458 )
Income tax (benefit) expense	(95 )	24
Net loss	\$(1,480 )	\$(1,482 )
Net loss per share:		
Basic and diluted	\$(0.05 )	\$(0.05 )
Weighted-average common shares outstanding:		
Basic and diluted	30,246,582	29,254,681

See accompanying notes to the consolidated financial statements.

**TRUPANION, INC.**

**Consolidated Statements of Comprehensive Loss**

**(in thousands)**

**(unaudited)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
Net loss	\$(1,480)	\$(1,482)
Other comprehensive (loss) income:		
Foreign currency translation adjustments	(190 )	12 )
Net unrealized (loss) on available-for-sale debt securities	(15 )	(7 )
Other comprehensive (loss) income, net of taxes	(205 )	5 )
Comprehensive loss	\$(1,685)	\$(1,477)

See accompanying notes to the consolidated financial statements.

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

	March 31, 2018 (unaudited)	December 31, 2017
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$30,786	\$25,706
Short-term investments	39,360	37,590
Accounts and other receivables	24,317	20,367
Prepaid expenses and other assets	3,046	2,895
Total current assets	97,509	86,558
Restricted cash	600	600
Long-term investments, at fair value	3,238	3,237
Property and equipment, net	8,275	7,868
Intangible assets, net	5,000	4,972
Other long-term assets	2,596	2,624
Total assets	\$117,218	\$105,859
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$3,343	\$2,716
Accrued liabilities and other current liabilities	8,347	7,660
Reserve for veterinary invoices	13,450	12,756
Deferred revenue	26,757	22,734
Total current liabilities	51,897	45,866
Long-term debt	14,851	9,324
Deferred tax liabilities	1,002	1,002
Other liabilities	1,221	1,233
Total liabilities	68,971	57,425
Stockholders' equity:		
Common stock: \$0.00001 par value, 100,000,000 shares authorized; 31,181,627 and 30,430,915 shares issued and outstanding at March 31, 2018; 30,778,796 and 30,121,496 shares issued and outstanding at December 31, 2017	—	—
Preferred stock: \$0.00001 par value, 10,000,000 shares authorized; no shares issued and outstanding	—	—
Additional paid-in capital	139,009	134,511
Accumulated other comprehensive loss	(297 )	(92 )
Accumulated deficit	(84,264 )	(82,784 )
Treasury stock, at cost: 755,985 shares at March 31, 2018 and 657,300 shares at December 31, 2017	(6,201 )	(3,201 )
Total stockholders' equity	48,247	48,434
Total liabilities and stockholders' equity	\$117,218	\$105,859
See accompanying notes to the consolidated financial statements.		



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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Operating activities</b>		
Net loss	\$(1,480 )	\$(1,482 )
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	927	1,036
Stock-based compensation expense	968	781
Other, net	23	97
Changes in operating assets and liabilities:		
Accounts and other receivables	(3,926 )	(3,372 )
Prepaid expenses and other assets	(129 )	(219 )
Accounts payable, accrued liabilities, and other liabilities	910	(295 )
Reserve for veterinary invoices	743	1,093
Deferred revenue	4,041	4,218
Net cash provided by operating activities	2,077	1,857
<b>Investing activities</b>		
Purchases of investment securities	(7,140 )	(5,172 )
Maturities of investment securities	5,300	3,871
Purchases of property and equipment	(992 )	(462 )
Other investments	—	(2,710 )
Net cash used in investing activities	(2,832 )	(4,473 )
<b>Financing activities</b>		
Proceeds from exercise of stock options	481	1,037
Proceeds from debt financing, net of financing fees	5,500	—
Other financing	(216 )	(142 )
Net cash provided by financing activities	5,765	895
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash, net	70	21
Net change in cash, cash equivalents, and restricted cash	5,080	(1,700 )
Cash, cash equivalents, and restricted cash at beginning of period	26,306	24,237
Cash, cash equivalents, and restricted cash at end of period	\$31,386	\$22,537
<b>Supplemental disclosures</b>		
Noncash investing and financing activities:		
Purchases of property and equipment included in accounts payable and accrued liabilities	680	93
Property and equipment acquired under lease	—	45
Issuance of common stock for cashless exercise of warrants	3,000	—
See accompanying notes to the consolidated financial statements.		

## **TRUPANION, INC.**

### **Notes to the Consolidated Financial Statements (unaudited)**

#### **1. Nature of Operations and Significant Accounting Policies**

##### ***Description of Business and Basis of Presentation***

Trupanion, Inc. (collectively with its wholly-owned subsidiaries, the Company) provides medical insurance for cats and dogs throughout the United States, Canada and Puerto Rico.

The financial data as of December 31, 2017 was derived from the Company's audited consolidated financial statements. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and, in management's opinion, have been prepared on the same basis as the audited financial statements and include all adjustments, consisting of normal recurring adjustments, necessary for the fair presentation of the Company's financial position, results of operations, comprehensive loss, and cash flows for the interim periods. These unaudited interim consolidated financial statements should be read in conjunction with the Company's audited financial statements included in the Company's Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission (SEC) on February 13, 2018 (the 2017 10-K). The Company's accounting policies are described in Note 1 to the audited financial statements included in the 2017 10-K. Operating results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the full fiscal year or any other interim period.

##### ***Use of Estimates***

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from such estimates. See Note 1 to the audited financial statements included in the 2017 10-K for additional discussion of these estimates and assumptions.

##### ***Accumulated Other Comprehensive Loss***

There were no reclassifications out of accumulated other comprehensive loss during the three months ended March 31, 2018 and 2017.

##### ***Income Taxes***

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

##### ***Recent Accounting Pronouncements***

In February 2016, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) amending the lease presentation guidance. The ASU requires organizations that lease assets to recognize the rights and obligations created by those leases on the consolidated balance sheets. This ASU is effective for fiscal years beginning after December 15, 2018 including interim periods within that reporting period, with early adoption permitted. The Company has determined this guidance will require recognition of a lease liability and corresponding asset on the consolidated balance sheets 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. The Company plans to adopt this guidance as of January 1, 2019, and is in the process of evaluating the impact on its consolidated financial statements.

#### **2. Net Loss per Share**

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

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

	Three Months Ended	
	March 31,	
	2018	2017
Stock options	3,878,716	3,983,098
Restricted stock awards and restricted stock units	546,638	351,702
Warrants	510,000	810,000

### 3. Investment Securities

The amortized cost, gross unrealized holding gains and losses, fair value of long-term investments, which are classified as available-for-sale, and fair value of short-term investments by major security type and class of security were as follows as of March 31, 2018 and December 31, 2017 (in thousands):

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of March 31, 2018				
Available-for-sale:				
Foreign deposits	\$2,253	\$ —	\$ —	\$2,253
Municipal bond	1,000	—	(15 )	985
	\$3,253	\$ —	\$ (15 )	\$3,238
Short-term investments:				
U.S. Treasury securities	\$5,784	\$ —	\$ (2 )	\$5,782
Certificates of deposit	690	—	—	690
U.S. government funds	32,886	—	—	32,886
	\$39,360	\$ —	\$ (2 )	\$39,358

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

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

	March 31, 2018	
	Amortized Cost	Fair Value
Available-for-sale:		
Due after one year through five years	\$2,253	\$2,253
Due after five years through ten years	1,000	985
	\$3,253	\$3,238

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

#### 4. Fair Value

##### Investments

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

	As of March 31, 2018		
	Fair Value	Level 1	Level 2
<b>Assets</b>			
Restricted cash	\$600	\$600	\$—
Foreign deposits	2,253	2,253	—
Municipal bond	985	—	985
Money market funds	7,717	7,717	—
Total	\$11,555	\$10,570	\$985

	As of December 31, 2017		
	Fair Value	Level 1	Level 2
<b>Assets</b>			
Restricted cash	\$600	\$600	\$—
Foreign deposits	2,237	2,237	—
Municipal bond	1,000	—	1,000
Money market funds	5,167	5,167	—
Total	\$9,004	\$8,004	\$1,000

The Company measures the fair value of restricted cash, foreign deposits, and money market funds based on quoted prices in active markets for identical assets. The fair value of the municipal bond is based on either recent trades in inactive markets or quoted market prices of similar instruments and other significant inputs derived from or corroborated by observable market data.

##### Fair Value Disclosures

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

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

## 5. Debt

The Company has a revolving line of credit of up to \$30.0 million, maturing December 2019. The facility is secured by any and all interests in the Company's assets that are not otherwise restricted. Interest on the revolving line of credit is payable monthly at the greater of 4.5%, or 1.25% plus the prime rate (6.00% at March 31, 2018). The credit agreement includes other ancillary services and letters of credit of up to \$4.5 million, and requires a deposit of restricted cash of \$0.6 million. As of March 31, 2018, the Company was in compliance with all financial and non-financial covenants required by the credit agreement.

Borrowings on the revolving line of credit are limited to the lesser of \$30.0 million and the total amount of cash and securities held by the Company's insurance subsidiaries (American Pet Insurance Company and Wyndham Insurance Company (SAC) Limited Segregated Account AX). As of March 31, 2018, available borrowing capacity on the line of credit was \$13.0 million, with an outstanding balance of \$2.0 million for ancillary services and letters of credit, and borrowings under the facility were \$15.0 million, recorded net of financing fees of \$0.1 million.

## 6. Commitments and Contingencies

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

## 7. Reserve for Veterinary Invoices

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

### *Reserve for veterinary invoices*

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

	Three Months Ended	
	March 31,	
<b>Subscription</b>	<b>2018</b>	<b>2017</b>
Reserve at beginning of year	\$11,059	\$8,538
Veterinary invoices during the period related to:		
Current year	45,198	36,518
Prior years	(61 )	(195 )
Total veterinary invoice expense	45,137	36,323
Amounts paid during the period related to:		
Current year	36,142	28,868
Prior years	8,250	6,400
Total paid	44,392	35,268
Non-cash expenses	156	93
Reserve at end of period	\$11,648	\$9,500

The Company's reserve for the subscription business segment increased from \$11.1 million at December 31, 2017 to \$11.6 million at March 31, 2018. This change was comprised of \$45.1 million in expense recorded during the period less \$44.4 million in payments of veterinary invoices. The \$45.1 million in veterinary invoice expense incurred includes a reduction of \$0.1 million to the reserves relating to prior years, which is the result of ongoing analysis of recent payment trends. For the three months ended March 31, 2017, the Company decreased prior year reserves by

\$0.2 million as a result of analysis of payment trends.

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

<b>Other Business</b>	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
Reserve at beginning of year	\$1,697	\$983
Veterinary invoices during the period related to:		
Current year	5,218	3,048
Prior years	(242 )	(184 )
Total veterinary invoice expense	4,976	2,864
Amounts paid during the period related to:		
Current year	3,734	2,092
Prior years	1,137	634
Total paid	4,871	2,726
Non-cash expenses	—	—
Reserve at end of period	\$1,802	\$1,121

The Company's reserve for the other business segment increased from \$1.7 million at December 31, 2017 to \$1.8 million at March 31, 2018. This change was comprised of \$5.0 million in expense recorded during the period less \$4.9 million in payments of veterinary invoices. The \$5.0 million in veterinary invoice expense incurred includes a reduction of \$0.2 million to the reserves relating to prior years, which is the result of ongoing analysis of recent payment trends. For the three months ended March 31, 2017, the Company decreased prior year reserves by \$0.2 million as a result of analysis of payment trends.

***Reserve for veterinary invoices, by year of occurrence***

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

<b>Subscription</b>	<b>As of</b>
	<b>March 31,</b>
	<b>2018</b>
Year of Occurrence	
2016	\$453
2017	2,295
2018	8,900
	\$11,648
<b>Other Business</b>	<b>As of</b>
	<b>March</b>
	<b>31, 2018</b>
Year of Occurrence	
2017	317
2018	1,485
	\$1,802

## **8. Stock-Based Compensation and Stockholders' Equity**

### ***Stock-based Compensation***

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

**Three  
Months  
Ended  
March  
31,  
2018**