

TRUPANION INC.
Form 10-Q
May 06, 2016

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, 2016

or

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)

907 NW Ballard Way

Seattle, Washington 98107

(855) 268 - 9606

(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 (§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, 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

Accelerated filer

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

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 28, 2016 there were approximately 28,655,461 shares of the registrant's common stock outstanding.

TRUPANION, INC.
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Note About Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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,” expressions that 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 “Trupanion,” “we,” “us,” “our” and similar references refer to Trupanion, Inc. and its subsidiaries taken as a whole.

Investors and others should note that we announce material financial information to our investors using our investor relations website (<http://investors.trupanion.com>), SEC filings, press releases, public conference calls and webcasts. We use these channels, as well as social media, to communicate with our members and the public about our company, our services and other issues. It is possible that the information we post on social media could be deemed to be material information. Therefore, we encourage investors, the media, and others interested in our company to review the information we post on the United States (“U.S.”) social media channels listed on our investor relations website.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Trupanion, Inc.

Consolidated Statements of Operations

(in thousands, except for share and per share data)

(unaudited)

	Three Months Ended March 31,	
	2016	2015
Revenue	\$42,699	\$ 33,310
Cost of revenue:		
Claims expenses	30,604	23,351
Other cost of revenue	4,791	4,377
Gross profit	7,304	5,582
Operating expenses:		
Sales and marketing	3,840	3,651
Technology and development	2,287	2,798
General and administrative	3,722	3,697
Total operating expenses	9,849	10,146
Operating loss	(2,545)	(4,564)
Interest expense	30	245
Other (income) expense, net	(17)	19
Loss before income taxes	(2,558)	(4,828)
Income tax expense	14	108
Net loss	\$(2,572)	\$(4,936)
Net loss per share attributable to common stockholders:		
Basic and diluted	\$(0.09)	\$(0.18)
Weighted-average shares used to compute net loss per share attributable to common stock holders:		
Basic and diluted	27,999,248	27,337,302

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

	Three Months Ended March 31,	
	2016	2015
Net loss	\$(2,572)	\$(4,936)
Other comprehensive income (loss):		
Foreign currency translation adjustments	289	(129)
Change in unrealized losses on available-for-sale securities	2	(8)
Other comprehensive income (loss), net of taxes	291	(137)
Comprehensive loss	\$(2,281)	\$(5,073)

Trupanion, Inc.

Consolidated Balance Sheets

(in thousands, except for share data)

	March 31, 2016	December 31, 2015
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 17,526	\$ 17,956
Short-term investments	25,567	25,288
Accounts and other receivables	8,464	8,196
Prepaid expenses and other assets	2,038	2,193
Total current assets	53,595	53,633
Long-term investments, at fair value	2,489	2,388
Equity method investment	296	300
Property and equipment, net	9,587	9,719
Intangible assets, net	4,865	4,854
Other long term assets	38	23
Total assets	\$ 70,870	\$ 70,917
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 1,027	\$ 1,289
Accrued liabilities	2,988	4,189
Claims reserve	6,854	6,274
Deferred revenue	11,785	11,042
Deferred tax liabilities	169	169
Other payables	809	654
Total current liabilities	23,632	23,617
Long-term debt	968	—
Deferred tax liabilities	1,431	1,433
Other liabilities	531	511
Total liabilities	26,562	25,561
Stockholders' equity:		
Common stock, \$0.00001 par value per share, 200,000,000 shares authorized at March 31, 2016 and December 31, 2015, 29,195,507 and 28,574,528 issued and outstanding at March 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 authorized at March 31, 2016 and December 31, 2015, and 0 issued and outstanding at March 31, 2016 and December 31, 2015.	—	—
Additional paid-in capital	124,077	122,844
Accumulated other comprehensive loss	(211)	(502)
Accumulated deficit	(76,957)	(74,385)
Treasury stock, at cost: 620,979 shares at March 31, 2016 and December 31, 2015.	(2,601)	(2,601)
Total stockholders' equity	44,308	45,356
Total liabilities and stockholders' equity	\$ 70,870	\$ 70,917

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

	Three Months Ended March 31,	
	2016	2015
Operating activities		
Net loss	\$(2,572)	\$(4,936)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	785	566
Stock-based compensation expense	696	703
Other	9	(116)
Changes in operating assets and liabilities:		
Accounts receivables	(234)	75
Prepaid expenses and other current assets	153	(152)
Accounts payable	(200)	(387)
Accrued liabilities	(1,267)	(736)
Claims reserve	521	76
Deferred revenue	676	329
Other payables	135	(330)
Net cash used in operating activities	(1,298)	(4,908)
Investing activities		
Purchases of investment securities	(3,959)	(3,206)
Maturities of investment securities	3,700	4,245
Purchases of property and equipment	(653)	(1,590)
Other	(34)	—
Net cash used in investing activities	(946)	(551)
Financing activities		
Tax withholding on restricted stock	—	(384)
Proceeds from exercise of stock options	486	367
Proceeds from (repayment of) debt financing	987	(14,900)
Net cash provided by (used in) financing activities	1,473	(14,917)
Effect of foreign exchange rates on cash, net	341	(228)
Net change in cash and cash equivalents	(430)	(20,604)
Cash and cash equivalents at beginning of period	17,956	53,098
Cash and cash equivalents at end of period	\$17,526	\$32,494
Supplemental disclosures		
Income taxes paid	—	(98)
Interest paid	(16)	(249)
Noncash investing and financing activities:		
Increase in payables for property and equipment	58	367

Trupanion, Inc.

Notes to the Consolidated Financial Statements (unaudited)

1. Nature of Operations and Summary of Significant Accounting Policies

Description of Business

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

Basis of Presentation

The consolidated balance sheet data as of December 31, 2015 was derived from audited consolidated financial statements. The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for unaudited consolidated financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. 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. These unaudited consolidated financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and accompanying notes for the year ended December 31, 2015 included in the Company's Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission on February 17, 2016. The accompanying unaudited consolidated financial statements reflect all adjustments consisting of normal recurring adjustments which, in the opinion of management, are necessary for a fair presentation of the Company's financial position and results of its operations, as of and for the periods presented. Operating results for the three months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016, or for any other 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 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 and income tax uncertainties. Actual results could differ from the estimates used in preparing the consolidated financial statements.

Accumulated Other Comprehensive Loss

There were no reclassifications out of accumulated other comprehensive loss during the three months ended March 31, 2016 and 2015.

Recent Accounting Pronouncements

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. This guidance is effective for annual reporting periods beginning after December 15, 2015 and interim periods beginning after December 15, 2016. Early adoption of this guidance is permitted, and must be applied retrospectively by providing comparative disclosures for each period presented. The Company plans to adopt this guidance as of January 1, 2016. The Company is in the process of assessing the impact of this guidance.

In November 2015, the FASB issued an ASU amending the accounting for income taxes and requiring all deferred tax assets and liabilities 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 plans to prospectively adopt this guidance as of January 1, 2017. The Company is in the process of assessing the impact of this guidance.

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 is in the process of assessing the impact of this guidance.

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 to be up to the employees' maximum individual tax rate in the relevant jurisdiction without resulting in liability classification of the award. 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 plans to adopt this guidance as of January 1, 2017. 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 are not included in the diluted net loss per common share calculation because they would have had an antidilutive effect:

	As of March 31,	
	2016	2015
Stock options	4,760,535	4,677,592
Restricted stock awards and units	472,384	592,625
Warrants	869,999	869,999

3. 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 March 31, 2016 and December 31, 2015 (in thousands):

	Amortized Cost	Gross Unrealized Holding Losses	Fair Value
As of March 31, 2016			
Available-for-sale:			
Foreign deposits	\$ 1,541	\$ —	\$ 1,541
Municipal bond	1,000	(52)	948
	\$ 2,541	\$ (52)	\$ 2,489
Short-term investments:			
U.S. Treasury securities	\$ 5,891	\$ —	\$ 5,891
Certificates of deposit	670	—	670
U.S. government funds	19,006	—	19,006
	\$ 25,567	\$ —	\$ 25,567

	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):

	March 31, 2016	
	Amortized Cost	Fair Value
Available-for-sale:		
Due under one year	\$—	\$—
Due after one year through five years	1,541	1,541
Due after five years through ten years	1,000	948
Due after ten years	—	—
	\$ 2,541	\$ 2,489

The Company had one investment with an unrealized loss of \$0.1 million and a fair value of \$0.9 million at March 31, 2016 and December 31, 2015, respectively. The debt security has been in the unrealized loss position for more than 12 months. The Company has assessed the bond for credit impairment and has 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 a 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.

4. 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
March
31,
2016