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 June 30, 2021

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)

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	Trading Symbol	Name of each exchange on which registered
Common stock, $0.00001 par value per share	TRUP	The NASDAQ Stock Market LLC

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

☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

☒ Yes ☐ No

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

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	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 July 29, 2021, there were approximately 40,234,964 shares of the registrant's common stock outstanding.

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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 (Exchange Act), 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 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 "we," "us," "our" and similar references refer to Trupanion, Inc. and its subsidiaries taken as a whole.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

TRUPANION, INC.
Consolidated Statements of Operations
(in thousands, except share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Revenue	$ 168,260	$ 117,920	$ 322,945	$ 229,221
Cost of revenue:				
Veterinary invoice expense[(1)]	118,282	82,049	228,152	161,689
Other cost of revenue[(1)]	25,433	16,004	49,148	29,813
Total cost of revenue	143,715	98,053	277,300	191,502
Operating expenses:				
Technology and development[(1)]	4,079	2,293	7,810	4,413
General and administrative[(1)]	7,435	5,073	14,651	9,933
Sales and marketing[(1)]	19,390	9,242	39,094	19,684
Depreciation and amortization	3,158	1,723	6,251	3,104
Total operating expenses	34,062	18,331	67,806	37,134
Gain (loss) from investment in joint venture	5	(27)	(80)	(86)
Operating (loss) income	(9,512)	1,509	(22,241)	499
Interest expense	3	341	1	720
Other income, net	(99)	(202)	(161)	(484)
(Loss) income before income taxes	(9,416)	1,370	(22,081)	263
Income tax (benefit) expense	(195)	17	(412)	43
Net (loss) income	$ (9,221)	$ 1,353	$ (21,669)	$ 220
Net (loss) income per share:				
Basic	$ (0.23)	$ 0.04	$ (0.54)	$ 0.01
Diluted	$ (0.23)	$ 0.04	$ (0.54)	$ 0.01
Weighted average shares of common stock outstanding:				
Basic	40,142,872	35,143,592	39,922,885	35,075,322
Diluted	40,142,872	36,688,167	39,922,885	36,601,927

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

Veterinary invoice expense	$ 672	$ 245	$ 2,971	$ 423
Other cost of revenue	552	99	1,487	189
Technology and development	800	133	1,464	233
General and administrative	2,322	1,075	4,141	1,804
Sales and marketing	2,181	675	4,912	1,231

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Net (loss) income	$ (9,221)	$ 1,353	$ (21,669)	$ 220
Other comprehensive income (loss):				
Foreign currency translation adjustments	373	291	991	(339)
Net unrealized gain (loss) on available-for-sale debt securities	1	5	1	—
Other comprehensive income (loss), net of taxes	374	296	992	(339)
Comprehensive (loss) income	$ (8,847)	$ 1,649	$ (20,677)	$ (119)

See accompanying notes to the consolidated financial statements.

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

	June 30, 2021 (unaudited)	December 31, 2020
Assets		
Current assets:		
Cash and cash equivalents	$ 117,332	$ 139,878
Short-term investments	102,089	89,862
Accounts and other receivables	139,966	99,065
Prepaid expenses and other assets	10,535	8,222
Total current assets	369,922	337,027
Restricted cash	6,322	6,319
Long-term investments, at fair value	6,226	5,566
Property and equipment, net	74,405	72,602
Intangible assets, net	25,120	27,134
Other long-term assets	16,476	16,557
Goodwill	33,495	33,045
Total assets	$ 531,966	$ 498,250
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 4,863	$ 6,059
Accrued liabilities and other current liabilities	22,530	22,864
Reserve for veterinary invoices	35,856	28,929
Deferred revenue	126,614	92,547
Total current liabilities	189,863	150,399
Deferred tax liabilities	4,259	4,705
Other liabilities	3,639	3,207
Total liabilities	197,761	158,311
Stockholders' equity:		
Common stock: $0.00001 par value per share, 100,000,000 shares authorized; 41,164,220 and 40,231,055 issued and outstanding at June 30, 2021; 40,383,972 and 39,450,807 shares issued and outstanding at December 31, 2020	—	—
Preferred stock: $0.00001 par value per share, 10,000,000 shares authorized; no shares issued and outstanding	—	—
Additional paid-in capital	453,950	439,007
Accumulated other comprehensive income (loss)	4,063	3,071
Accumulated deficit	(113,029)	(91,360)
Treasury stock, at cost: 933,165 shares at June 30, 2021 and 933,165 shares at December 31, 2020	(10,779)	(10,779)
Total stockholders' equity	334,205	339,939
Total liabilities and stockholders' equity	$ 531,966	$ 498,250

See accompanying notes to the consolidated financial statements.

Trupanion, Inc.
Consolidated Statements of Stockholders' Equity
(in thousands, except share amounts)
(unaudited)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
	Shares	Amount					
Balance at April 1, 2021	40,056,406	$ —	$ 446,975	$ (103,808)	$ 3,689	$ (10,779)	$ 336,077
Issuance of common stock in connection with the Company's equity award programs, net of tax withholdings	174,649	—	318	—	—	—	318
Stock-based compensation expense	—	—	6,657	—	—	—	6,657
Other comprehensive income (loss)	—	—	—	—	374	—	374
Net income (loss)	—	—	—	(9,221)	—	—	(9,221)
Balance at June 30, 2021	40,231,055	$ —	$ 453,950	$ (113,029)	$ 4,063	$ (10,779)	$ 334,205

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
	Shares	Amount					
Balance at April 1, 2020	35,084,505	$ —	$ 234,642	$ (86,653)	$ (385)	$ (10,779)	$ 136,825
Issuance of common stock in connection with the Company's equity award programs, net of tax withholdings	161,787	—	1,141	—	—	—	1,141
Stock-based compensation expense	—	—	2,294	—	—	—	2,294
Other comprehensive income (loss)	—	—	—	—	296	—	296
Net income (loss)	—	—	—	1,353	—	—	1,353
Balance at June 30, 2020	35,246,292	$ —	$ 238,077	$ (85,300)	$ (89)	$ (10,779)	$ 141,909

See accompanying notes to the consolidated financial statements.

Trupanion, Inc.
Consolidated Statements of Stockholders' Equity
(in thousands, except share amounts)
(unaudited)

	Common Stock			Additional Paid-in Capital		Accumulated Deficit		Accumulated Other Comprehensive Income (Loss)		Treasury Stock		Total Stockholders' Equity
	Shares		Amount									
Balance at January 1, 2021	39,450,807	**$**	—	$ 439,007	$	(91,360)	$	3,071	$	(10,779)	$	339,939
Issuance of common stock in connection with the Company's equity award programs, net of tax withholdings	780,248		—	(325)		—		—		—		(325)
Stock-based compensation expense	—		—	15,268		—		—		—		15,268
Other comprehensive income (loss)	—		—	—		—		992		—		992
Net income (loss)	—		—	—		(21,669)		—		—		(21,669)
Balance at June 30, 2021	40,231,055	$	—	$ 453,950	$	(113,029)	$	4,063	$	(10,779)	$	334,205

	Common Stock			Additional Paid-in Capital		Accumulated Deficit		Accumulated Other Comprehensive Income (Loss)		Treasury Stock		Total Stockholders' Equity
	Shares		Amount									
Balance at January 1, 2020	34,947,017	$	—	$ 232,731	$	(85,520)	$	250	$	(10,701)	$	136,760
Issuance of common stock in connection with the Company's equity award programs, net of tax withholdings	302,575		—	1,346		—		—		—		1,346
Stock-based compensation expense	—		—	4,000		—		—		—		4,000
Repurchase of common stock	(3,300)		—	—		—		—		(78)		(78)
Other comprehensive income (loss)	—		—	—		—		(339)		—		(339)
Net income (loss)	—		—	—		220		—		—		220
Balance at June 30, 2020	35,246,292	$	—	$ 238,077	$	(85,300)	$	(89)	$	(10,779)	$	141,909

See accompanying notes to the consolidated financial statements.

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

	Six Months Ended June 30,	
	2021	2020
Operating activities		
Net (loss) income	$ (21,669)	$ 220
Adjustments to reconcile net (loss) income to cash provided by operating activities:		
Depreciation and amortization	6,251	3,104
Stock-based compensation expense	14,975	3,880
Other, net	(545)	102
Changes in operating assets and liabilities:		
Accounts and other receivables	(40,796)	(26,102)
Prepaid expenses and other assets	(2,092)	(444)
Accounts payable, accrued liabilities, and other liabilities	(872)	516
Reserve for veterinary invoices	6,870	3,264
Deferred revenue	33,956	23,234
Net cash (used in) provided by operating activities	(3,922)	7,774
Investing activities		
Purchases of investment securities	(43,373)	(26,550)
Maturities of investment securities	30,580	20,804
Purchases of property, equipment and intangible assets	(5,770)	(3,239)
Other	(73)	107
Net cash used in investing activities	(18,636)	(8,878)
Financing activities		
Proceeds from exercise of stock options	2,358	1,667
Shares withheld to satisfy tax withholding	(2,751)	(441)
Borrowings from line of credit, net of financing fees	—	3,735
Repayments to line of credit	—	(2,500)
Other	—	(78)
Net cash (used in) provided by financing activities	(393)	2,383
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash, net	408	(434)
Net change in cash, cash equivalents, and restricted cash	(22,543)	845
Cash, cash equivalents, and restricted cash at beginning of period	146,197	30,568
Cash, cash equivalents, and restricted cash at end of period	$ 123,654	$ 31,413
Supplemental disclosures		
Noncash investing and financing activities:		
Purchases of property and equipment included in accounts payable and accrued liabilities	$ 548	$ 273

See accompanying notes to the consolidated financial statements.

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, Puerto Rico, and Australia. The Company's data-driven, vertically-integrated approach enables the Company to provide pet owners with products that the Company believes are the highest value medical insurance, priced specifically for each pet’s unique characteristics.

The financial data as of December 31, 2020 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 income (loss), stockholders' equity 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 12, 2021 (the 2020 10-K). The Company's accounting policies are described in Note 1 to the audited financial statements included in the 2020 10-K. Operating results for the three and six months ended June 30, 2021 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 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 2020 10-K for additional discussion of these estimates and assumptions.

Reclassifications

Depreciation and amortization expenses have been reclassified as a separate line item in the consolidated statement of operations and prior period amounts have been reclassified from their original presentation to conform to the current period presentation. The Company has elected to present depreciation and amortization expenses as a separate line item to better align with management's view of the Company's operating results.

2. Net Income (Loss) per Share

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Basic earnings per share:				
Net (loss) income	$ (9,221)	$ 1,353	$ (21,669)	$ 220
Shares used in computation:				
Weighted average shares of common stock outstanding	40,142,872	35,143,592	39,922,885	35,075,322
Basic earnings per share	$ (0.23)	$ 0.04	$ (0.54)	$ 0.01
Diluted earnings per share:				
Net (loss) income	$ (9,221)	$ 1,353	$ (21,669)	$ 220
Shares used in computation:				
Weighted average shares of common stock outstanding	40,142,872	35,143,592	39,922,885	35,075,322
Stock options	—	1,390,249	—	1,382,192
Restricted stock awards and units	—	154,326	—	144,413
Weighted average shares of diluted common stock outstanding	40,142,872	36,688,167	39,922,885	36,601,927
Diluted earnings per share	$ (0.23)	$ 0.04	$ (0.54)	$ 0.01

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Stock options	916,434	—	916,434	—
Restricted stock awards and restricted stock units	1,175,228	56,311	1,175,228	56,311

3. Investments

The amortized cost, gross unrealized holding gains and losses, and estimates of fair value of long-term and short-term investments by major security type and class of security were as follows as of June 30, 2021 and December 31, 2020 (in thousands):

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of June 30, 2021				
Long-term investments:				
Foreign deposits	$ 5,224	$ —	$ —	$ 5,224
Municipal bond	1,000	2	—	1,002
	$ 6,224	$ 2	$ —	$ 6,226
Short-term investments:				
U.S. Treasury securities	$ 8,999	$ —	$ (2)	$ 8,997
Certificates of deposit	3,371	—	—	3,371
U.S. government funds	89,719	—	—	89,719
	$ 102,089	$ —	$ (2)	$ 102,087

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of December 31, 2020				
Long-term investments:				
Foreign deposits	$ 4,564	$ —	$ —	$ 4,564
Municipal bond	1,000	2	—	1,002
	$ 5,564	$ 2	$ —	$ 5,566
Short-term investments:				
U.S. Treasury securities	$ 6,494	$ —	$ (2)	$ 6,492
Certificates of deposit	1,696	—	—	1,696
U.S. government funds	81,672	—	—	81,672
	$ 89,862	$ —	$ (2)	$ 89,860

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

	As of June 30, 2021	
	Amortized Cost	Fair Value
Available-for-sale:		
Due after one year through five years	$ 6,224	$ 6,226
	$ 6,224	$ 6,226

The Company does not expect any credit losses from its held-to-maturity investments, considering the composition of the investment portfolio and the credit loss history of these investments. For available-for-sale debt securities, the Company determined that the unrealized losses were immaterial and due to non-credit factors. The Company does not intend to sell, nor is it more likely than not that the Company will be required to sell, the securities prior to maturity or prior to the recovery of the amortized cost basis.

4. Other Investments

Investment in Variable Interest Entity

The Company has invested $7.0 million in preferred stock of a privately held corporation with a complementary business line. The Company does not have power over the activities that most significantly impact the economic performance of the variable interest entity and is, therefore, not the primary beneficiary. The Company has the option to purchase all of the outstanding common shares issued by the variable interest entity in 2023 at an amount approximating its expected fair value. The preferred stock investment in the variable interest entity is accounted for as an available-for-sale debt security and measured at fair value at each balance sheet date.

Additionally, the Company has extended a $2.5 million revolving line of credit to the variable interest entity to fund its inventory purchases. The Company's investment and amounts loaned under the line of credit are recorded in other long-term assets on its consolidated balance sheet. The outstanding loan balance under the line of credit was $2.5 million as of June 30, 2021 and December 31, 2020. The Company has also entered into a series of agreements to provide ancillary services to the variable interest entity at cost. The Company provided $0.4 million and $0.7 million of these services for the six months ended June 30, 2021 and 2020, respectively, which were recorded against its operating expenses.

Investment in Joint Venture

In September 2018, the Company acquired a non-controlling equity interest in a joint venture in Australia, whereby it has committed to licensing certain intellectual property and contributing up to $2.2 million AUD upon the achievement of specific operational milestones over a period of at least four years from the agreement execution date. As of June 30, 2021, the Company has contributed $0.6 million AUD. This equity investment is accounted for using the equity method and is classified in other long-term assets on the Company's consolidated balance sheet. The Company's share of income and losses from this equity method investment is included in gain (loss) from investment in joint venture on its consolidated statement of operations. Also included in this line item are income and expenses associated with administrative services provided to the joint venture.

5. Fair Value

Investments

The following tables summarize, 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 June 30, 2021			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	$ 6,322	$ 6,322	$ —	$ —
Money market funds	80,656	80,656	—	—
Fixed maturities:				
Foreign deposits	5,224	5,224	—	—
Municipal bond	1,002	—	1,002	—
Investment in variable interest entity	7,949	—	—	7,949
Total	$ 101,153	$ 92,202	$ 1,002	$ 7,949

	As of December 31, 2020			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	$ 6,319	$ 6,319	$ —	$ —
Money market funds	99,054	99,054	—	—
Fixed maturities:				
Foreign deposits	4,564	4,564	—	—
Municipal bond	1,002	—	1,002	—
Investment in variable interest entity	7,949	—	—	7,949
Total	$ 118,888	$ 109,937	$ 1,002	$ 7,949

The Company measures the fair value of restricted cash, money market funds, and foreign deposits 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. Short-term investments are carried at amortized cost, and the fair value and changes in unrealized gains (losses) are disclosed in Note 3, Investments. The fair value of these investments is determined in the same manner as for available-for-sale securities and is considered a Level 1 measurement.

The Company's preferred stock investment in the variable interest entity (see Note 4) is accounted for as an available-for-sale debt security and measured at fair value at each balance sheet date. The estimated fair value of the preferred stock investment is a Level 3 measurement and is based on certain unobservable inputs such as the value of the underlying enterprise, volatility, time to liquidity, and market interest rates. An increase or decrease in any of these unobservable inputs would result in a change in the fair value measurement. Estimated fair value was $7.9 million as of June 30, 2021, unchanged from December 31, 2020, recorded in other long-term assets on the Company's consolidated balance sheet.

Fair Value Disclosures

The Company's other long-term assets balance included notes receivable of $6.1 million as of June 30, 2021 and December 31, 2020, recorded at their estimated collectible amount. The Company estimates that the carrying value of the notes 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. There was no significant activity in Level 3 of the hierarchy during the six months ended June 30, 2021.

The Company recognizes 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 six months ended June 30, 2021 and the year ended December 31, 2020.

6. Commitments and Contingencies

Certain state insurance regulators in the United States have contacted the Company regarding whether employees who had helped prospective members enroll by telephone in prior years were required to have an insurance license to conduct such telephone conversations. To date, the Company has resolved each of these matters in non-material amounts and believes it is compliant with the applicable regulations. The Company is currently engaged with a limited number of state insurance regulators to resolve this same legacy issue and believes it has adequately reserved for these matters.

In addition, from time to time the Company is or may become subject to various legal proceedings arising in the ordinary course of business, including proceedings against members, other entities or regulatory bodies. Estimated liabilities are recorded when it is both probable that a 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. The Company uses generally accepted actuarial methodologies, such as paid loss development methods, in estimating the amount of the reserve for veterinary invoices. The reserve is made for each of the Company's segments, subscription and other business, and is continually refined as the Company receives and pays veterinary invoices. Changes in management's assumptions and estimates may have a relatively large impact to the reserve and associated expense.

Reserve for veterinary invoices

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

	Six Months Ended June 30,	
Subscription	**2021**	**2020**
Reserve at beginning of year	$ 19,925	$ 15,541
Veterinary invoices during the period related to:		
Current year	171,795	130,825
Prior years	(816)	393
Total veterinary invoice expense	170,979	131,218
Amounts paid during the period related to:		
Current year	152,382	116,676
Prior years	14,420	12,129
Total paid	166,802	128,805
Non-cash expenses	3,089	514
Reserve at end of period	$ 21,013	$ 17,440

The Company's reserve for the subscription business segment increased from $19.9 million at December 31, 2020 to $21.0 million at June 30, 2021. This change was comprised of $171.0 million in expense recorded during the period less $166.8 million in payments of veterinary invoices. The $171.0 million in veterinary invoice expense incurred included a reduction of $0.8 million to the reserves relating to prior years, which was the result of ongoing analysis of recent payment trends. For the six months ended June 30, 2020, the Company increased prior year reserves by $0.4 million as a result of analysis of payment trends.

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

	Six Months Ended June 30,	
Other Business	**2021**	**2020**
Reserve at beginning of year	$ 9,004	$ 5,653
Veterinary invoices during the period related to:		
Current year	57,487	30,650
Prior years	(314)	(179)
Total veterinary invoice expense	57,173	30,471
Amounts paid during the period related to:		
Current year	43,038	23,994
Prior years	8,296	5,190
Total paid	51,334	29,184
Non-cash expenses	—	—
Reserve at end of period	$ 14,843	$ 6,940

The Company’s reserve for the other business segment increased from $9.0 million at December 31, 2020 to $14.8 million at June 30, 2021. This change was comprised of $57.2 million in expense recorded during the period less $51.3 million in payments of veterinary invoices. The $57.2 million in veterinary invoice expense incurred included a reduction of $0.3 million to the reserves relating to prior years, which was the result of ongoing analysis of recent payment trends. For the six months ended June 30, 2020, 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 the year to which the veterinary invoice relates, referred to as the year of occurrence.

Subscription		**As of June 30, 2021**
Year of Occurrence		
2019 and prior	$	1,422
2020		3,266
2021		16,325
	$	21,013

Other Business		**As of June 30, 2021**
Year of Occurrence		
2019 and prior	$	—
2020		394
2021		14,449
	$	14,843

8. Stock-Based Compensation

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

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2021	**2020**	**2021**	**2020**
Veterinary invoice expense	$ 672	$ 245	$ 2,971	$ 423
Other cost of revenue	552	99	1,487	189
Technology and development	800	133	1,464	233
General and administrative	2,322	1,075	4,141	1,804
Sales and marketing	2,181	675	4,912	1,231
Total expensed stock-based compensation	6,527	2,227	14,975	3,880
Capitalized stock-based compensation	131	67	293	120
Total stock-based compensation	$ 6,658	$ 2,294	$ 15,268	$ 4,000

As of June 30, 2021, the Company had 418 unvested stock options and 1,175,228 unvested restricted stock units that are expected to vest. Stock-based compensation expenses of $76.9 million related to unvested restricted stock units are expected to be recognized over a weighted average period of approximately 3.0 years.

Stock Options

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

	Number of Options	Weighted Average Exercise Price per Share	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2020	1,459,290	$ 9.93	$ 160,200
Granted	—	—	—
Exercised	(540,437)	4.49	48,468
Forfeited	(2,419)	11.77	—
Outstanding as of June 30, 2021	916,434	13.13	93,445
Exercisable as of June 30, 2021	916,016	$ 13.13	$ 93,407

As of June 30, 2021, stock options outstanding and stock options exercisable had a weighted average remaining contractual life of 4.5 years.

Restricted Stock Units

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

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested shares as of December 31, 2020	782,755	$ 34.81
Granted	686,647	100.58
Vested	(270,875)	40.00
Forfeited	(23,299)	70.96
Unvested shares as of June 30, 2021	1,175,228	$ 71.33

9. Stockholders' Equity

Common Stock and Preferred Stock

As of June 30, 2021, the Company had 100,000,000 shares of common stock authorized and 40,231,055 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 June 30, 2021, the Company had 10,000,000 shares of undesignated 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 (the Board), whenever funds are legally available. These rights are subordinate to the dividend rights of holders of any senior classes of stock outstanding at the time. The Company does not intend to declare or pay any cash dividends in the foreseeable future.

Share Repurchase Program

In April 2021, the Board approved a share repurchase program, pursuant to which the Company may, between May 2021 and May 2026, repurchase outstanding shares of the Company’s common stock. The Company did not repurchase any shares during the three months ended June 30, 2021.

10. Segments

The Company has two reporting segments: subscription business and other business. The subscription business segment currently includes revenue from subscription fees related to the Company's "Trupanion" branded products, while the other business segment is comprised of revenue from other product offerings that generally have a business-to-business relationship and a different margin profile than our subscription segment, including revenue from writing policies on behalf of third parties and revenue from other products and software solutions.

The chief operating decision maker reviews revenue and operating income (loss) to evaluate segment performance. Revenue, veterinary invoice expense, other cost of revenue, and sales and marketing expenses are generally directly attributed to each segment. Other operating expenses, such as technology and development expense, general and administrative expense, and depreciation and amortization, are allocated proportionately based on revenue in each segment. 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.

Operating income (loss) of the Company's segments were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Subscription business:				
Revenue	$ 120,373	$ 92,453	$ 233,665	$ 181,937
Veterinary invoice expense	87,253	66,030	170,979	131,218
Other cost of revenue	12,493	8,564	24,304	16,798
Technology and development	2,918	1,798	5,651	3,502
General and administrative	5,319	3,977	10,604	7,884
Sales and marketing	19,272	9,051	38,805	19,330
Depreciation and amortization	2,259	1,351	4,524	2,462
Subscription business operating income (loss)	(9,141)	1,682	(21,202)	743
Other business:				
Revenue	47,887	25,467	89,280	47,284
Veterinary invoice expense	31,029	16,019	57,173	30,471
Other cost of revenue	12,940	7,440	24,844	13,015
Technology and development	1,161	495	2,159	911
General and administrative	2,116	1,096	4,047	2,049
Sales and marketing	118	191	289	354
Depreciation and amortization	899	372	1,727	642
Other business operating income (loss)	(376)	(146)	(959)	(158)
Gain (loss) from investment in joint venture	5	(27)	(80)	(86)
Total operating income (loss)	$ (9,512)	$ 1,509	$ (22,241)	$ 499

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
United States	$ 139,128	$ 99,056	$ 266,887	$ 191,580
Canada and other	29,132	18,864	56,058	37,641
Total revenue	$ 168,260	$ 117,920	$ 322,945	$ 229,221

Substantially all of the Company's long-lived assets were located in the United States as of June 30, 2021 and December 31, 2020.

11. Business Combination

On October 30, 2020, the Company completed an acquisition of 100% of the equity of Aquarium Software Limited (Aquarium), a U.K.-based insurance software provider, for approximately $48.3 million in net cash. The acquired technology from Aquarium focuses on the pet space and, along with the acquired personnel, is intended to enable the Company to improve its back-end software to help facilitate growth opportunities. The Company incurred $0.6 million acquisition-related costs that were recorded in general and administrative expenses.

The acquisition is recorded using the purchase method of accounting in accordance with ASC 805, Business Combinations, which requires that the assets acquired and liabilities assumed to be recorded at their respective fair values at the acquisition date. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

	October 30, 2020
Current assets, net of cash acquired	$ 1,469
Property and equipment	171
Amortizable intangible assets	19,512
Goodwill	31,352
Other long-term assets	1,421
Current liabilities	(1,269)
Deferred tax liability and other liabilities	(4,361)
Total Consideration Transferred, net of cash acquired	$ 48,295

The results of Aquarium's operations have been included in the consolidated financial statements since the acquisition date, but have been immaterial to the Company's consolidated financial statements.

12. Related Parties

In August 2018, the Company invested $0.3 million in a limited liability entity in exchange for a 17.5% ownership interest. The investee is considered to be a related party, as the Company has the ability to exercise significant influence over the investee. In February 2020, the Company entered into a service agreement with the investee, under which the Company incurred $0.8 million and $1.6 million of expenses for consulting services provided by the investee during the three and six months ended June 30, 2021, respectively.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview

We provide medical insurance for cats and dogs throughout the United States, Canada, Puerto Rico, and Australia. Our data-driven, vertically-integrated approach enables us to provide pet owners with products that offer what we believe is the highest value medical insurance, priced specifically for each pet’s unique characteristics and coverage level. Our growing and loyal membership base provides us with highly predictable and recurring revenue. We operate our subscription business segment similar to other subscription-based businesses, with a focus on achieving a target margin prior to our pet acquisition expense and acquiring as many pets as possible at our targeted average estimated internal rate of return.

We operate in two business segments: subscription business and other business. We currently generate revenue in our subscription business segment from subscription fees for our “Trupanion” branded products. Fees are paid at the beginning of each subscription period, which automatically renews on a monthly basis. We generate revenue in our other business segment primarily by writing policies on behalf of third parties. We do not undertake the marketing efforts for these policies and have a business-to-business relationship with these third parties. Our other business segment also includes revenue from other products and software solutions that have a different margin profile from our subscription business.

We generate leads for our subscription business segment from a diverse set of member acquisition channels, which we then convert into members through our contact center, website and other direct-to-consumer activities. These channels include leads from third-parties such as veterinarians and referrals from existing members. Veterinary hospitals represent our largest referral source. We engage our “Territory Partners” to have face-to-face visits with veterinarians and their staff. Territory Partners are dedicated to cultivating direct veterinary relationships and building awareness of the benefits of high quality medical insurance to veterinarians and their clients. Veterinarians then educate pet owners, who visit our website or call our contact center to learn more about, and potentially enroll in, Trupanion. We also receive a significant number of new leads from existing members adding pets and referring their friends and family members. Our direct-to-consumer acquisition channels serve as important resources for pet owner education and drive new member leads and conversion. We monitor average pet acquisition cost to evaluate the efficiency of our sales and marketing programs in acquiring new members and measure effectiveness based on our targeted return on investment.

Our Response to the COVID-19 Pandemic

We have not experienced a material adverse impact on our business due to COVID-19, but we continue to monitor conditions closely and adapt our operations to meet federal, state and local guidance. Our focus remains on promoting employee health and safety, serving our members and ensuring business continuity. Our Seattle headquarters is now open for those who want to work in that office, in compliance with applicable regulations and guidance.

While conditions appear to be improving, particularly as more people get vaccinated, the impacts of COVID-19 and related economic conditions on our results are highly uncertain and in many ways outside of our control. The scope, duration and magnitude of the direct and indirect effects of COVID-19 are evolving rapidly and in ways that are difficult, if possible, to anticipate. For additional details, see the section titled "Risk Factors."

Key Operating Metrics

The following tables set forth total pets enrolled and key operating metrics for our subscription business for the six months ended June 30, 2021 and 2020 and for each of the last eight fiscal quarters.

	Six Months Ended June 30,	
	2021	2020
Total Business:		
Total pets enrolled (at period end)	1,024,226	744,727
Subscription Business:		
Total subscription pets enrolled (at period end)	643,395	529,400
Monthly average revenue per pet	$ 63.34	$ 59.19
Lifetime value of a pet, including fixed expenses	$ 681	$ 597
Average pet acquisition cost (PAC)	$ 281	$ 222
Average monthly retention	98.72 %	98.66 %

	Three Months Ended							
	June. 30, 2021	Mar. 31, 2021	Dec. 31, 2020	Sept. 30, 2020	Jun. 30, 2020	Mar. 31, 2020	Dec. 31, 2019	Sept. 30, 2019
Total Business:								
Total pets enrolled (at period end)	1,024,226	943,854	862,928	804,251	744,727	687,435	646,728	613,694
Subscription Business:								
Total subscription pets enrolled (at period end)	643,395	609,835	577,957	552,909	529,400	508,480	494,026	479,427
Monthly average revenue per pet	$ 63.69	$ 62.97	$ 62.03	$ 60.87	$ 59.40	$ 58.96	$ 58.58	$ 58.12
Lifetime value of a pet, including fixed expenses	$ 681	$ 684	$ 653	$ 615	$ 597	$ 535	$ 523	$ 511
Average pet acquisition cost (PAC)	$ 284	$ 279	$ 272	$ 261	$ 199	$ 247	$ 222	$ 208
Average monthly retention	98.72 %	98.73 %	98.71 %	98.69 %	98.66 %	98.59 %	98.58 %	98.59 %

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

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

Monthly average revenue per pet. Monthly average revenue per pet is calculated as amounts billed in a given period 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 subscription 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 subscription business.

Lifetime value of a pet, including fixed expenses. Lifetime value of a pet, including fixed expenses, is calculated based on subscription revenue less cost of revenue 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. This amount is also reduced by the fixed expenses related to our subscription business, which are the pro-rata portion of general and administrative and technology and development expenses, less stock-based compensation, based on revenues. This amount, on a per pet basis, is 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 lifetime value of a pet, including fixed expenses, to estimate the value we might expect from new pets over their implied average subscriber life in months, if they behave like the average pet in that respective period. When evaluating the amount of sales and marketing expenses we may want to incur to attract new pet enrollments, we refer to the lifetime value of a pet, including fixed expenses, as well as our estimated internal rate of return calculation for an average pet, which also includes an estimated surplus capital charge, to inform the amount of acquisition spend in relation to the estimated payback period.

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

Average monthly retention. Average monthly retention is measured as the monthly retention rate of enrolled subscription pets for each applicable period averaged over the 12 months prior to the period end date. As such, our average monthly retention rate as of June 30, 2021 is an average of each month's retention from July 1, 2020 through June 30, 2021. We calculate monthly retention as the number of pets that remain after subtracting all pets that cancel during a month, including pets that enroll and cancel within that month, divided by the total pets enrolled at the beginning of that month. We monitor average monthly retention because it provides a measure of member satisfaction and allows us to calculate the implied average subscriber life in months.

Non-GAAP Financial Measures

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

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

The following tables reconcile net acquisition cost to sales and marketing expense (in thousands) for the six months ended June 30, 2021 and 2020 and for each of the last eight fiscal quarters:

	Six Months Ended June 30,	
	2021	2020
Sales and marketing expense	$ 39,094	$ 19,684
Net of sign-up fee revenue	(2,524)	(1,546)
Excluding:		
Stock-based compensation expense	(4,912)	(1,231)
Other business segment sales and marketing expense	(289)	(354)
Net acquisition cost	$ 31,369	$ 16,553

	Three Months Ended							
	June. 30, 2021	Mar. 31, 2021	Dec. 31, 2020	Sept. 30, 2020	Jun. 30, 2020	Mar. 31, 2020	Dec. 31, 2019	Sept. 30, 2019
Sales and marketing expense	$ 19,390	$ 19,704	$ 14,809	$ 13,344	$ 9,242	$ 10,442	$ 9,212	$ 9,255
Net of sign-up fee revenue	(1,260)	(1,264)	(919)	(827)	(781)	(765)	(730)	(790)
Excluding:								
Stock-based compensation expense	(2,181)	(2,731)	(801)	(741)	(675)	(556)	(547)	(577)
Other business segment sales and marketing expense	(118)	(171)	(201)	(265)	(191)	(163)	(152)	(94)
Net acquisition cost	$ 15,831	$ 15,538	$ 12,888	$ 11,511	$ 7,595	$ 8,958	$ 7,783	$ 7,794

Components of Operating Results

General

We operate in two business segments: subscription business and other business. We currently generate revenue in our subscription business segment from subscription fees related to our "Trupanion" branded products. Our other business segment includes revenue from other product offerings that generally have a business-to-business relationship and different margin profiles than our subscription segment, including revenue from writing policies on behalf of third parties and revenue from other products and software solutions.

Revenue

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

We generate revenue in our other business segment primarily from writing policies on behalf of third parties where we do not undertake the direct consumer marketing. This segment also includes revenue from other products and software solutions which have a different margin profile than our subscription business.

Cost of Revenue

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

Veterinary invoice expense

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

Other cost of revenue

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

Operating Expenses

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

Technology and Development

Technology and development expenses primarily consist of personnel costs and related expenses for our technology staff, which includes information technology development and infrastructure support, including third-party services. It also includes expenses associated with development of new products and offerings.

General and Administrative

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

Sales and Marketing

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

Depreciation and amortization

Depreciation and amortization expenses consist of depreciation of property, equipment, and software developed for internal use, as well as amortization of finite-lived intangible assets.

Gain (loss) from investment in joint venture

Gain (loss) from investment in joint venture consists of the share of income and losses from our equity method investment in a joint venture, as well as income and expenses associated with administrative services provided to the joint venture.

Stock-based compensation

Stock-based compensation is included in the cost and expense line items above. Stock-based compensation will vary depending on corporate performance, measured by the estimated increase in our intrinsic value. For example, when the company has delivered strong performance, stock-based compensation may increase as a result of incentive-based grants being awarded according to our equity incentive plan.

Factors Affecting Our Performance

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

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

Timing of initiatives. Over time we plan to implement new initiatives to improve our member experience, make modifications to our subscription plan, introduce new coverage plans, pursue pet food or other adjacent opportunities, improve our technology, increase the veterinary hospitals using our direct pay software, 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 profitability 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 mix of business between the United States and Canada changes, our metrics, such as our monthly average revenue per pet, and our exposure to foreign exchange fluctuations will be impacted. Any expansion into other international markets could have similar effects.

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

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
	(in thousands)			
Revenue:				
Subscription business	$ 120,373	$ 92,453	$ 233,665	$ 181,937
Other business	47,887	25,467	89,280	47,284
Total revenue	168,260	117,920	322,945	229,221
Cost of revenue:				
Subscription business(1)	99,746	74,594	195,283	148,016
Other business	43,969	23,459	82,017	43,486
Total cost of revenue	143,715	98,053	277,300	191,502
Operating expenses:				
Technology and development(1)	4,079	2,293	7,810	4,413
General and administrative(1)	7,435	5,073	14,651	9,933
Sales and marketing(1)	19,390	9,242	39,094	19,684
Depreciation and amortization	3,158	1,723	6,251	3,104
Total operating expenses	34,062	18,331	67,806	37,134
Gain (loss) from investment in joint venture	5	(27)	(80)	(86)
Operating (loss) income	(9,512)	1,509	(22,241)	499
Interest expense	3	341	1	720
Other income, net	(99)	(202)	(161)	(484)
(Loss) income before income taxes	(9,416)	1,370	(22,081)	263
Income tax (benefit) expense	(195)	17	(412)	43
Net (loss) income	$ (9,221)	$ 1,353	$ (21,669)	$ 220

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
	(in thousands)			
Cost of revenue	$ 1,224	$ 344	$ 4,458	$ 612
Technology and development	800	133	1,464	233
General and administrative	2,322	1,075	4,141	1,804
Sales and marketing	2,181	675	4,912	1,231
Total stock-based compensation expense	$ 6,527	$ 2,227	$ 14,975	$ 3,880

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
	(as a percentage of revenue)			
Revenue	100 %	100 %	100 %	100 %
Cost of revenue	85	83	86	84
Operating expenses:				
Technology and development	2	2	2	2
General and administrative	4	4	5	4
Sales and marketing	12	8	12	9
Depreciation and amortization	2	1	2	1
Total operating expenses	20	16	21	16
Gain (loss) from investment in joint venture	—	—	—	—
Operating (loss) income	(6)	1	(7)	—
Interest expense	—	—	—	—
Other income, net	—	—	—	—
(Loss) income before income taxes	(6)	1	(7)	—
Income tax (benefit) expense	—	—	—	—
Net (loss) income	(5)%	1 %	(7)%	— %

Stock-based compensation expense:	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
	(as a percentage of revenue)			
Cost of revenue	1 %	— %	1 %	— %
Technology and development	—	—	—	—
General and administrative	1	1	1	1
Sales and marketing	1	1	2	1
Total stock-based compensation expense	4 %	2 %	5 %	2 %

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
	(as a percentage of subscription revenue)			
Subscription business revenue	100 %	100 %	100 %	100 %
Subscription business cost of revenue	83	81	84	81

Comparison of the Three and Six Months Ended June 30, 2021 and 2020

Revenue

	Three Months Ended June 30,			Six Months Ended June 30,		
	2021	2020	% Change	2021	2020	% Change
	(in thousands, except percentages, pet and per pet data)					
Revenue:						
Subscription business	$ 120,373	$ 92,453	30 %	$ 233,665	$ 181,937	28 %
Other business	47,887	25,467	88	89,280	47,284	89
Total revenue	$ 168,260	$ 117,920	43	$ 322,945	$ 229,221	41
Percentage of Revenue by Segment:						
Subscription business	72 %	78 %		72 %	79 %	
Other business	28	22		28	21	
Total revenue	100 %	100 %		100 %	100 %	
Total pets enrolled (at period end)	1,024,226	744,727	38	1,024,226	744,727	38
Total subscription pets enrolled (at period end)	643,395	529,400	22	643,395	529,400	22
Monthly average revenue per pet	$ 63.69	$ 59.40	7	$ 63.34	$ 59.19	7
Average monthly retention	98.72 %	98.66 %		98.72 %	98.66 %	

Three months ended June 30, 2021 compared to three months ended June 30, 2020. Total revenue increased by $50.3 million, or 43%, to $168.3 million for the three months ended June 30, 2021. Revenue from our subscription business segment increased by $27.9 million, or 30%, to $120.4 million for the three months ended June 30, 2021. This increase in subscription business revenue was primarily due to a 22% increase in total subscription pets enrolled as of June 30, 2021 compared to a year ago, and a 7% year over year increase in average revenue per pet (approximately 4% on a constant currency basis). Increases in pricing were primarily due to the increased cost and utilization of veterinary care, as well as changes in the Canadian currency exchange rate. Revenue from our other business segment increased by $22.4 million, or 88%, to $47.9 million for the three months ended June 30, 2021, primarily due to a 77% increase in enrolled pets in this segment.

Six months ended June 30, 2021 compared to six months ended June 30, 2020. Total revenue increased by $93.7 million, or 41%, to $322.9 million for the six months ended June 30, 2021. Revenue from our subscription business segment increased by $51.7 million, or 28%, to $233.7 million. This increase in subscription business revenue was primarily due to a 22% increase in total subscription pets enrolled as of June 30, 2021 compared to a year ago, and a 7% year over year increase in average revenue per pet (approximately 5% on a constant currency basis). Increases in pricing were primarily due to the increased cost and utilization of veterinary care, as well as changes in the Canadian currency exchange rate. Revenue from our other business segment increased by $42.0 million, or 89%, to $89.3 million for the six months ended June 30, 2021, primarily due to a 77% increase in enrolled pets in this segment.

Cost of Revenue

	Three Months Ended June 30,			Six Months Ended June 30,		
	2021	2020	% Change	2021	2020	% Change
	(in thousands, except percentages, pet and per pet data)					
Cost of Revenue:						
Subscription business:						
Veterinary invoice expense	$ 87,253	$ 66,030	32 %	$ 170,979	$ 131,218	30 %
Other cost of revenue	12,493	8,564	46	24,304	16,798	45
Total cost of revenue	99,746	74,594	34	195,283	148,016	32
Other business:						
Veterinary invoice expense	31,029	16,019	94	57,173	30,471	88
Other cost of revenue	12,940	7,440	74	24,844	13,015	91
Total cost of revenue	$ 43,969	$ 23,459	87	82,017	43,486	89
Percentage of Revenue by Segment:						
Subscription business:						
Veterinary invoice expense	72 %	71 %		73 %	72 %	
Other cost of revenue	10	9		10	9	
Total cost of revenue	83	81		84	81	
Other business:						
Veterinary invoice expense	65	63		64	64	
Other cost of revenue	27	29		28	28	
Total cost of revenue	92 %	92 %		92	92	
Total pets enrolled (at period end)	1,024,226	744,727	38	1,024,226	744,727	38
Total subscription pets enrolled (at period end)	643,395	529,400	22	643,395	529,400	22
Monthly average revenue per pet	$ 63.69	$ 59.40	7	$ 63.34	$ 59.19	7

Three months ended June 30, 2021 compared to three months ended June 30, 2020. Cost of revenue for our subscription business segment was $99.7 million for the three months ended June 30, 2021, compared to $74.6 million for the same period in the prior year. The increase of 34% in subscription cost of revenue was primarily the result of a 22% increase in subscription pets enrolled and the increase in veterinary invoice expense per pet, which was attributable to both increased cost and utilization of veterinary care and lower than normal veterinary invoice expense in the second quarter of the prior year due to the impacts of COVID-19. Additionally, stock-based compensation expense increased $0.9 million during the period due to new performance grants in the first quarter of this year. Cost of revenue for our other business segment increased by $20.5 million, or 87%, to $44.0 million for the three months ended June 30, 2021, primarily due to the increase in enrolled pets in this segment.

Six months ended June 30, 2021 compared to six months ended June 30, 2020. Cost of revenue for our subscription business segment was $195.3 million for the six months ended June 30, 2021, compared to $148.0 million for the same period in the prior year. The increase of 32% in subscription cost of revenue was primarily the result of a 22% increase in subscription pets enrolled and an increase of 7% in veterinary invoice expense per pet due to increases in the cost and utilization of veterinary care. Additionally, stock-based compensation expense increased $3.8 million during the period due to new performance grants in the first quarter of this year, including the full impact of one-time team grants of $2.3 million in the first quarter of this year. Cost of revenue for our other business segment increased by $38.5 million, or 89%, to $82.0 million for the six months ended June 30, 2021, primarily due to the increase in enrolled pets in this segment.

Technology and Development Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2021	2020	% Change	2021	2020	% Change
	(in thousands, except percentages)					
Technology and development	$ 4,079	$ 2,293	78 %	$ 7,810	$ 4,413	77 %
Percentage of total revenue	2 %	2 %		2 %	2 %	

Three months ended June 30, 2021 compared to three months ended June 30, 2020. Technology and development expenses increased by $1.8 million, or 78%, to $4.1 million for the three months ended June 30, 2021. The increase was primarily driven by development expenses of $1.1 million related to new product offerings, or 0.7% of total revenue, and $0.7 million of increased stock-based compensation during the period due to new performance grants in the first quarter of this year. Overall, technology and development expenses remained consistent at approximately 2% of revenue year over year.

Six months ended June 30, 2021 compared to six months ended June 30, 2020. Technology and development expenses increased by $3.4 million, or 77%, to $7.8 million for the six months ended June 30, 2021. The increase was primarily driven by development expenses of $1.9 million related to new product offerings, or 0.6% of total revenue, and $1.2 million of increased stock-based compensation during the period due to new performance grants in the first quarter of this year. Overall, technology and development expenses remained consistent at approximately 2% of revenue year over year.

General and Administrative Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2021	2020	% Change	2021	2020	% Change
	(in thousands, except percentages)					
General and administrative	$ 7,435	$ 5,073	47 %	$ 14,651	$ 9,933	47 %
Percentage of total revenue	4 %	4 %		5 %	4 %	

Three months ended June 30, 2021 compared to three months ended June 30, 2020. General and administrative expenses increased by $2.4 million, or 47%, to $7.4 million for the three months ended June 30, 2021. The increase in expense was primarily due to a $1.2 million increase in stock-based compensation, a $0.5 million increase in compensation expense related primarily to increased headcount, a $0.4 million increase in facilities-related expenses, and a $0.3 million increase in legal, tax and other professional service fees. Overall, general and administrative expenses remained consistent at 4% of revenue year over year.

Six months ended June 30, 2021 compared to six months ended June 30, 2020. General and administrative expenses increased by $4.7 million, or 47%, to $14.7 million for the six months ended June 30, 2021. The increase in expense was primarily due to a $2.3 million increase in stock-based compensation, a $1.0 million increase in compensation expense related primarily to increased headcount, a $0.8 million increase in facilities-related expenses, and a $0.7 million increase in legal, tax and other professional service fees. Overall, general and administrative expenses remained consistent at approximately 4% to 5% of revenue year over year.

Sales and Marketing Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2021	2020	% Change	2021	2020	% Change
	(in thousands, except percentages, pet and per pet data)					
Sales and marketing	$ 19,390	$ 9,242	110 %	$ 39,094	$ 19,684	99 %
Percentage of total revenue	12 %	8 %		12 %	9 %	
Subscription Business:						
Total subscription pets enrolled (at period end)	643,395	529,400	22	643,395	529,400	22
Average pet acquisition cost (PAC)	$ 284	$ 199	43	$ 281	$ 222	27

Three months ended June 30, 2021 compared to three months ended June 30, 2020. Sales and marketing expenses increased by $10.1 million, or 110%, to $19.4 million for the three months ended June 30, 2021, driving new subscription pet enrollments to increase 46% year over year. The $10.1 million increase was primarily attributable to a $5.4 million increase in sales and marketing expenses to generate leads and increase conversion rates and a $3.1 million increase in compensation expenses primarily related to headcount increases. Additionally, stock-based compensation expense increased $1.5 million during the period due to new performance grants in the first quarter of this year.

Six months ended June 30, 2021 compared to six months ended June 30, 2020. Sales and marketing expenses increased by $19.4 million, or 99%, to $39.1 million for the six months ended June 30, 2021, driving new subscription pet enrollments to increase 50% year over year. The $19.4 million increase was attributable to a $9.1 million increase in sales and marketing expenses to generate leads and increase conversion rates and a $6.5 million increase in compensation expenses primarily related to headcount increases. Additionally, stock-based compensation expense increased $3.7 million during the period due to new performance grants in the first quarter of this year.

Depreciation and Amortization

	Three Months Ended June 30,			Six Months Ended June 30,		
	2021	2020	% Change	2021	2020	% Change
	(in thousands, except percentages)					
Depreciation and amortization	$ 3,158	$ 1,723	83%	$ 6,251	$ 3,104	101%
Percentage of total revenue	2 %	1 %		2 %	1 %	

Depreciation and amortization expenses have been reclassified as a separate line item in the consolidated statement of operations and prior period amounts have been reclassified from their original presentation to conform to the current period presentation. We elected to present depreciation and amortization expenses as a separate line item to better align with management's view of our operating results.

Three months ended June 30, 2021 compared to three months ended June 30, 2020. Depreciation and amortization expense increased by $1.4 million, or 83%, to $3.2 million for the three months ended June 30, 2021. The change was primarily due to $1.1 million incremental amortization as a result of acquired intangible assets in the fourth quarter of 2020.

Six months ended June 30, 2021 compared to six months ended June 30, 2020. Depreciation and amortization expense increased by $3.1 million, or 101%, to $6.3 million for the six months ended June 30, 2021. In addition to increased depreciation that is in line with business growth, the change was primarily due to $2.1 million incremental amortization as a result of acquired intangible assets in the fourth quarter of 2020.

Stock-based compensation

Three months ended June 30, 2021 compared to three months ended June 30, 2020. Stock-based compensation is included in the cost and expense line items in the consolidated statements of operations, discussed above. Stock-based compensation expense in total was $6.5 million during the quarter, up from $2.2 million in the prior year period. The amount of stock-based compensation recognized largely reflects the timing and vesting of our annual performance grants, including grants in the first quarter of this year for the strong 2020 performance, calculated according to our equity incentive plan.

Six months ended June 30, 2021 compared to six months ended June 30, 2020. Stock-based compensation is included in the cost and expense line items in the consolidated statements of operations, discussed above. Stock-based compensation expense in total was $15.0 million during the quarter, up from $3.9 million in the prior year period. The amount of stock-based compensation recognized largely reflects the timing and vesting of our annual performance grants, including grants in the first quarter of this year for the strong 2020 performance, calculated according to our equity incentive plan. Of the $15.0 million, $4.3 million was related to a one-time 2020 performance grant, shared with the entire team and fully recognized in the first quarter of this year.

Liquidity and Capital Resources

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

	Six months ended June 30, 2021	Six months ended June 30, 2020
Net cash provided by (used in) operating activities	$ (3,922)	$ 7,774
Net cash used in investing activities	(18,636)	(8,878)
Net cash provided by (used in) financing activities	(393)	2,383
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash, net	408	(434)
Net change in cash, cash equivalents and restricted cash	$ (22,543)	$ 845

As of June 30, 2021, we had $219.4 million in cash, cash equivalents and short-term investments. Most of the assets in our insurance subsidiaries are subject to certain capital and dividend rules and regulations prescribed by jurisdictions in which they are authorized to operate. As of June 30, 2021, total assets and liabilities held outside of our insurance entities were $237.8 million and $28.5 million, respectively, including $6.8 million of cash and cash equivalents that were segregated from other operating funds and held in trust for the payment of veterinary invoices on behalf of our insurance subsidiaries. For further information, refer to "—Regulation".

Our primary sources of liquidity are our existing cash, cash equivalents, and short-term investments, as well as cash provided by operations. We believe these sources are sufficient to fund our operations and capital requirements for the next 12 months. As we continue to grow and consider strategic opportunities, however, we may explore additional financing to fund our operations and growth or to meet capital requirements. Financing could include equity, equity-linked, or debt financing. Additional financing may not be available to us on acceptable terms, or at all.

Our primary requirements for liquidity are paying veterinary invoices, funding operations and capital requirements, investing in new member acquisition, and investing in enhancements to our member experience. In December 2020, we elected to terminate our line of credit facility and repaid all then outstanding obligations.

In April 2021, our Board approved a share repurchase program, pursuant to which the Company may, between May 2021 and May 2026, repurchase outstanding shares of our common stock. While the Board has approved the program, any repurchase will be subject to quarterly assessments based on parameters we set. We cannot predict the timing or extent of any repurchases of shares of common stock, as such repurchases will depend on a number of factors, some of which are beyond our control. These include uses of capital in a given quarter, available cash, our stock price relative to our estimated intrinsic value, and general market conditions. We did not repurchase any shares under this program during the quarter ended June 30, 2021.

Operating Cash Flows

We derive operating cash flows primarily from the sale of our subscription plans, which is used to pay veterinary invoices and other cost of revenue. Additionally, cash is used to support the growth of our business by reinvesting to acquire new pet enrollments and to fund projects that improve our members' experience. Net cash used in operating activities was $3.9 million for the six months ended June 30, 2021, compared to a $7.8 million net cash provided by operating activities for the six months ended June 30, 2020. The change was primarily driven by increased pet acquisition spend during the quarter to drive new pet enrollments and future growth, faster payment of veterinary invoices as a result of increased utilization of claim automation, as well as timing differences between collections from members and payments of veterinary invoices and payments to vendors. Changes in accounts receivable and deferred revenue were primarily related to annual policies with monthly payment terms within our other business segment.

Investing Cash Flows

Net cash used in investing activities was $18.6 million for the six months ended June 30, 2021, primarily related to the net purchase of investments to increase our statutory capital, as well as purchases of property, equipment and intangible assets, primarily related to development of internal use software focused on new product initiatives and member experience improvements.

Financing Cash Flows

Net cash used in financing activities was $0.4 million for the six months ended June 30, 2021, compared to $2.4 million net cash provided by financing activities during the same period in the prior year, primarily due to a decrease in borrowings under the line of credit facility. In December 2020, we elected to terminate the facility and repaid all then outstanding obligations.

Regulation

As of June 30, 2021, our insurance entities collectively held $102.0 million in short-term investments and $162.8 million in other current assets, including $22.0 million held in cash and cash equivalents to be used for operating expenses of our insurance subsidiaries. Most of the assets in our insurance entities are subject to certain capital and dividend rules and regulations prescribed by jurisdictions in which they are authorized to operate. We expect our required capital held within our insurance entities to grow as our business grows.

American Pet Insurance Company (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, 2020, APIC was required to maintain at least $79.1 million of risk-based capital to avoid this additional regulatory oversight. As of that date, APIC maintained $93.2 million of risk-based capital.

ZPIC Insurance Company (ZPIC)

We established a new wholly-owned insurance subsidiary, ZPIC, in the second quarter of 2021. ZPIC is domiciled in the state of Missouri. As of June 30, 2021, ZPIC has not started underwriting any insurance policies.

Wyndham Insurance Company (SAC) Limited (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. In April 2021, our parent entity received a dividend of $5.6 million from WICL Segregated Account AX as allowed under our agreements with WICL. As required by the Office of the Superintendent of Financial Institutions regulations related to our reinsurance agreement with Omega General Insurance Company, we are required to maintain a Canadian Trust account with the greater of CAD $2.0 million or 120% of unearned Canadian premium plus 20% of outstanding Canadian claims, including all incurred but not reported claims. As of December 31, 2020, the account held CAD $5.8 million.

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

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

Contractual Obligations

We enter into long-term contractual obligations and commitments in the normal course of business, primarily debt obligations and non-cancellable vendor service agreements. Management believes there have been no material changes to our contractual obligation disclosure as of June 30, 2021, compared to those discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2020.

Critical Accounting Policies and Significant Estimates

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

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

There have been no material changes to our critical accounting policies and estimates as compared to those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2020.

Item 3. Quantitative and Qualitative Disclosures About Market Risks

Management believes there have been no material changes to our quantitative and qualitative disclosures about market risks during the six months ended June 30, 2021, compared to those discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2020.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control

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

Limitations on Effectiveness of Controls and Procedures

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

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

Summary of Material Risk Factors

Our business is subject to numerous risks and uncertainties of which you should be aware. Among others, these risks relate to:

- Our results of operations, including adverse impacts from the ongoing COVID-19 pandemic, our significant net losses since inception, our ability to achieve or maintain profitability in the future, and our ability to maintain our rate of revenue growth;
- Our ability to grow our member base, including by attracting new members from internet searches and from leads generated from Territory Partners, veterinarians and other third parties, to retain these members, and to recover our member acquisition costs;
- Our engagement of Territory Partners as independent contractors rather than employees;
- The pricing of our subscription, the actual levels of our veterinary invoice expense (which may increase with use of our patented software for direct payment of invoices), and our ability to timely and accurately process valid invoices and to identify improper invoices;
- Our need to maintain certain levels of surplus capital under applicable insurance regulations;
- Competitive challenges and our ability to maintain and enhance our brand;
- Emerging claim and coverage issues;
- Our ability to maintain and scale our infrastructure, to invest in or acquire businesses, products and technologies, and otherwise to manage our growth;
- Our reliance on key personnel, strategic relationships and a Canadian insurance company for our Canadian operations;
- Variations in our operating results, fluctuations in foreign exchange rates, other issues relating to expanding our operations internationally, and general changes in the economy;
- Our efforts to establish multiple insurance subsidiaries;
- Our ability to maintain effective internal controls and security measures;
- Our acceptance of automatic fund transfers and credit card and debit card payments;
- Owning an office building;
- Our ability to protect our intellectual property (IP), to avoid violating IP rights of other, and to maintain relationships with third parties providing necessary IP and technology to us;
- Litigation or regulatory proceedings;
- Compliance with covenants in our current credit agreement and limitations that may arise in connection with any future indebtedness we may incur;
- Tax liabilities and our ability to use net operating loss carryforwards;
- Compliance with the numerous laws and regulations applicable to our business, including state, federal and foreign laws relating to insurance, privacy, the internet, email and texting, and accounting matters; and
- Our common stock, including trading price declines from missed earnings guidance, inadequate analyst coverage, trading volatility, lack of dividends, concentrated ownership, and anti-takeover provisions in our governing documents.

Risks Related to Our Business and Industry

Our results of operations may be adversely impacted by the COVID-19 pandemic.

The global spread of the COVID-19 pandemic and related containment efforts have created significant economic disruption. To date, the pandemic has not had a material adverse impact on our business, although it could impact growth rates in the future.

- The economic impact on consumers resulting from the COVID-19 pandemic and related public health measures may result in decreased new enrollments in our subscription and increased cancellations as consumers may shift their spending in response to economic uncertainty. Such a shift could materially adversely affect us if we are unable to adjust our subscription to match consumer needs.
- Governmental lockdowns, restrictions or new regulations have and could in the future impact the ability of our Territory Partners to conduct face-to-face visits with veterinarians and their staff. The extent and/or duration of these restrictions and limitations could impact our ability to promote and support our subscription through the veterinary channel.
- While we have not seen definitive evidence, some veterinarians have reported that pets may contract COVID-19. The extent to which COVID-19 may be communicable among humans, dogs and cats and its health impact on pets is somewhat uncertain and an increase in COVID-19 among pets may cause our veterinary invoice expense to increase.
- While we are not currently experiencing any meaningful decreases in veterinary invoice expenses, several insurance companies within the property and casualty insurance space have provided refunds to policyholders in light of reduced claims trends they are experiencing, and it is possible that state insurance regulators may require us to provide refunds or otherwise change our behavior.
- The duration of the pandemic, whether it may recur, and its other long-term impacts are highly uncertain and cannot be predicted. These risks and uncertainties make it challenging to manage our growth, maintain business relationships, price our subscription plans and otherwise plan for our business.

Beginning in spring 2020, in accordance with local and state directives, we shifted our operations from our corporate office facility located in Seattle, Washington, and substantially all of our personnel began working from home. As COVID-19 related restrictions ease and more people get vaccinated, we have begun the process of transitioning those personnel who are comfortable working in an office setting back to our corporate office facility but a significant number of our personnel continue to work from home. While we learned during COVID-19 that we can work very effectively in a fully-remote environment, the partial return to in-office work and the potential transition to permanent remote working arrangements for some employees may result in increased costs, decreased efficiency, deterioration of corporate culture, greater exposure to cybersecurity threats, or other operational risks. Similarly, many of our Territory Partners, our vendors, the businesses for which we write policies in our other business segment, and our strategic partners may continue to work from home, and many veterinary hospitals are working at reduced staffing levels and hours of operation.

In addition, our management team has spent, and will likely continue to spend, significant time, attention and resources monitoring the COVID-19 pandemic and associated global economic uncertainty and seeking to manage its effects on our business and workforce. Our efforts to re-open our corporate office facility safely may also expose our employees and other third parties to health risks and us to associated liability, and they will involve additional financial burdens.

While the pandemic conditions appear to be improving, the impacts of COVID-19 and related economic conditions on our results remain highly uncertain and in many ways outside of our control. The scope, duration and magnitude of the direct and indirect effects of COVID-19 are evolving rapidly and in ways that are difficult, if possible, to anticipate.

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

We have incurred significant cumulative net losses since our inception. We incurred net losses of $5.8 million and $1.8 million in the years ended December 31, 2020 and 2019, respectively, and as of December 31, 2020, we had an accumulated deficit of $91.4 million. We have funded our operations through equity financings, borrowings under a revolving line of credit and term loans and, since 2016, positive cash flows from operations. Our ability to achieve and maintain profitability will depend in significant part on our obtaining new members, retaining our existing members and ensuring that our expenses, including our sales and marketing expenses, do not exceed our revenue. We expect to make significant expenditures and investments in member acquisition and product initiatives and these expenditures may not result in additional growth. Our recent growth in revenue and membership may not be sustainable or may decrease, and we may not generate sufficient revenue to maintain profitability. Additionally, we budget for our expenses 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 estimates. Accordingly, any significant shortfall of revenue in relation to our estimates could have an immediate negative effect on our financial results.

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 cost-efficient and effective sales and marketing programs to attract new members;
- convert leads into enrollments;
- maintain high retention rates;
- increase the lifetime value per pet;
- maintain positive relationships with veterinarians and other lead sources;
- maintain positive relationships with and increase the number and efficiency of Territory Partners;
- create and maintain positive relationships with strategic partners, particularly partners who create software solutions for veterinary practices;
- continue to offer products with a superior value with competitive features and rates;
- price our subscriptions in relation to actual operating expenses and achieve required regulatory approval for pricing changes;
- recruit, integrate and retain skilled, qualified and experienced sales department professionals who can demonstrate our value proposition to new and existing members;
- provide our members with superior member service, including timely and efficient payment of veterinary invoices, and by recruiting, integrating and retaining skilled and experienced personnel who can efficiently review veterinary invoices and process payments;
- generate new and maintain existing relationships and programs in our other business segment;
- react to existing and new competitors;
- protect and defend our critical intellectual property;
- increase awareness of and positive associations with our brand;
- react to unexpected developments and general macroeconomic conditions, including pandemics and related economic impacts; and
- successfully respond to and comply with regulations affecting our business and defend or prosecute any litigation.

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

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

We have made and plan to continue to make significant investments to grow our member base. We spent $45.1 million on sales and marketing to acquire new members for the year ended December 31, 2020. Our average pet acquisition cost and the number of new pets we enroll depends on a number of factors and assumptions, 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 increased over time and has significantly varied in the past. In the future, our average pet acquisition cost may continue to rise and 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.

In addition, we base our decisions regarding our member acquisition expenditures primarily on our internal rate of return generated on an average pet. This analysis depends substantially on estimates and assumptions based on our historical experience with pets enrolled in earlier periods, including our key operating metrics. If our estimates and assumptions regarding our internal rate of return and the lifetime value of the pets that we project to acquire and our related decisions regarding investments in member acquisition prove incorrect, or if our calculation of internal rate of return and 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.

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. Certain of our competitors have spent additional funds to promote their products in search results over us. If we decide to respond by purchasing search advertising, our pet acquisition costs would increase which may harm our business, operating results and financial condition.

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

Our ability to grow our business depends on retaining and expanding our member base. For the year ended December 31, 2020, we generated 77.0% of our revenue from subscriptions. In order to continue to increase our membership, we must continue to convince prospective members of the benefits of pet insurance in general and our subscription in particular. To maintain our existing member base, we need to continue to reinforce the value of our subscription.

We utilize Territory Partners, who are paid fees based on enrollments in their regions, to communicate the benefits of medical insurance to veterinarians through, prior to the COVID-19 pandemic, in-person visits and more recently, through remote communications. Veterinarians then educate pet owners, who visit our website or call our contact center to learn more about these benefits, and potentially become members. We also invest in other third-party and direct to consumer member acquisition channels, though we have limited experience with some of them. We plan to expand the number of our Territory Partners and other lead-generation sources and to engage in other marketing activities, including direct to consumer advertising and increasing our social media footprint, which are likely to increase our acquisition costs. In addition, these plans may face unexpected delays, costs or other challenges, such as decreased ability of Territory Partners to conduct in-person veterinarian or less effective development of other third-party relationships.

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

- the competitiveness of our subscription, including its perceived value, simplicity, and fairness;
- changes in consumer shopping behaviors due to circumstances outside of our control, such as economic conditions, the COVID-19 pandemic and containment efforts, and consumers’ ability or willingness to pay for our product;
- regulatory requirements, including those that make the experience on our website cumbersome or difficult to navigate or that hinder our ability to speak with potential members quickly and in a way that is conducive to conversion;
- system failures or interruptions in our website or contact center; and
- changes in the mix of consumers who learn about us through various member acquisition channels.

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 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.

We have historically experienced high average monthly retention rates. For example, our average monthly retention rate between 2010 and 2020 was 98.5%. We expect to continue to make significant expenditures relating to the retention of existing members, including an increase in the number of inside account managers and development and implementation of new technology platforms designed to encourage retention of these members.

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

We rely significantly on Territory Partners, veterinarians and other third parties, including strategic partners, to generate leads.

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, existing members, complementary online and other businesses, animal shelters, breeders and veterinary affiliates, including veterinarian purchasing groups and associations 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 as we grow.

Veterinary leads represent our largest member acquisition channel. We spend significant time and resources attracting qualified Territory Partners and providing them with current information about our business and they, in turn, communicate the benefits of medical insurance for pets to veterinarians. Our relationship with our Territory Partners may be terminated at any time (for instance, if they feel unsupported or undervalued by us), and, if terminated, we may not recoup the costs associated with educating them about our subscription or be able to maintain any relationships they may have developed with veterinarians within their territories. Sometimes a single relationship may be used to cover multiple territories so that a terminated relationship with a Territory Partner could significantly affect our company. Further, if we experience an increase in the rate at which Territory Partner relationships are terminated, we may not develop or maintain relationships with veterinarians as quickly as we have in the past or need to in order to implement our business strategy and our growth and financial performance could be adversely affected.

Our ability to generate leads through veterinary hospitals could be negatively impacted if our policy is perceived to be inadequate, unreliable, cumbersome or otherwise does not provide sufficient value, or if our process for paying veterinary invoices is unsatisfactory to the veterinarians and their clients.

If we fail to establish or 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 exam day offer program, our member levels and sales and marketing expenses may be adversely affected.

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

Territory Partners are independent contractors and, accordingly, we do not directly provide the same direction, motivation and oversight over Territory Partners as we otherwise could if Territory Partners were our own employees. Further, Territory Partners may themselves employ or engage others; we refer to these partners and their associates, collectively, as our Territory Partners. We do not control a Territory Partner’s employment or engagement of others, and it is possible that the actions of their employees and/or contractors could create threatened or actual legal proceedings against us. Moreover, Territory Partners may not require, or applicable law may not permit, that employees or other service providers engaged by Territory Partners be subject to non-compete obligations and these employees and service providers may provide services to our competitors.

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

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

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

The prices of our subscriptions are based on assumptions and estimates. If our actual experience differs from the assumptions and estimates used in pricing our subscriptions or if we are unable to obtain any necessary regulatory approval for our pricing, our revenue and financial condition could be adversely affected.

The pricing of our subscriptions reflects amounts we expect to pay for a pet's medical care and we derive these prices from assumptions that we make based on our analytics platform. Our analytics platform draws upon pet data we collect and we use this data to price our policy in response to 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 hospital preferences. Some data that feeds into our analytics platform is provided by third-party sources and these sources may limit or prevent us from accessing the data. Additionally, the assumptions we make about breeds and other factors in pricing may prove to be inaccurate and, accordingly, these pricing analytics may not accurately reflect the expense that we will ultimately incur. Furthermore, if any of our competitors develop similar or better data systems, adopt similar or better underwriting criteria and pricing models or receive our data, our competitive advantage could decline or be lost.

The prices of our subscriptions also reflect assumptions and estimates regarding our own operating costs and expenses. We monitor and manage our pricing and overall sales mix to achieve our target returns. If the actual costs, including veterinary invoice expenses, operating costs and expenses within anticipated pricing allowances, are greater than our assumptions and estimates such that the premiums we collect are insufficient to cover these expenses, then our profitability could be adversely affected and our revenue may be insufficient to maintain profitability. Conversely, if our pricing assumptions differ from actual results such that we overprice risks, our competitiveness and growth prospects could be adversely affected.

In addition, many states have adopted laws or are considering proposed legislation that, among other things, limit the ability of insurance companies to effect rate increases or to cancel, reduce or not renew existing policies, and many state regulators have the power to reduce, or to disallow increases in premium rates. Most states require licensure and regulatory approval prior to marketing new insurance products. Our practice has been to regularly reevaluate the price of our subscriptions, with any pricing changes implemented at least annually, subject to the review and approval of applicable state regulators, who may reduce or disallow our pricing changes. Such review has often in the past resulted, and may in the future result, in delayed implementation of pricing changes and prevent us from making changes we believe are necessary to achieve our targeted payout ratio, which could adversely affect our operating results and financial condition. If external factors caused veterinary invoice expenses to significantly decrease, the review and approval of our proposed pricing may be impacted. 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.

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

We maintain a recorded reserve for veterinary invoices that is based on our best estimates of the amount of veterinary invoices we expect to pay, inclusive of an estimate for veterinary invoices we have not yet received, after considering internal factors, including data from our proprietary data analytics platform, experience with similar cases, actual veterinary invoices paid, historical trends involving veterinary invoice payment patterns, patterns of receipt of veterinary invoices, seasonality, pending levels of unpaid veterinary invoices, veterinary invoice processing programs and contractual terms. We may also consider external factors, including changes in the law, court decisions, changes to regulatory requirements and economic conditions. Because reserves are estimates of veterinary invoices that have been incurred but are not yet submitted to us, setting 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.

Rising costs of veterinary care and the increasing availability and usage of more expensive, technologically advanced medical treatments may increase the amounts of veterinary invoices we receive. Increases in the number of veterinary invoices we receive could arise from unexpected events that are inherently difficult to predict, such as a pandemic that spreads through the pet population, tainted pet food or supplies or an unusually high number of serious injuries or illnesses. We may experience volatility in the number of veterinary invoices we receive from time to time, and short-term trends may not continue over the longer term. The number of veterinary invoices may be affected by the level of care and attentiveness an owner provides to the pet, the pet's breed and age (at enrollment) and other factors outside of our control, as well as fluctuations in member retention rates and by new member initiatives that encourage an increase in veterinary invoices and other new member acquisition activities.

The ultimate cost of paying veterinary invoices and the related administration may vary materially from recorded reserves, and such variance may result in adjustments to the reserve for veterinary invoices, which could have a material effect on our operating results and resources available for acquiring additional members.

If more veterinary hospitals install and use our patented proprietary software, the number or amounts of veterinary invoices we receive is likely to increase.

Our patented proprietary software is designed to integrate directly with most software systems used by veterinary hospitals and allow us to receive and pay veterinarian invoices directly. We believe that it is critical to our long-term success to improve the member experience so we encourage veterinary hospitals to install and use our software. We have found that installation and use of our software by a veterinary hospital could increase the number of invoices we receive from that practice. As more veterinary hospitals install our software, we expect the number or amounts of veterinary invoices to increase and result in an increase in our cost of revenue, which may have a material adverse effect on our financial condition.

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

Our subsidiary, APIC, 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 $79.1 million as of December 31, 2020. We are also subject to a contractual obligation related to our reinsurance agreement with Omega, who writes our policies in Canada. Under this agreement, we are required to fund a Canadian trust account in accordance with Canadian regulations. As of December 31, 2020, the account held CAD $5.8 million.

To comply with these regulations and 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.

Our success depends on our ability to review, process, and pay veterinary invoices timely and accurately.

We believe member satisfaction depends on our ability to accurately evaluate and pay veterinary invoices in a timely manner. Many factors can affect our ability to do this, including the training, experience and skill of our personnel, our ability to reduce the number of payment requests made for services not included in our subscription, effectiveness of management, our ability to develop or select and implement appropriate procedures, supporting technologies and systems, changes in our policy and veterinarian compliance with our protocols and procedures. Our failure to pay veterinary invoices, accurately and in a timely manner, or to deploy resources appropriately, could result in unanticipated costs to us, lead to material litigation, undermine member goodwill and our reputation, and impair our brand image and, as a result, materially and adversely affect our competitiveness, financial results, prospects and liquidity.

We may not identify fraudulent or improperly inflated veterinary invoices.

It is possible that a member, or a third-party could submit a veterinary invoice which we would then pay that appears authentic but in fact does not reflect services provided or products purchased for which the member paid. It is also possible that veterinarians will charge insured customers higher amounts than they would charge their non-insured clients for the same service or product. Such activity could lead to unanticipated costs to us and/or to time and expense to recover such costs. They could also lead to strained relationships with veterinarians and/or members, and could adversely affect our competitiveness, financial results and liquidity.

We are and will continue to be faced with many competitive challenges, any of which could adversely affect our prospects, operating results and financial condition.

We compete with pet owners that self-finance unexpected veterinary invoices with savings or credit, as well as traditional “pet insurance” providers and relatively new entrants into our market. The vast majority of pet owners in the United States and Canada do not currently have medical insurance for their pets. We are focused primarily on expanding our share of the overall market, and we view our primary competitive challenge as educating pet owners on why our subscription is a better alternative to self-financing.

Additionally, there are traditional insurance companies that provide pet insurance products, either as a stand-alone product or along with a broad range of other insurance products, such as wellness. In addition, new entrants backed by large insurance companies, such as Marsh, Nationwide, and Geico, have attempted to enter the pet insurance market in the past and may do so again in the future. Further, traditional “pet insurance” providers may consolidate or take other actions to mimic the efficiencies from our vertically-integrated structure or create other operational efficiencies, which could lead to increased competition.

Some of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, technical, marketing and other resources than we do. Some of our competitors may be able to undertake more extensive marketing initiatives for their brands and services, devote more resources to website and systems development and make offers that are more attractive to potential employees, referral sources and third-party service providers.

To compete effectively, we believe we will need to continue to invest significant resources in sales and marketing, in improving our member service levels, in the online experience and functionalities of our website and in other technologies and infrastructure. Failure to compete effectively against our current or future competitors could result in loss of current or potential members, which could adversely affect our pricing, lower our revenue, prevent us from maintaining profitability and diminish our brand strength.

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

- the efficacy and viability of our sales and marketing programs;
- the perceived value of our subscription;
- the quality of service provided, including the fairness, ease and timeliness of reviewing and paying veterinary invoices;
- actions of our competitors, Territory Partners, veterinarians and others;
- 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 will 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. For instance, we have found that search engine optimization costs have increased as competitors have spent additional funds to promote their products in search results over us. 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 could be adversely affected, which would harm our business, operating results and financial condition.

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

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

Our business depends on our ability to maintain and scale the infrastructure necessary to operate our technology platform, which includes our analytics and pricing engine, systems for managing veterinary invoice payments, customer relationship management system, billing system, contact center phone system and website. We use these technology frameworks to price our subscriptions, enroll members, engage with current members and pay veterinary invoices. Our members review and purchase subscriptions through our website and contact center, and for those veterinary hospitals who have installed our patented proprietary software, we receive and pay veterinarian invoices directly through our software. 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. Further, our development and implementation activities may not be successful, may not be well-received by veterinarians or by new or existing members, particularly if they are costly, cumbersome or unreliable, and we may incur delays or cost overruns or elect to curtail our currently planned expenditures related to them. Even if our system improvements are well-received, they may be or become obsolete due to technological reasons or the availability of alternative solutions in the marketplace. If new solutions and enhancements are not successful on a long-term basis, we may not realize benefits from these investments, and our business and financial condition could be adversely affected.

In addition, 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.

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 and this commitment may also result in increased costs (such as member acquisition costs or costs associated with increases in the number or amounts of veterinary invoices received) generated by our business, which could prevent us from remaining profitable and could impair our ability to compete effectively for business. 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 and 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. If we do not successfully implement improvements in these areas, our business, operating results and financial condition will be harmed.

Emerging claim and coverage issues may adversely affect our business.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge, including new or expanded theories of liability. These or other changes could impose new financial obligations on us by extending coverage beyond our underwriting intent or otherwise require us to make unplanned modifications to the products and services that we provide, or cause the delay or cancellation of products and services that we provide. In some instances, these changes may not become apparent until sometime after we have issued subscriptions that are affected by the changes. As a result, the full extent of liability under our subscriptions may not be known for many years after subscription begins.

Our operating results may vary, which could 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, particularly as the COVID-19 pandemic evolves. 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 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.

Seasonal or periodic variations in the behavior of our members also may cause fluctuations in our financial results. Enrollment in our subscription tends to be discretionary in nature and may be sporadic, reflecting overall economic conditions, budgeting constraints, pet-buying patterns and a variety of other factors, many of which are outside our control. For example, we have experienced 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.

Mergers or other strategic transactions involving our competitors could weaken our competitive position, which could adversely affect our ability to compete effectively and harm our results of operations.

Our industry is highly fragmented, and we believe it is likely that some of our existing competitors will consolidate or be acquired. In addition, some of our competitors may enter into new alliances with each other or may establish or strengthen cooperative relationships with systems integrators, third-party consulting firms or other parties. Any such consolidation, acquisition, alliance or cooperative relationship could adversely affect our ability to compete effectively and lead to pricing pressure and our loss of market share and could result in a competitor with greater financial, technical, marketing, service and other resources, all of which could harm our business, financial condition, cash flows and results of operations.

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 employees, including 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. We would be adversely affected if we fail to adequately plan for the succession of our senior management and other key employees. 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. 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.

We may continue to create, invest in or acquire businesses, products and technologies, which could divert our management's attention, result in additional dilution to our stockholders, otherwise disrupt our operations or harm our operating results.

We have in the past created, invested in or acquired complementary businesses, products, technologies and new lines of business, and we may continue to do so in the future. Our ability to successfully evaluate and manage investment opportunities, or make and integrate acquisitions or products, is unproven. For example, we have invested in a pet food initiative, and we believe that pet food may be an important part of our offerings over the long term. We do not have experience manufacturing, selling, or distributing food products and pet food manufacturing facilities and pet food products are subject to many laws and regulations administered by the United States Department of Agriculture, the Federal Food and Drug Administration, the Occupational Safety and Health Administration, and other federal, state, local, and foreign governmental agencies relating to the production, packaging, labelling, storage, distribution, quality, and safety of food products and the health and safety of employees. We have also recently acquired technology intended to enable us to improve our back-end software and facilitate certain expansion efforts, but technology integration is complicated, expensive and time consuming, and it may not result in us realizing the intended benefits from the acquisition.

The pursuit of potential new products, investments or acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable opportunities, whether or not they are consummated. Further, even if we successfully invest in or acquire additional businesses or technologies, we may not achieve the anticipated benefits from the transaction. The investment or acquisition may also expose us to additional risks, including from unknowingly inheriting liabilities that are not adequately covered by indemnities. Acquisitions or investments could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results.

If we do not spend our development budget efficiently or effectively on commercially successful and innovative offerings and products, we may not realize the expected benefits of our strategy. Further, our development efforts with respect to new products and offerings could distract management from current operations, and will divert capital and other resources from our more established products and offerings. If an investment or acquisition fails to meet our expectations, our business, operating results and financial condition may suffer.

We may not realize the benefits of our current and planned transactions with Aflac.

In October 2020, we entered into a Strategic Alliance Agreement, a Stock Purchase Agreement and a Shareholder Agreement with Aflac Incorporated (Aflac). Aflac purchased an aggregate of $200.0 million of our common stock.

The Strategic Alliance Agreement sets forth the structure for an alliance with Aflac, including its intended benefits to us relating to brand, access and distribution as well as go-to-market matters. We and Aflac have agreed to negotiate in good faith and to act reasonably with each other in order to agree on such terms as are necessary to fully implement the alliance. However, we may be unable to establish the terms for and implement the alliance and, as a result, we may not realize the intended benefits of the alliance. In addition, we have agreed not to develop with a third party any worksite employee benefit regarding its pet insurance in the United States or Japan and to work exclusively with Aflac to develop opportunities in Japan's pet insurance marketplace, which may prevent us from pursuing alternative opportunities. If we are unable to implement the terms of the alliance, Aflac's obligations in the Shareholder Agreement, including standstill obligations and contractual holding period requirements, would terminate, which may have an adverse effect on our stock price and otherwise cause our business to suffer.

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 revenue is attributable to a variety of different types of strategic partnership arrangements. These partnerships involve various risks, depending on their structure, including the following:

- we may be unable to maintain or secure favorable relationships with strategic partners;
- our strategic partners may not be successful in creating leads;
- we may be unable to convert leads from our strategic partners into enrolled pets;
- our strategic partners could terminate their relationships with us;
- our strategic partners may acquire or form alliances with our competitors, thereby reducing their business 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.

Any inability to secure, maintain or effectively manage these complicated relationships with strategic partners could have a material adverse effect on our revenue and operating results.

Our business and financial condition is subject to risks related to our writing of policies for unaffiliated third parties.

Our other business segment includes revenues and expenses involving contractual relationships with unaffiliated third parties and related 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 and 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, the pet insurance policies we write for general agents are subject to materially different terms and conditions than our subscription. They are typically annual policies with monthly payment terms, which can result in accounts receivable balances and payment timing patterns we do not experience in our subscription business. The relationships with these general agents may 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 revenue with different general agents. For the year ended December 31, 2020, premiums from policies sourced by general agents accounted for 21% of our total revenue, and one general agent sourced members whose premiums accounted for over 10% of our total revenue. Further, the unaffiliated general agents administer these policies and market them to consumers. If the general agents make operating decisions that adversely affect its business or brand, our business or brand could also be adversely affected.

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

In Canada, our pet insurance subscription is written by Omega, and we assume all premiums written by Omega and the related veterinary invoice expense through an agency agreement and a fronting and administration agreement. 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 Canadian members, or suspend member enrollment and renewals in Canada until we enter into a relationship with another third party to write our subscription or we set up an entity able to perform this service, 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.

Changes in the foreign exchange rates may adversely affect our revenue and operating results.

We offer our subscription in Canada and in the future may offer it in other countries, which exposes us to the risk of changes in currency exchange rates. For the year ended December 31, 2020, approximately 16% of our total revenue was generated in Canada. Fluctuations in the relative strength of the US dollar has in the past and could in the future adversely affect our revenue and operating results.

Our decision to set up multiple insurance subsidiaries may complicate our business and harm our results of operations.

Currently, APIC, our wholly owned subsidiary, underwrites memberships for our U.S. subscription product, and Omega, a third party, underwrites memberships for our Canadian subscription product. We are in the process of setting up additional wholly owned insurance companies in the U.S. and Canada to underwrite our subscription and in the future we may decide to set up and operate additional wholly-owned insurance companies in the U.S., Canada or a different country. The pursuit of acquiring or forming a new insurance subsidiary may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable opportunities, whether or not the formation or acquisition is completed. Further, even if we are successful in forming or acquiring a new insurance subsidiary we may not achieve the anticipated benefits. In addition, we may require additional capital to meet our risk-based capital requirements for the new insurance subsidiaries and will be subject to additional regulatory scrutiny in the jurisdiction of incorporation and any additional jurisdictions the insurance subsidiary operates. Failure to comply with laws, regulations and guidelines applicable to a new insurance subsidiary could result in significant liability, result in the loss of revenue and otherwise harm our business, operating results and financial condition.

If we are unable to 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.

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

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

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

Our data repository contains proprietary information that we believe gives us a competitive advantage, including data on veterinary invoices received and other data with respect to members, Territory Partners, veterinarians and other third parties. We also collect and utilize demographic and other information from and about our members when they visit our website, call our contact center and apply for enrollment. Further, we use tracking technologies, including "cookies," to help us manage and track our members' interactions and deliver relevant advice and advertising. 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. 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. In the event of a loss of our systems or data, we could experience increased costs, delays, legal liability and reputational harm, 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 store and/or transmit our members' confidential information, including credit card and bank account numbers and other private information. Because the methods used to obtain unauthorized access to private information change frequently and may be difficult to detect for long periods of time, security breaches would expose us to a risk of loss of this information, litigation and possible liability. Our payment services are similarly 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.

In addition, cyber-attacks or acts of terrorism could cause disruptions in our business or the economy as a whole. Our servers and systems may also be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems, which could lead to interruptions, delays, loss of critical data or the unauthorized disclosure of confidential member data. We currently have limited disaster recovery capability, and our business interruption insurance may be insufficient to compensate us for losses that may occur. Such disruptions could negatively impact our ability to run our business, which could have an adverse effect on our operating results and financial condition.

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

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

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

We are also subject to payment card association operating rules, certification requirements and rules governing electronic funds transfers, including the Payment Card Industry Data Security Standard (PCI DSS), a security standard applicable to companies that collect, store or transmit certain data regarding credit and debit cards, holders and transactions. Although we are currently compliant with PCI DSS, in the past we were not, and in the future we may not be, fully or materially compliant with PCI DSS, or other payment card operating rules. Any failure to comply with the PCI DSS 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 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 will prevent illegal or improper use of our payment systems or the theft, loss or misuse of data pertaining to credit and debit cards, credit and debit card holders and credit and debit card transactions.

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

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

We have limited experience owning an office building and may face unexpected costs.

In August 2018, we purchased our home office building. Prior to this purchase, we had no experience owning an office building. It is difficult to predict all costs associated with maintaining the building and ensuring it is suitable for our use and that of other tenants and maintain compliance with all environmental and other regulations applicable to ownership of real estate. It is possible that the other current tenants in the building may cease to rent space in the building, which would decrease rental income we expect to receive from them. Tenants may also negotiate tenant improvements, requiring capital expenditures that may adversely impact our financial position. In addition, we may identify structural defects or other conditions, or we may determine that remodeling or renovations are necessary given our business operations and objectives. Managing tenants, maintaining the building, and otherwise facing the costs and responsibilities of being the owner of a building may be a distraction from our core business and cause our performance to suffer.

Failure to adequately protect our intellectual property could substantially harm our business and operating results.

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

Our proprietary software is protected by patents. These patents may not be sufficient to maintain effective product exclusivity because patent rights are limited in time and do not always provide effective protection. Furthermore, our efforts to enforce or protect our patent rights may be ineffective, could result in substantial costs and diversion of resources, could result in the invalidation of our patent rights, and could substantially harm our operating results. Even where our patents rights are enforced, legal remedies available for harm caused to us by infringing products may be inadequate to make us whole. Further, our successful assertion of our patent against one competing product is not necessarily predictive of our future success or failure in asserting the same patent against a second competing product. In addition, patents have a limited lifespan. In the United States, the natural expiration of a patent is generally 20 years after it is filed. Various extensions may be available. However, the life of a patent, and the protection it affords, is limited. Once the patent life has expired for our software, our competitors will be able to use our patented technology.

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

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

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

We cannot predict the outcome of these actions or proceedings, and the cost of defending such actions or proceedings could be material. Further, defending such actions or proceedings could divert our management and key personnel from our business operations. If we are found liable in any action or proceeding, we may have to pay substantial damages or fines, which may have a material adverse effect on our business, operating results, financial condition and prospects. More critically, an adverse result from a proceeding could require us to change the way we conduct our business, including our marketing and promotional practices, and such a result may have a greater adverse effect on our business than monetary damages or fines. 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.

We may have additional tax liabilities.

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

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

As of December 31, 2020, we had U.S. federal net operating loss carryforwards of approximately $157.8 million that will begin to expire in 2027. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (the Code), if a corporation undergoes an "ownership change," the corporation's ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes, such as research tax credits, to offset its post-change income taxes may be limited. In general, an "ownership change" occurs if there is a cumulative change in our ownership by "5-percent stockholders" that exceeds 50 percentage points over a rolling three-year period. Similar rules may apply under state tax laws. Pursuant to Sections 382 and 383 of the Code, annual use of our net operating loss carryforwards and credit carryforwards may be limited by previous and future ownership changes.

Changes in the economy may affect consumer spending on our subscription and this may negatively impact our business, operating results and financial condition.

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

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

As part of our growth plan, we have explored, and expect to continue to explore, opportunities to expand our operations internationally. For instance, we entered the Australian market through a joint venture and we are actively exploring entering other countries. We have limited history of marketing, selling, administrating and supporting our subscription for consumers outside of the United States, Canada, and Puerto Rico. In general, international sales and operations may be subject to a number of risks, including the following:

- regulatory rules and practices, foreign exchange controls, tariffs, tax laws and treaties that are different than those we operate under currently;
- the costs and resources required to modify our subscription appropriately to suit the needs and expectations of residents and veterinarians in such foreign countries;
- our data analytics platform may have limited applicability in foreign countries, which may impact our ability to develop adequate underwriting criteria and accurately price subscriptions in such countries;
- increased expenses incurred in establishing and maintaining office space and equipment for our international operations;
- technological incompatibility between our patented proprietary software and software used by veterinarians;
- difficulties in modifying our business model or subscription 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 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;
- the uncertainty of protection for intellectual property rights in some countries; and
- general economic and political conditions in these foreign markets.

These 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.

Risks Related to Compliance with Laws and Regulations

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

Memberships in our U.S. subscription product are underwritten by APIC. APIC is an insurance company domiciled in the state of New York and licensed by the New York Department of Financial Services (NY DFS). 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 (NAIC) 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, state insurance regulators will compare, on an annual basis as of December 31 or more often as deemed necessary, an insurer's total adjusted capital and surplus to assess an insurer's capital adequacy. If an insurer's risk-based capital falls below a specific threshold, the regulator may take action, which can range from directing an insurer to propose a plan to increase its capital to an acceptable level to placing the insurer under regulatory control.

Applicable regulations regarding risk-based capital may change, and/or the NY DFS may increase APIC's required levels of risk-based capital in the future. Regardless, we anticipate that we will need to maintain greater amounts of risk-based capital if our pet enrollment continues to grow. Additionally, a reduction in our risk-based capital may result in a 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. For instance, our arrangement with Aflac requires that, before we issue or sell equity to another investor, we are required to provide Aflac an opportunity to purchase equity allowing them to maintain their ownership percentage. This requirement may introduce delays or prevent us from raising funds through the issuance of securities. If we raise additional funds through the issuance of equity or convertible securities, the percentage ownership of holders of our common stock could be significantly diluted and these newly issued securities may have rights, preferences or privileges senior to those of holders of our common stock. Further, volatility in the credit or equity markets may have an adverse effect on our ability to obtain debt or equity financing or the cost of such financing. Similarly, our access to funds may be impaired if regulatory authorities or rating agencies take negative actions against us. If a combination of these factors were to occur, our internal sources of liquidity may prove to be insufficient and, in such case, we may not be able to successfully obtain additional financing on favorable terms. If funds are unavailable to us on reasonable terms when we need them, we may be unable to meet our risk-based capital requirements, train and support our employees, support Territory Partners, maintain the competitiveness of our technology, pursue business opportunities, service our existing debt, pay veterinary invoices or acquire new members, any of which could have an adverse effect on our business, operating results and financial condition.

Our business is heavily regulated, and if we fail to comply with the numerous applicable laws and regulations our business and operating results could be harmed.

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

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

- impose fines and other penalties; and
- impose continuing education requirements.

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

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

Due to the complexity, periodic modification and differing interpretations of insurance laws and regulations, we have not always been, and we may not always be, in compliance with them. A regulator's interpretation of existing laws or regulations may change without notice. Failure to comply with insurance laws, regulations and guidelines or other laws and regulations applicable to our business could result in significant liability, additional department of insurance licensing requirements, the revocation of licenses in a particular jurisdiction or our inability to sell subscriptions, which could significantly increase our operating expenses, result in the loss of our revenue and otherwise harm our business, operating results and financial condition.

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

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

States may adopt new laws that may adversely affect our operating results and financial condition.

The NAIC may draft model laws that focus on medical insurance for pets. States may enact new laws to adopt what the NAIC drafts, or a state may enact its own new laws or regulations that could affect our industry. Many states have considered and may continue to consider proposed legislation that could significantly affect our operations, including, for example, our ability to effect rate increases, to cancel or not issue existing policies, or how to market our product. Implementing changes in order to comply with new laws or regulations could also be time-consuming and costly.

We may not receive approval for changes to an existing product, for a proposed new product or for pricing changes, or we may not receive such approvals in a timely manner.

Most states require licensure and regulatory approval prior to marketing new insurance products or changing premiums for existing products. From time to time, we seek to make updates to our existing subscription product. We may also introduce new products that make changes that are more extensive to the product approved in a state. With respect to pricing, our practice has been to regularly reevaluate the price of our subscriptions, with any pricing changes implemented at least annually, subject to the review and approval of the state regulators, who may reduce or disallow our pricing changes. Such review has often in the past resulted, and may in the future result, in delayed implementation of pricing changes and prevent us from making changes we believe are necessary to achieve our targeted payout ratio, which could adversely affect our operating results and financial condition. A delayed approval may require us to have larger rate increases in subsequent periods. 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.

We may be affected by mandatory participation in plans that could result in contributions from insurance subsidiaries we own.

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

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

Insurance regulations generally require that each individual who sells, solicits or negotiates insurance on our behalf must maintain a valid license in the jurisdiction in which the activity occurs. Regulations also generally prohibit paying an insurance commission to an unlicensed person or entity. Regulations may also require certain individuals who process claims to be licensed. These requirements are subject to a variety of interpretations between jurisdictions. We may not interpret and apply the requirements in the same manner as all applicable regulators, and, even if we have, the requirements or regulatory interpretations of those requirements may change. Regulators have in the past and/or may in the future determine that certain of our personnel or third parties were performing licensable activities without the required license, including for example a veterinary hospital employee. 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. Regulators may also deem payments we make to an unlicensed entity or person to be improper. We would also likely be required to modify our business practices and/or sales and marketing programs, or license the affected individuals, which may be impractical or costly and time-consuming to implement. Any modification of our business or marketing practices in response to regulatory licensing requirements could harm our business, operating results or financial condition.

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

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

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. 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.

Law and regulations of the Internet, email and texting could adversely affect our business.

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

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

Our accounting is becoming more complex, and relies upon estimates or judgments relating to our critical accounting policies. If our accounting is erroneous or based on assumptions that change or prove to be incorrect, our operating results could fall below the expectations of securities analysts and investors, resulting in a decline in our stock price.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes, and also to comply with many complex requirements and standards. We devote substantial resources to compliance with accounting requirements and we base our estimates on our best judgment, historical experience, information derived from third parties, and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets, liabilities, equity, revenue and expenses that are not readily apparent from other sources. However, various factors are causing our accounting to become complex, such as our recent building acquisition, our investments in strategic opportunities and our test expansion into foreign markets. Ongoing evolution of our business, further international expansion, and entry into complementary businesses such as pet food, may compound these complexities. Our operating results may be adversely affected if we make accounting errors or our judgments prove to be wrong, assumptions change or actual circumstances differ from those in our assumptions, which could cause our operating results to fall below the expectations of securities analysts and investors or guidance we may have provided, resulting in a decline in our stock price and potential legal claims. Significant judgments, assumptions and estimates used in preparing our consolidated financial statements include those related to revenue recognition, reserve for veterinary invoices, business combinations, and income taxes.

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 independent registered public accounting firm 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. In addition, we have recently provided information regarding how we think about the drivers of and our method of calculating our intrinsic value, including related statements regarding discounted cash flows and underlying assumptions (such as pet enrollment, revenue per pet, lifetime values of a pet, pet acquisition costs, and other costs and expenses).

These statements are based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic and competitive risks and uncertainties, many of which are beyond our control, including those described in these "Risk Factors" and elsewhere in this report. 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 and other information regarding our view of the drivers and calculation method of our intrinsic value is to provide a basis for our management to discuss our business and outlook with analysts and investors.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying these statements will not materialize or will vary significantly from actual results. Accordingly, these statements are only estimates of what management believes is reasonable as of the date of release. Actual results may vary and the variations may be material. In light of the foregoing, investors are urged not to rely upon our guidance or other information regarding our view of the drivers and calculation method of our intrinsic value in making an investment decision regarding our common stock. In addition, we do not accept any responsibility for any projections or reports published by any such third parties, and we urge you not to place undue reliance on those statements.

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

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

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

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

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

- variations in our operating results, earnings per share, cash flows from operating activities, and key operating metrics, and how those results compare to analyst expectations;
- forward-looking guidance that we provide to the public and industry and financial analysts related to future revenue and profitability, and any change in that guidance or our failure to achieve the results reflected in that guidance;
- the net increases in the number of members, either independently or as compared with published expectations of industry, financial or other analysts that cover our company;
- announcements of changes to our subscription, strategic alliances, acquisitions or significant agreements by us or by our competitors;
- recruitment or departure of key personnel;
- recent private sale of our securities to Aflac;
- 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. 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. Other than potential repurchases of 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. 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.

Our Board recently approved an Employee Severance and Change in Control Plan that applies to each employee of our company. This plan provides certain benefits to our employees in the event there is a change in control of our company and an employee is terminated under certain conditions. Potential acquirers may determine that the possible payments under this plan make an acquisition of our company unattractive.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed/Furnished Herewith
		Form	File No.	Exhibit	Exhibit Filing Date	
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 Certificate of Incorporation of the Registrant.	8-K	001-36537	3.1	6/3/2016	
3.3	Amended and Restated Bylaws of the Registrant.	10-K	001-36537	3.3	2/12/2021	
31.1	Certification of Principal Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Principal Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1*	Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
32.2*	Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS	XBRL Instance Document - the instance does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document					X
101.SCH	Inline XBRL Taxonomy Extension Schema Document.					X
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document.					X
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document.					X
101.LAB	Inline XBRL Taxonomy Extension Labels Linkbase Document.					X
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.					X
104	Cover Page Interactive Data File (formatted in Inline XBRL and contained in Exhibit 101)					X

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

	TRUPANION, INC.
Date: August 5, 2021	/s/ Darryl Rawlings
	Darryl Rawlings Chief Executive Officer *(Principal Executive Officer)*
Date: August 5, 2021	/s/ Tricia Plouf
	Tricia Plouf Co-President and Chief Financial Officer *(Principal Financial and Accounting Officer)*

Exhibit 31.1

Certification of Principal Executive Officer
Pursuant To Exchange Act Rule 13a-14(a)/15d-14a
As Adopted Pursuant To Section 302 of the Sarbanes-Oxley Act Of 2002

I, Darryl Rawlings, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Trupanion, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 5, 2021

/s/ Darryl Rawlings

Darryl Rawlings
Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

Certification of Principal Financial Officer
Pursuant To Exchange Act Rule 13a-14(a)/15d-14a
As Adopted Pursuant To Section 302 of the Sarbanes-Oxley Act Of 2002

I, Tricia Plouf, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Trupanion, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2021

/s/ Tricia Plouf

Tricia Plouf
Co-President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 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

I, Darryl Rawlings, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Quarterly Report of Trupanion, Inc. on Form 10-Q for the quarterly period ended June 30, 2021, as filed with the Securities and Exchange Commission, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Trupanion, Inc.

Date: August 5, 2021

/s/ Darryl Rawlings

Darryl Rawlings
Chief Executive Officer
(Principal Executive Officer)

Exhibit 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

I, Tricia Plouf, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Quarterly Report of Trupanion, Inc. on Form 10-Q for the quarterly period ended June 30, 2021, as filed with the Securities and Exchange Commission, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Trupanion, Inc.

Date: August 5, 2021

/s/ Tricia Plouf

Tricia Plouf
Co-President and Chief Financial Officer
(Principal Financial Officer)