

TRUPANION, INC.

Form 10-Q

May 03, 2019

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____ to ____

Commission File Number: 001-36537

TRUPANION, INC.

(Exact name of registrant as specified in its charter)

Delaware

83-0480694

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

6100 4th Avenue S, Suite 200

Seattle, Washington 98108

(855) 727 - 9079

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. xYes o No

Indicate by check mark whether the registrant has submitted electronically 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). x Yes o No

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

Large accelerated filer x Accelerated filer o

Non-accelerated filer o Smaller reporting company o

Emerging growth company o

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. o

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

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Trading Symbol</u>	<u>Name of each exchange on which registered</u>
Common stock, \$0.00001 par value per share	TRUP	NASDAQ Capital Market

As of April 25, 2019, there were approximately 34,489,695 shares of the registrant's common stock outstanding.

TRUPANION, INC.
TABLE OF CONTENTS

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements (unaudited)</u>	<u>1</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>15</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>28</u>
Item 4. <u>Controls and Procedures</u>	<u>29</u>
<u>PART II - OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>30</u>
Item 1A. <u>Risk Factors</u>	<u>30</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>56</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>56</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>56</u>
Item 5. <u>Other Information</u>	<u>56</u>
Item 6. <u>Exhibits</u>	<u>56</u>
<u>Signatures</u>	<u>57</u>
<u>Exhibit Index</u>	<u>58</u>

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,” 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	
	March 31,	
	2019	2018
Revenue	\$86,978	\$ 69,760
Cost of revenue:		
Veterinary invoice expense	61,282	50,113
Other cost of revenue	10,664	8,583
Gross profit	15,032	11,064
Operating expenses:		
Technology and development	2,669	2,164
General and administrative	5,419	4,458
Sales and marketing	8,227	5,938
Total operating expenses	16,315	12,560
Operating loss	(1,283)	(1,496)
Interest expense	317	219
Other income, net	(344)	(140)
Loss before income taxes	(1,256)	(1,575)
Income tax expense (benefit)	40	(95)
Net loss	\$(1,296)	\$(1,480)
Net loss per share:		
Basic and Diluted	\$(0.04)	\$(0.05)
Weighted average shares of common stock outstanding:		
Basic and Diluted	34,292,367	30,246,585

See accompanying notes to the consolidated financial statements.

TRUPANION, INC.

Consolidated Statements of Comprehensive Income (Loss)

(in thousands)

(unaudited)

	Three Months Ended	
	March 31,	
	2019	2018
Net loss	\$(1,296)	\$(1,480)
Other comprehensive income (loss):		
Foreign currency translation adjustments	189	(190)
Net unrealized gain (loss) on available-for-sale debt securities	19	(15)
Other comprehensive income (loss), net of taxes	208	(205)
Comprehensive loss	\$(1,088)	\$(1,685)

See accompanying notes to the consolidated financial statements.

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

	March 31, 2019 (unaudited)	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$26,622	\$26,552
Short-term investments	61,648	54,559
Accounts and other receivables	37,568	31,565
Prepaid expenses and other assets	4,847	5,300
Total current assets	130,685	117,976
Restricted cash	1,400	1,400
Long-term investments, at fair value	3,701	3,554
Property and equipment, net	69,365	69,803
Intangible assets, net	7,839	8,071
Other long-term assets	8,315	6,706
Total assets	\$221,305	\$207,510
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$2,897	\$2,767
Accrued liabilities and other current liabilities	12,059	11,347
Reserve for veterinary invoices	17,175	16,062
Deferred revenue	38,594	33,027
Total current liabilities	70,725	63,203
Long-term debt	18,078	12,862
Deferred tax liabilities	1,002	1,002
Other liabilities	1,491	1,270
Total liabilities	91,296	78,337
Stockholders' equity:		
Common stock: \$0.00001 par value per share, 100,000,000 shares authorized; 35,397,330 and 34,467,465 shares issued and outstanding at March 31, 2019; 34,781,121 and 34,025,136 shares issued and outstanding at December 31, 2018	—	—
Preferred stock: \$0.00001 par value per share, 10,000,000 shares authorized; no shares issued and outstanding	—	—
Additional paid-in capital	226,262	219,838
Accumulated other comprehensive loss	(545)	(753)
Accumulated deficit	(85,007)	(83,711)
Treasury stock, at cost: 929,865 shares at March 31, 2019 and 755,985 shares at December 31, 2018	(10,701)	(6,201)
Total stockholders' equity	130,009	129,173
Total liabilities and stockholders' equity	\$221,305	\$207,510
See accompanying notes to the consolidated financial statements.		

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

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity	
Balance at January 1, 2019	34,025,136	\$	-\$219,838	\$ (83,711	) \$ (753	) \$ (6,201	) \$ 129,173
Exercise of warrants, net	276,120	—	4,500	—	—	(4,500)	—	
Issuance of common stock in connection with the Company's equity award programs, net of tax withholdings	166,209	—	507	—	—	—	507	
Stock-based compensation expense	—	—	1,417	—	—	—	1,417	
Other comprehensive income	—	—	—	—	208	—	208	
Net loss	—	—	—	(1,296)—	—	(1,296)
Balance at March 31, 2019	34,467,465	\$	-\$226,262	\$ (85,007	) \$ (545	) \$ (10,701	) \$ 130,009

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity	
Balance at January 1, 2018	30,121,496	\$	-\$134,511	\$ (82,784	) \$ (92	) \$ (3,201	) \$ 48,434
Exercise of warrants, net	201,315	—	3,000	—	—	(3,000)	—	
Issuance of common stock in connection with the Company's equity award programs, net of tax withholdings	108,104	—	481	—	—	—	481	
Stock-based compensation expense	—	—	1,017	—	—	—	1,017	
Other comprehensive loss	—	—	—	—	(205)—	(205)
Net loss	—	—	—	(1,480)—	—	(1,480)
Balance at March 31, 2018	30,430,915	\$	-\$139,009	\$ (84,264	) \$ (297	) \$ (6,201	) \$ 48,247

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended	
	March 31,	
	2019	2018
Operating activities		
Net loss	\$(1,296)	\$(1,480)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	1,613	927
Stock-based compensation expense	1,357	968
Other, net	(3 )	) 23
Changes in operating assets and liabilities:		
Accounts and other receivables	(5,894)	(3,926)
Prepaid expenses and other assets	325	(129)
Accounts payable, accrued liabilities, and other liabilities	1,256	910
Reserve for veterinary invoices	1,078	743
Deferred revenue	5,523	4,041
Net cash provided by operating activities	3,959	2,077
Investing activities		
Purchases of investment securities	(17,350)	(7,140)
Maturities of investment securities	10,205	5,300
Purchases of property, equipment and intangible assets	(878)	(992)
Other	(1,479)	—
Net cash used in investing activities	(9,502)	(2,832)
Financing activities		
Proceeds from exercise of stock options	661	481
Shares withheld to satisfy tax withholding	(197)	—
Proceeds from debt financing, net of financing fees	5,200	5,500
Other financing	(271)	(216)
Net cash provided by financing activities	5,393	5,765
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash, net	220	70
Net change in cash, cash equivalents, and restricted cash	70	5,080
Cash, cash equivalents, and restricted cash at beginning of period	27,952	26,306
Cash, cash equivalents, and restricted cash at end of period	\$28,022	\$31,386
Supplemental disclosures		
Noncash investing and financing activities:		
Issuance of common stock for cashless exercise of warrants	\$4,500	\$3,000
Purchases of property and equipment included in accounts payable and accrued liabilities	\$141	\$680
See accompanying notes to the consolidated financial statements.		

TRUPANION, INC.

Notes to the Consolidated Financial Statements (unaudited)

1. Nature of Operations and Significant Accounting Policies

Description of Business and Basis of Presentation

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

The financial data as of December 31, 2018 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 14, 2019 (the 2018 10-K). The Company's accounting policies are described in Note 1 to the audited financial statements included in the 2018 10-K. Operating results for the three months ended March 31, 2019 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 2018 10-K for additional discussion of these estimates and assumptions.

Recently Adopted Accounting Pronouncements

The Company adopted Accounting Standards Update (ASU) No. 2016-02 Leases (Topic 842), as amended, using the modified retrospective approach under which the transition provisions were applied as of January 1, 2019. In addition, the Company elected the "package of practical expedients" under the transition guidance within the new standard to not reassess prior conclusions about lease identification, lease classification, and initial direct costs for existing lease contracts. The Company also elected the practical expedient to not separate lease and non-lease components, if any, for all lease contracts.

Upon adoption of this standard, the Company recorded approximately \$0.1 million right-of-use assets and lease liabilities for operating leases. They were classified as other long-term assets and other liabilities on the Company's consolidated balance sheets. The standard did not have a material impact on the Company's consolidated statements of operations, stockholders' equity, or cash flows.

Recent Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board (FASB) issued an ASU amending the measurement of credit losses on financial instruments. The ASU requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. This replaces the existing incurred loss impairment model with an expected loss methodology, which will result in more timely recognition of credit losses. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within that reporting period, with early adoption permitted. The Company is currently in the process of evaluating the impact the adoption of this ASU will have on its consolidated financial statements.

In August 2018, the FASB issued an ASU that eliminates certain disclosure requirements for fair value measurements, requires new disclosures regarding significant unobservable inputs used to develop Level 3 fair value measurements, and modifies certain existing disclosure requirements for Level 3 fair value measurements. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within that reporting period, with early adoption permitted. The Company is currently evaluating the impact the adoption of this ASU will have on its consolidated financial statements.

2. Net Income (Loss) per Share

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

The 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	
	March 31,	
	2019	2018
Stock options	2,513,946	3,878,716
Restricted stock awards and restricted stock units	716,319	546,638
Warrants	30,000	510,000

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 March 31, 2019 and December 31, 2018 (in thousands):

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of March 31, 2019				
Long-term investments:				
Foreign deposits	\$2,701	\$ —	\$ —	\$2,701
Municipal bond	1,000	—	—	1,000
	\$3,701	\$ —	\$ —	\$3,701
Short-term investments:				
U.S. Treasury securities	\$6,660	\$ —	\$ —	\$6,660
Certificates of deposit	438	1	—	439
U.S. government funds	54,550	—	—	54,550
	\$61,648	\$ 1	\$ —	\$61,649

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of December 31, 2018				
Long-term investments:				
Foreign deposits	\$2,573	\$ —	\$ —	\$2,573
Municipal bond	1,000	—	(19)	981
	\$3,573	\$ —	\$ (19)	\$3,554
Short-term investments:				
U.S. Treasury securities	\$6,645	\$ —	\$ (3)	\$6,642
Certificates of deposit	437	—	—	437
U.S. government funds	47,477	—	—	47,477
	\$54,559	\$ —	\$ (3)	\$54,556

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

	As of March 31, 2019	
	Amortized Cost	Fair Value
Available-for-sale:		
Due after one year through five years	\$3,701	\$3,701
	\$3,701	\$3,701

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

4. Other Investments

Investment in Variable Interest Entity

In July 2018, the Company purchased \$3.0 million in preferred stock of a privately held corporation with a complementary business line. The Company does not have power over the activities that most significantly impact the economic performance of the variable interest entity and is, therefore, not the primary beneficiary. The Company's investment in preferred stock is accounted for as an available-for-sale debt security. Through January 2020, the Company has agreed to purchase an additional \$4.0 million in preferred stock of the variable interest entity, contingent upon the exercise of this option by the variable interest entity. The Company has the option to purchase the variable interest entity on the fifth anniversary of the initial preferred stock purchase. Additionally, the Company has extended a \$2.5 million revolving line of credit to the variable interest entity. The Company's investment and amounts loaned under the line of credit are recorded in other long-term assets on its consolidated balance sheet. Outstanding loan balance under the line of credit was \$2.1 million and \$0.6 million as of March 31, 2019 and December 31, 2018, respectively.

Investment in Joint Venture

In September 2018, the Company acquired a non-controlling equity interest in a joint venture, whereby it has committed to licensing certain intellectual property and contributing up to \$2.2 million AUD upon the achievement of specific operational milestones over a period of at least four years from the agreement execution date. As of March 31, 2019, the Company has contributed \$0.3 million AUD. This equity interest is classified in other long-term assets.

5. Fair Value

Investments

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

	As of March 31, 2019			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	\$1,400	\$1,400	\$—	\$—
Money market funds	4,022	4,022	—	—
Fixed maturities:				
Foreign deposits	2,701	2,701	—	—
Municipal bond	1,000	—	1,000	—
Investment in variable interest entity	3,000	—	—	3,000
Total	\$12,123	\$8,123	\$1,000	\$3,000

	As of December 31, 2018			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	\$1,400	\$1,400	\$—	\$—
Money market funds	2,010	2,010	—	—
Fixed maturities:				
Foreign deposits	2,573	2,573	—	—
Municipal bond	981	—	981	—
Investment in variable interest entity	3,000	—	—	3,000
Total	\$9,964	\$5,983	\$981	\$3,000

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. The estimated fair value of the Company's investment in the variable interest entity is a Level 3 measurement, and is based on market interest rates, the assessed creditworthiness of the entity, and the estimated fair value of the entity's common stock. As of March 31, 2019, the Company estimates that the purchase price approximates the fair value. Short-term investments are carried at amortized cost and the fair value is disclosed in Note 3, 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.

Fair Value Disclosures

The Company's other long-term assets balance included \$4.5 million of notes receivable as of March 31, 2019 and \$3.0 million of notes receivable as of December 31, 2018, recorded at its estimated collectible amount. The Company estimates that the carrying value of the note receivable approximates its fair value. The estimated fair value represents a Level 3 measurement within the fair value hierarchy, and is based on market interest rates and the assessed creditworthiness of the third party.

The Company estimates the fair value of its long-term debt based upon rates currently available to the Company for debt with similar terms and remaining maturities. This is a Level 3 measurement. Based upon the terms of the debt, the carrying amount of long-term debt approximated fair value at March 31, 2019 and December 31, 2018.

6. Debt

The Company has a revolving line of credit of up to \$50.0 million, maturing June 2021. The facility is secured by any and all interests in the Company's assets that are not otherwise restricted. Interest on the revolving line of credit is payable monthly at the greater of 4.5%, or 1.25% plus the prime rate (6.75% at March 31, 2019). The credit agreement includes other ancillary services and letters of credit of up to \$4.5 million, and requires a deposit of restricted cash of \$1.4 million. The credit agreement requires the Company to comply with various financial and non-financial covenants. As of March 31, 2019, the Company was in compliance with all financial and non-financial covenants required by the credit agreement.

Borrowings on the revolving line of credit are limited to the lesser of \$50.0 million and the total amount of cash and securities held by the Company's insurance subsidiaries (American Pet Insurance Company and Wyndham Insurance Company (SAC) Limited Segregated Account AX). As of March 31, 2019, available borrowing capacity on the line of credit was \$31.4 million, with an outstanding balance of \$0.4 million for ancillary services and letters of credit, and borrowings under the facility of \$18.2 million, recorded net of financing fees of \$0.1 million.

7. 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.

8. 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 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):

	Three Months Ended	
	March 31,	
Subscription	2019	2018
Reserve at beginning of year	\$13,875	\$11,059
Veterinary invoices during the period related to:		
Current year	53,436	45,198
Prior years	202	(61)
Total veterinary invoice expense	53,638	45,137
Amounts paid during the period related to:		
Current year	42,650	36,142

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Prior years	10,015	8,250
Total paid	52,665	44,392
Non-cash expenses	201	156
Reserve at end of period	\$14,647	\$11,648

10

The Company's reserve for the subscription business segment increased from \$13.9 million at December 31, 2018 to \$14.6 million at March 31, 2019. This change was comprised of \$53.6 million in expense recorded during the period less \$52.7 million in payments of veterinary invoices. The \$53.6 million in veterinary invoice expense incurred included an adjustment of \$0.2 million to the reserves relating to prior years, which was the result of ongoing analysis of recent payment trends. For the three months ended March 31, 2018, the Company decreased prior year reserves by \$0.1 million as a result of analysis of payment trends.

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

Other Business	Three Months Ended	
	March 31,	
	2019	2018
Reserve at beginning of year	\$2,187	\$1,697
Veterinary invoices during the period related to:		
Current year	7,995	5,218
Prior years	(351)	(242)
Total veterinary invoice expense	7,644	4,976
Amounts paid during the period related to:		
Current year	5,856	3,734
Prior years	1,447	1,137
Total paid	7,303	4,871
Non-cash expenses	—	—
Reserve at end of period	\$2,528	\$1,802

The Company's reserve for the other business segment increased from \$2.2 million at December 31, 2018 to \$2.5 million at March 31, 2019. This change was comprised of \$7.6 million in expense recorded during the period less \$7.3 million in payments of veterinary invoices. The \$7.6 million in veterinary invoice expense incurred included a reduction of \$0.4 million to the reserves relating to prior years, which was the result of ongoing analysis of recent payment trends. For the three months ended March 31, 2018, the Company decreased prior year reserves by \$0.2 million as a result of analysis of payment trends.

Reserve for veterinary invoices, by year of occurrence

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

Subscription	As of March 31, 2019
Year of Occurrence	
2017 and prior	\$1,042
2018	3,020
2019	10,585
	\$14,647
Other Business	As of March 31, 2019
Year of Occurrence	
2017 and prior	\$12
2018	377
2019	2,139
	\$2,528

9. Stock-Based Compensation

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

	Three Months Ended March 31,	
	2019	2018
Veterinary invoice expense	\$ 161	\$ 120
Other cost of revenue	86	77
Technology and development	63	49
General and administrative	618	449
Sales and marketing	429	273
Total stock-based compensation	\$ 1,357	\$ 968

As of March 31, 2019, the Company had 399,417 unvested stock options and 716,319 unvested restricted stock awards and restricted stock units that are expected to vest. Stock-based compensation expenses of \$2.6 million related to unvested stock options and \$16.8 million related to unvested restricted stock awards and restricted stock units are expected to be recognized over a weighted average period of approximately 1.7 years and 2.9 years, respectively.

Stock Options

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

	Number of Options	Weighted Average Exercise Price per Share	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2018	2,621,503	\$ 9.01	\$ 43,136
Granted	—	—	—
Exercised	(105,963)	6.48	2,376
Forfeited	(1,594)	15.26	—
Outstanding as of March 31, 2019	2,513,946	9.11	59,401

Exercisable as of March 31, 2019 2,114,529 \$ 7.74 \$ 52,873

As of March 31, 2019, stock options outstanding and stock options exercisable had a weighted average remaining contractual life of 5.4 years and 5.0 years, respectively.

Restricted Stock Awards and Restricted Stock Units

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

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested shares as of December 31, 2018	451,160	\$ 22.16
Granted	337,279	29.89
Vested	(66,903)	27.92
Forfeited	(5,217)	27.99
Unvested shares as of March 31, 2019	716,319	\$ 25.22

10. Leases

The Company leases certain office space and equipment from third parties and recognizes lease expense on a straight-line basis over the lease term. Leases with an initial term of 12 months or less are not recorded on its consolidated balance sheets. The Company had \$0.1 million right-of-use assets and lease liabilities for long-term operating leases as of March 31, 2019.

The Company also leases a portion of its building to third parties and records related rental income within general and administrative expense in the consolidated statements of operations. These leases have remaining initial lease terms of 2 years to 8 years, some of which give the tenants options to renew the leases for up to an additional 10 years, and options to terminate the leases after 3 years of the initial lease terms, with early termination fees required. The Company recorded rental income of \$0.6 million for the three months ended March 31, 2019.

The following table summarizes the Company's future rental payments to be received from non-cancellable leases in place as of March 31, 2019 (in thousands):

Year ending December 31:

2019	\$1,603
2020	1,460
2021	1,210
2022	1,173
2023	1,210
Thereafter	3,238
Total rental payments	\$9,894

11. Stockholders' Equity

As of March 31, 2019, the Company had 100,000,000 shares of common stock authorized and 34,467,465 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 March 31, 2019, the Company had 10,000,000 shares of undesignated shares of preferred stock authorized for future issuance and did not have any outstanding shares of preferred stock. The holders of common stock are also entitled to receive dividends as and when declared by the board of directors of the Company, whenever funds are legally available. These rights are subordinate to the dividend rights of holders of all classes of stock outstanding at the time. The Company is unable to pay dividends to stockholders as of March 31, 2019 due to restrictions in its credit agreements.

In June 2018, the Company completed a follow-on public offering (the June 2018 follow-on public offering) whereby the Company sold 2,090,909 shares of common stock (inclusive of 272,727 shares of common stock sold by the Company pursuant to the full exercise of the underwriters' option to purchase additional shares) at a price to the public of \$33.00 per share. The Company received aggregate net proceeds from the June 2018 follow-on public offering of \$65.7 million, after deducting underwriting discounts and commissions and offering expenses payable by the Company. The proceeds were primarily used to purchase real estate consisting of properties in use as the Company's home office. In addition, in August 2018, the Company issued 303,030 shares of common stock via a private placement to an accredited investor as a portion of the purchase price of the real estate.

During the three months ended March 31, 2019, 450,000 of the Company's outstanding warrants were exercised. As of March 31, 2019, warrants to purchase 30,000 shares of the Company's common stock at \$10.00 per share remained outstanding, which will expire on July 2, 2019.

12. Segments

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

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

	Three Months Ended March 31,	
	2019	2018
Revenue:		
Subscription business	\$74,222	\$61,517
Other business	12,756	8,243
	86,978	69,760
Veterinary invoice expense:		
Subscription business	53,638	45,137
Other business	7,644	4,976
	61,282	50,113
Other cost of revenue:		
Subscription business	6,749	5,877
Other business	3,915	2,706
	10,664	8,583
Gross profit:		
Subscription business	13,835	10,503
Other business	1,197	561
	15,032	11,064
Technology and development	2,669	2,164
General and administrative	5,419	4,458
Sales and marketing:		
Subscription business	8,097	5,851
Other business	130	87
	8,227	5,938
Operating loss	\$(1,283)	\$(1,496)

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