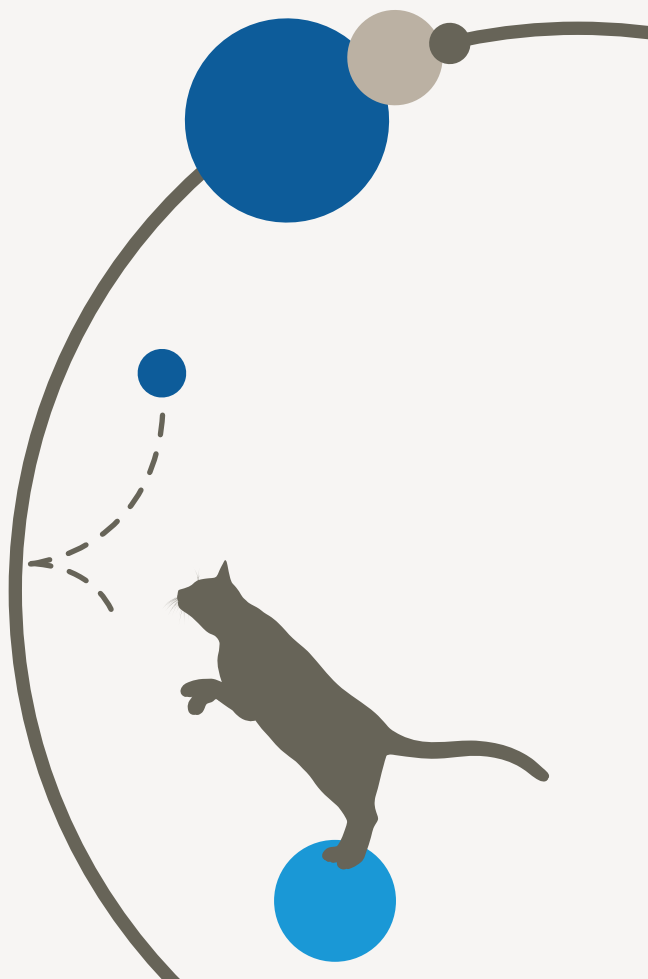
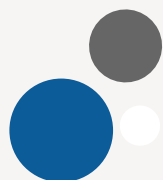


trupanion™

Medical insurance for the life of your pet.

# Shareholder Letter

2018



**APRIL 25, 2019**

## **TO OUR SHAREHOLDERS,**

This letter is being published a few months shy of our five-year anniversary as a public company. Looking ahead to the next five to ten years, our annual goal is to grow revenue 20% to 30%, achieve and maintain an adjusted operating margin of 15% of revenue, and reinvest as much of it as possible while achieving an anticipated internal rate of return (IRR) between 30% and 40% for a single average pet. If we can achieve these three goals on an annual basis while continuing to build moats around our business and maintaining our culture, we will have had a good year.

By these measures, 2018 was a good and consistent year. Revenue was up 25%, our adjusted operating income grew 36%, and our Pet Acquisition team was able to deploy \$24 million dollars which, based on our calculations, provides a 37% internal rate of return on a single average pet.

As we approach our fifth year as a public company and pass mile nine in my marathon analogy, it's the right time to go back to our values and ask, "Have we done what we said we would do?"

On the whole, my answer is yes. But before I go into why, I want to set the stage by opening with our inaugural shareholder letter to give you a chance to reset with me around who we are as a business, why we are here and what we believe in.

PLEASE READ OR RE-READ THE  
2014 SHAREHOLDER LETTER  
W/A FEW UPDATES! ☺ - DAKRYL

April, 20 2015

## TO OUR SHAREHOLDERS

3,766,033  
INVOICES  
RECEIVED  
@  
END OF  
'18

2014 ended with our 1,000,000th veterinary invoice being paid after a member's pet, a mixed breed dog named Marlee, became sick. We enrolled our first pet in 2000, and a lot has changed since then, yet it is humbling to recognize that our mission is as applicable today as it was when I started the company – arguably more. In Marlee's case, she required only \$13.18 of medication to solve her problem, but over the years we have seen other members' pets pass \$30,000 and \$40,000 in paid veterinary invoices. No claim is too big or too small for Trupanion!

As this is our first shareholder letter as a public company, I would like to take this opportunity to provide a better understanding of how we at Trupanion operate and think.

STILL THE TARGET! →

By the end of this letter, I hope you will understand that not only do we care about creating shareholder wealth, but we truly care about our shareholders as integral team members. Our plan now includes achieving free cash flow positive by the end of Q2 2016. In the next five years, we plan to achieve scale, which we define as 650,000-750,000 pets. At scale, our target is to have 5% fixed expenses and a 15% discretionary margin from our subscription business (before sales and marketing), with our discretionary income funding all our growth, including our capital requirements. This may be aggressive, but I commit to updating you on our progress toward these goals every year. If you are already an investor, I hope you feel comfortable with your decision. If you are not yet a shareholder, I hope you consider adding us to your long-term portfolio.

In our view, the role of a publicly-traded company is to create shareholder wealth by solving a large problem with a unique and defensible solution while aligning the interests of all of our constituents. Our constituents include responsible, loving pet owners; veterinarians and their co-workers; Trupanion Territory Partners; Trupanion employees; and Trupanion shareholders.

↑  
+ DEPARTMENTS OF INSURANCE

## The problem Trupanion is solving

183.9M  
IN '10

Pet owners in North America spent \$55 billion caring for the 180 million dogs and cats last year, and that number is expected to increase in 2015. Responsible, loving pet owners understand how to take care of their dogs and cats. We exercise them, play with them, feed them high-quality food, and make sure they receive preventive health care like flea control, dental cleanings, and annual checkups. They sleep in our bed and on our couches, we use them as our screen savers — and we spent \$500 million dressing them up for Halloween last year. But, most of all, we love them as they love us... unconditionally.

Where we as responsible pet owners struggle is when they become sick or injured. We know where to go for help - our trusted local veterinarian. But we stress over budgeting and planning for the cost of that veterinary care.

"...RESPONSIBLE, LOVING PET OWNERS — DO NOT WANT A RETURN ON INVESTMENT. NOBODY IN THEIR RIGHT MIND WANTS THEIR PET TO BE 'UNLUCKY' OR EVEN 'AVERAGE.'"

estimated  
\$72.13B  
IN '18

Why is this such a challenge? A few reasons:

1. We have no idea if our pet is going to be "lucky," "unlucky," or "average."
2. Accidents and illnesses do not occur at convenient or predictable times.
3. The local cost of veterinary care varies by a wide margin by hospital and an even wider margin if you include referral, specialty and 24-hour emergency hospitals.
4. The risk profile of each cat and dog is very different.
5. Large veterinary invoices now can cost \$10,000, \$20,000, \$30,000 — up to \$40,000; therefore scrambling for a credit card is no longer a viable option.

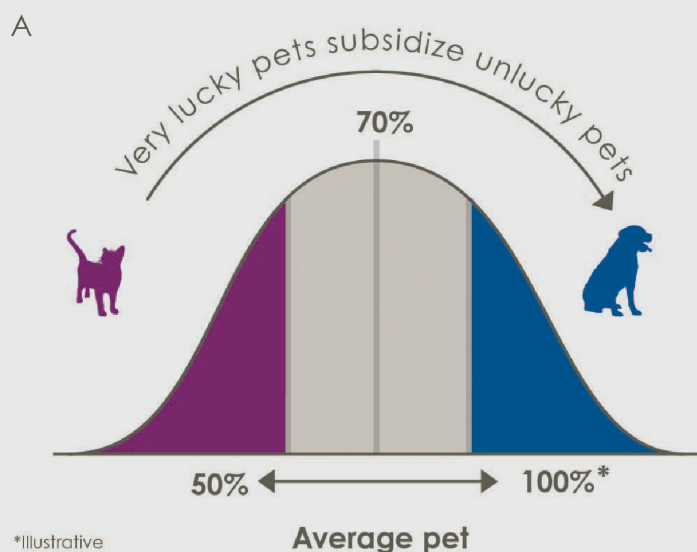
Trupanion solves these problems by sharing the risk equally between the "lucky," "unlucky," and "average" dog or cat, taking into account the local cost of veterinary care, and the risk profile of the pet.

These factors allow us to create "price" categories - over 1.2 million price categories last year. These categories are designed to let us share risks equally and fairly among the "lucky," "unlucky," or "average" dog or cat. For example, one category is "Golden Retrievers," another is "dog residing in Santa Barbara," and a third is "cats enrolling at the age of six."



We do not try to predict the future. Our responsibility is to understand the costs associated with each category and its underlying trend, and then add a 30% margin. This “cost plus” approach allows us to pay 70 cents on the dollar to the “average” pet owner over the life of their pet (see graph A).

It is important to note that our members - responsible, loving pet owners - do not want a return on investment. Nobody in their right mind wants their pet to be “unlucky” or even “average.” Our members say, “I hope we never need to use Trupanion, but I feel better knowing that if we do, Trupanion will do what they say.” Stop and think about this for a minute... maybe three minutes if you are not a pet owner.



\*Illustrative

## Defensible solution

We believe that we have a unique long-term defensible solution. It starts and ends with being the low-cost operator, meaning that our cost to administer and the cost to acquire new members are lowest in North America and very difficult for any existing or new company to emulate. This does not mean that our product will be cheapest in the market; it means that we have the ability to consistently use a higher percentage of our members' monthly subscription fees toward paying veterinary invoices (see graph B on next page).

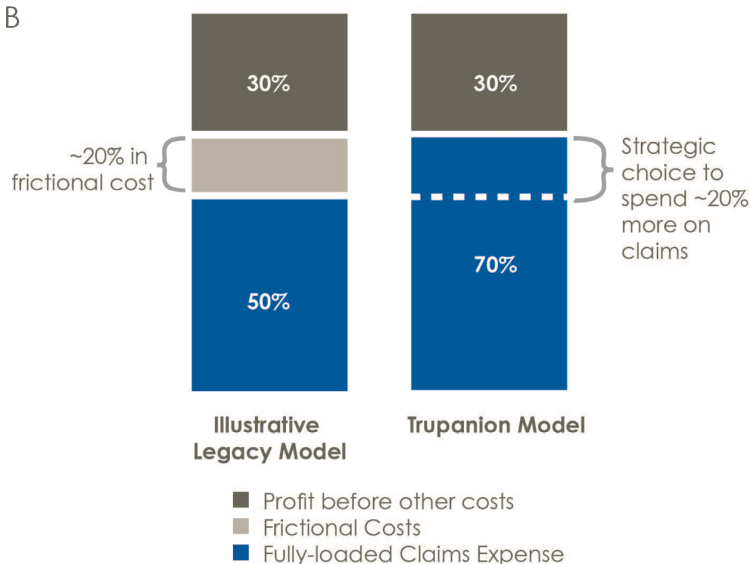
To be completely fair and transparent, it is our underlying costs that are low today. Similar to OpenTable when they went public, our costs in an existing, established market are low. In new

"OUR PROPRIETARY DATABASE HAS BEEN BUILT OVER 15 YEARS USING OVER 7.5 MILLION PET MONTHS OF INFORMATION AND INCLUDES OVER 1 MILLION CLAIMS."

markets, until we reach scale, the cost of acquiring new pets will be higher. Likewise, our fixed expenses, which include our G&A and our technology investments, will run higher for the short term as we invest ahead of scale to be the long-term category leader.

Trupanion's proprietary data has given us a unique advantage in the marketplace. We have a central team of analysts of varying backgrounds (actuary, finance, math, engineering) who serve as the "truth department" and support all areas of the business. They provide transparency into company data for better decision-making and use advanced techniques to extract insights from this data. Our proprietary database has been built over 15 years using over 7.5 million pet months of information and includes over 1 million claims. Pricing accurately allows us to share our high value proposition with each pet owner. We are confident that we lead the industry with our data analytics. Knowing what I know today, it would take me over 13 years to replicate our 15 years of data.

B



One of the biggest differentiators for Trupanion is our unique approach to the market through a field team we call Territory Partners. We fundamentally believe that support from veterinarians is critical to driving broader acceptance of medical insurance for pets in North America. We have built our success around this belief, making pet owners aware of our solution by using Territory Partners to educate veterinarians, and encouraging them to actively recommend Trupanion in their hospitals. Territory Partners build relationships and trust with veterinarians as the local face of Trupanion. In 2014, we estimate that we made over 80,000 face-to-face visits. Over the last 15 years we've made hundreds of thousands of visits with veterinarians.

123

At the end of 2014, we had 70 people in the field and we expect to have 85 by the end of 2015. We ended 2014 with over 6,000 active hospitals, compared to over 5,000 active hospitals at the

9,700 IN '18

C

## Trupanion's Territory Partner Model



end of 2013. An active hospital is not a hospital that displays our brochures, but a hospital that has had a pet enrolled over the previous three months.

This approach is effective at creating members and efficient from a pet acquisition cost perspective (see graph C).

In order to maintain these important veterinary relationships, we are consistently looking for ways to enhance the Trupanion experience in the hospital. Trupanion Express™ is our no-cost software solution that revolutionizes the member experience and removes a major barrier — the reimbursement model — that has historically existed between “pet insurance” providers and veterinarians. For pet owners, their 90% coverage through Trupanion is paid directly to the veterinarian at the time of invoice — dramatically reducing out-of-pocket costs. For veterinarians, Trupanion coverage enables them to move forward with “plan A” care for any sick or injured pet while growing their top and bottom lines. In the process,

Trupanion collects additional proprietary data to further improve our pricing accuracy, while maintaining a strong relationship with supportive hospitals. At the end of 2014, we had approximately 175 of our 6,000 active hospitals using Trupanion Express™. These hospitals are among our most active, representing over 20% of our claims dollars. While still early, following implementation, we’re seeing improved referral and conversion rates. Longer term, we also expect this to aid retention rates (see graph D on next page).

Data analytics, expansion of our Territory Partner sales force, and focus on Trupanion Express™ are all strategic investments aimed at scaling our business and driving the penetration of medical insurance for pets north of the approximately 1% it is today in the United States and Canada.

3,510  
OF OUR  
9,700  
ACTIVE  
HOSPITALS  
IN '18

## Aligning the interests of all of our constituents

Responsible, loving pet owners want a solution to their underlying problem of budgeting for the costs of veterinary care if their pet becomes sick or injured. They demand coverage for the medical issues most likely to occur to their pets. They want to use their veterinarian of choice and to have 90% of the actual invoice paid directly to their veterinarian so they do

not have to come out of pocket and suffer through a cumbersome reimbursement model. They do not want to be penalized if their pet becomes “unlucky.” Most importantly, they want value. Unfortunately, pet owners were not seeing these things offered in the traditional products available on the market.

From day one, I have been dedicated to meeting these needs and today we offer a superior product that is inherently different than what

D



NOW 10 sec. w/  
CLAIM AUTOMATION!

"THE VALUE OF THE TRUPANION SOLUTION COMES IN THE FORM OF PAYING THE INDUSTRY'S HIGHEST SUSTAINABLE PERCENTAGE BETWEEN WHAT PET OWNERS PAY IN THE WAY OF MONTHLY COST AND WHAT WE PAY IN VETERINARY INVOICES FOR THE 'AVERAGE PET.'"

pet owners perceive as pet insurance in North America. In fact, we do not describe ourselves as "pet insurance" — we are medical insurance for cats and dogs. Why is that? Each pet owner you meet will have a different perception of what "pet insurance" is — wellness-only coverage, accident-only coverage, an HMO-like product that restricts where you can get care, fee schedules that restrict how much care you can receive, and unequivocally all reimbursement-based.

We clearly solve all of these problems — and more. We cover hereditary and congenital conditions (those things most likely to happen to a pet), we don't raise rates because a pet has claims, we have no payout limits, and we're eliminating the reimbursement model with Trupanion Express™. The value of the Trupanion solution comes in the form of paying the industry's highest sustainable percentage between what pet owners pay in the way of monthly cost and what we pay in veterinary invoices

for the "average pet." This is a strong value not only for the pet owner — but for the veterinarian and the pet as well. We're aligning the interests of the pet owner and the veterinarian, allowing both parties to focus on providing the best care, rather than the cost.

I would like to draw a comparison between Trupanion and another subscription membership company that I greatly admire. Costco members inherently understand if they are purchasing a 60" flat screen, a bottle of Bordeaux, a can of tuna, or a roll of toilet paper, that they are always getting the best deal. Trupanion members need to know that whether they are paying \$33/month for their cat or \$144/month for their Bulldog, they are getting the industry's best deal, for a product that works, and from a company they can trust (see graph E).

E Value Per Category\*



\*Illustrative.

\*\*Assumes 2-year old pet selecting a \$100 deductible



## Let's have a discussion about veterinarians, the cost of veterinary care and our philosophy around these items

Trupanion has been built from the ground-up based on our relationships with veterinarians and their staff. They are extremely loyal and consistent once we earn their trust. Veterinarians and their staff chose their occupation because they love pets. Getting into veterinary school can be more difficult than getting into medical school or dental school. Yet veterinarians earn considerably less than their counterparts on the human side.

The delivery of veterinary medicine is thriving. There are 28,000 veterinary hospitals across North America and approximately 26,000 are independently owned. They are extremely efficient, providing the same surgeries, medicine, diagnostics, and hospitalization as their human counterparts at a fraction of the cost. The costs of veterinary care are market-driven due to such a high percentage of independent hospitals serving the needs of their local pet owners in a way that sets their hospital apart from the competition down the street or around the corner. Veterinarians are also highly respected within their community, often rated among the highest professions alongside medical doctors and pharmacists.

Understanding the motivations, values and perspectives of veterinarians and their staff is critical to our long-term success. They do not want their industry screwed up like the human side. This means no to any HMO-like models. Having insurance companies drive the pricing of care or selection of hospital is not acceptable. They want to serve their clients' needs, not waste their time on filling out forms. They know the difference between a high-quality product and one that has limitations and exclusions. They understand what appropriate care is and are passionate about providing it. Compassionate euthanasia is a part of veterinary medicine, and will always be a part of veterinary medicine; but economic euthanasia is heartbreaking to all veterinarians and their staff. Finally, they agree that medical insurance for cats and dogs is for catastrophic issues, not wellness or routine care.

Trupanion's product pays 90% of the veterinarian's actual invoice for all diagnostics, surgeries, medications, and hospital care. We have no payout limits - period. We do not penalize pet owners if their pet becomes sick or is injured. We cover all medical conditions that arise after a pet owner gets Trupanion; this includes the things most likely to occur to their pet's breed, known as congenital or hereditary conditions. Trupanion has only one simple plan, so it is easy for veterinarians and their staff to understand and therefore explain to their clients. Trupanion has the ability to integrate with the veterinarian's practice management

21,000 →  
IN 18 DUE TO  
CORPORATE  
CONSOLIDATION

"WE ARE NOT TRYING TO CONTROL THE COST OF VETERINARY CARE; WE ARE SIMPLY TRYING TO UNDERSTAND THE COSTS FOR THE AVERAGE PET IN EACH CATEGORY, AND ADD A 30% MARGIN."

software, so we replace cumbersome paperwork with a couple of clicks and the ability to pay the veterinarian directly.

We are not trying to control the cost of veterinary care; we are simply trying to understand the costs for the average pet in each category, and add a 30% margin. This makes the budgeting manageable to the responsible, loving pet owner.

## Why our values are so important

Trupanion employees love pets. On an average day in our Seattle office we will have about 400 employees working alongside 200+ dogs and cats. This is an important part of our culture, as our four-legged friends constantly remind us why we come to work. To ensure the comfort of all the pets, we have full-time dog walkers. Our average employee has years of experience in veterinary hospitals, shelters, doggy day cares or other related fields. Similar to the demographics of a veterinary hospital, we have a high percentage of female employees between the ages of 24 and 40. In January, to supplement our dog walking services, we launched a child care center for our employees with two-legged children under the age of three. THROUGH PRE-K

Another Seattle company that we admire is Starbucks and in particular their values on "social conscience." We at Trupanion believe

DAYCARE HAS 37 KIDS NOW

that our environment and values are critical to our long-term success. We feel strongly that everyone at Trupanion is equally important; we all have the same size desk and the same benefits regardless of whether we are hourly or salaried or our tenure with the company. We want everyone to be fulfilled and comfortable being themselves. We have a sign on our wall that shows the Oscar Wilde quote, "Be yourself, everyone else is taken" and we take that motto seriously.

Our values are not something we put on marketing materials - they are beliefs or traits that are shared by our community and define our culture. We believe that the values of a company are similar to the characteristics of an individual. If you were to describe a friend to a co-worker you may use words like smart, funny, loyal, and crazy. The combination of these words would paint a picture to your co-worker about your friend. If a pet owner or veterinarian describes Trupanion in a way that lines up with our values, then we have the underpinning of a Brand. Our values are:

- We do what we say
- Simple is better
- We do not punish unlucky pets
- We're innovative and fair
- We love pets!

Our values are listed in the order of priority — if someone loves pets, but they do not do what they say? That individual does not belong at Trupanion.

## Shareholders have been with us since the beginning

I started Trupanion 15 years ago in Vancouver, BC. From the beginning, I have had shareholders. For the first few years the company was bootstrapped with my personal proceeds earned from the sale of my cigar business, and from the trust of eight individuals who invested \$25,000 each. Several years later, and before taking on any institutional investors, we agreed to pay \$35,000 to each of the eight individuals and they kept 100% of their shares. It was very important then, as it is today, to repay shareholders and to do what we say.

Our commitment to our institutional investors was to take our learnings from our first seven years in Canada and to create and build a category for medical insurance for cats and dogs in the United States & Canada. In 2008, we said that we would build relationships with veterinarians, get the underpinnings of a consumer brand, expand upon our data, focus on the consumer experience, and take the company public in 2014.

On July 18, 2014 we took Trupanion (TRUP) public on the New York Stock Exchange and embarked life as a public company.

## 2014 performance

First, an overview. While becoming a public company was a major milestone, it was truly only one moment in time for us. We had a full year of hard work, accomplishments, and setbacks. I believe we did several things well and several things poorly in 2014, and I'll outline them here.

**In the negative column,** we disappointed ourselves and others by having a pricing miss in Q3 & Q4, which was outside of our allowable tolerance and affected our gross margin. For this miss I blame myself. For several years we had been extremely accurate at our pricing, so much so that I became overly confident and focused on weaker areas of our business.

Primarily, I focused on improving the quality, selection and training of our national sales force of Territory Partners (an area we began to fumble in 2012 and 2013), as well as preparing to take the company public. What I didn't account for during this time was the speed in which the company was able to execute change in processes. I had a flat organizational structure and unfortunately I was a critical component in disseminating information across departments. Said another way, the impact of the way we were changing our claims process was not clearly understood in our pricing department and we got surprised. The organizational structure was adjusted in the fourth quarter of 2014 and we now have five clear owners of every key metric and line item



on our profit and loss and cash flow statements. These owners meet weekly and I am no longer a barrier to the dissemination of information.

The second area where we let ourselves down was holding on to some people longer than we should have, specifically some Territory Partners who we had previously on-boarded too quickly and, to be fair to them, without enough training and tools to increase their odds of being successful. When talking about having the right people in the right seat on the bus, my experience tells me this will not be the last time we acknowledge this failure.

A third area that disappointed me was our focus on increasing enrollments and same-store sales ahead of a more foundational goal of increasing enrollments by adding more active hospitals. It would be lovely to do both well, but we mixed up the priorities last year.

**In the positive column**, we believe we raised more than enough money to carry us through to cash flow positive. We have no intention of going back to the markets to raise additional capital.

To set appropriate expectations clearly, I should caveat that if we miraculously discover a new lever that will dramatically and cost-effectively change our growth projection curve, and it requires additional capital, we will do what's best for the company and shareholders long-term. I put this miraculous new lever probability somewhere between very low and extremely low. After 15 years, we are not expecting to find a silver bullet.

Second, we have improved the hiring, training and selection of our Territory Partners. In 2014, we launched a program we call "Trupanion University" where current and prospective Territory Partners participate in an extensive three-week training on Trupanion.

Third, we have significantly advanced our knowledge, product and processes to allow us to improve our member experience, facilitating our long-term goal of paying veterinarians directly and eliminating the cumbersome reimbursement model. Trupanion Express™ is very important to our long-term ambitions and in 2015 we intend to learn much more to ensure we get the full impact when we are eventually deployed throughout North America.

## Let's move on to the numbers

We are not at the stage where I can start talking about earnings per share. What I can go over is the top line, bottom line, and some of our key metrics. But first, it's important to understand how we think about our business metrics internally. We use the old-fashioned cash flow method.

We collect cash at the beginning of the month, and then pay veterinary invoices, variable expenses to support member service, taxes and fees, and fixed expenses in the way of technology and general and administrative expense (G&A). The remaining cash, before sales and marketing, is what we term our "discretionary income." We can choose to

WE SPENT \$3.3M  
ON TRAINING  
IN '18



spend this discretionary income to acquire new members, invest in foundational one-time initiatives, re-purchase shares, or one day, distribute to our shareholders.

Please note our discretionary income is not recognized by GAAP accounting or the SEC, but we certainly are not the first direct-to-consumer subscription company that thinks about their business this way. John Malone and TCI (the cable company) in the late seventies introduced the investment community to the term EBITDA when they needed to describe cash flow in their business in lieu of earnings per share. TCI shareholders were well rewarded when they educated themselves in how they managed their business based on cash.

It should also be noted that the discrepancy between our actual cash flow and GAAP accounting for revenue is approximately 200 basis points in the positive direction. The two-point swing is related to the requirement to defer approximately half of a month's revenue forward one month as our members pay on differing days during the month and receive a month of coverage.

Back to the GAAP accounting and other key metrics in 2014:

- Revenue was ~~\$116M~~ 304.0M
- AEBITDA was a loss of ~~(-\$10M)~~ +8.6M
- Free cash flow was ~~(-\$16M)~~ +8.3M\*
- Adjusted Revenue Per Pet (our version of ARPU) was ~~(\$44)~~ per month \$53.44

- PAC was ~~\$119~~ (pet acquisition cost) \$104
- LVP was ~~\$590~~ (lifetime value of a pet) \$710
- LVP/PAC was ~~5.0X~~ 4.3
- Discretionary income was ~~\$3M~~ \$31.9M

All the above key metrics, excluding fluctuations in foreign exchange rates, were at or slightly ahead of analyst consensus.

## Notable milestones in 2014

- 2014 showed continued revenue and pet growth (see graph F on page 14).
- We added 213 people to our home office team — that is 44% growth over 2013. We also welcomed 67 new pets to the office, making our Trupanion family now a total of 227 pets and ~~413~~ 586 EMPLOYEES IN '18 employees — a 1:2 pet to human ratio.
- We launched the US Veterans Service Dog Program, working with the US Department of Veterans Affairs. Through this program, approved veterans' service dogs receive quality veterinary care and Trupanion covers 100% of all coverable expenses — this includes treatment for pre-existing conditions and wellness and preventive exams, as well as everything covered for Trupanion's members. This program shows up in our "Other Business" section of our P&L.

\* SEE TABLE 1 IN '18 LETTER

- Our Member Care team initiated a new partnership with Aspect, a workforce management solution, to help deliver exceptional service. Aspect allows Trupanion members to move from channel to channel and connect to the same team member. Almost overnight, Trupanion shaved 30 seconds off average wait times by leveraging skills-based routing. Aspect technology has also helped Trupanion improve timeliness of email responses and stay within service level goals.
- We made our stock market debut on the New York Stock Exchange. Several team members traveled to New York City to ring the closing bell. The traditional celebratory dinner was held picnic-style in Central Park while we dined on Shake Shack burgers. The rest of the office partied at home with champagne and cupcakes. Our stock opened at \$10 per share, and we raised \$82 million.
- We launched our new website — a robust, fully responsive, world-class web platform and what we believe is the best possible 'front door' for Trupanion. After its launch, The Interactive Media Council named Trupanion.com the winner of the 2014 Interactive Media Award for Best in Class Website.

- We hosted a three-day conference in downtown Seattle for our Territory Partner sales force. The conference featured keynote speakers Richard Galanti, Costco CFO; Howard Schultz, Starbucks CEO; David Loewe, Seattle Humane Society CEO; and Kristin Hamilton, Koru CEO.
- Our Chief Technology Officer, Craig Susen, was awarded the CTO of the Year Innovator Award.
- Through our Member Donation Program, our members donated over \$104,000 to charities across the United States and Canada. These charities include The American Humane Association, National Canine Cancer Foundation, The Farley Foundation, and the BC SPCA Biscuit Fund. We also donated 9,107 pounds of pet food to the Seattle Humane Society in our annual pet food drive and sponsored 49 children in need for the holidays.
- Our Child Care Center hosted its open house. The center is available to Trupanion employees at no cost, and serves children aged 6 weeks to 2.5 years. The Child Care Center was officially opened January 5.
- We ended the year with 232,000 enrolled pets, 70 regional sales people in the field and 6,073 active hospitals.

10.28 TONS  
TO SIX  
LOCAL SHELTERS

49 KIDS

THROUGH  
PRE-K

520,000  
PETS!

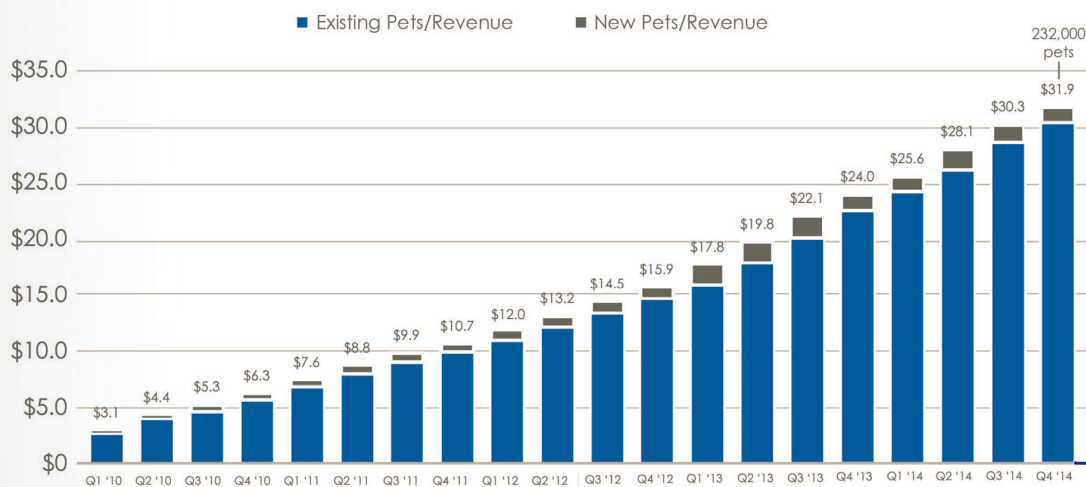
123 TPs!

9,700  
HOSPITALS IN '18

\$82.6

F

## Total Revenue by New vs. Existing Pets\*



\*All revenue amounts reflect adjusted revenue, in millions. For a description of how we calculate adjusted revenue, see "Management's Discussion and Analysis of Financial Conditions and Results of Operations — Non-GAAP Financial Measures." Existing Pets/Revenue reflects adjusted revenue from subscription pets who had active subscriptions at the beginning of the quarter and recurring adjusted revenue from our other business segment. New pets/revenue reflects adjusted revenue from subscription pets enrolling during the quarter and adjusted revenue added during the quarter from our other business segment.

## Our business model

Our business model is simple. But the execution of our business model is challenging. It requires focus, years of data, and a great team.

Our business model is similar to the cable industry in the 1960's, the cellular industry in the 1980's, and more recently, two companies we admire - Netflix and Pandora. Purely, we are a direct-to-consumer monthly subscription service.

Subscription service companies rely on a high value proposition for their members, something they feel and value. The best subscription companies have a high cost of goods, an exceptional member experience, and the lowest frictional costs.

The model is to spend X to acquire a new member and to have the discretionary income return substantially more than X over the life of the subscription. Margin percentages are less important than the amount of free cash generated over the life of the subscription. One

"OUR BUSINESS MODEL IS SIMPLE. BUT THE EXECUTION OF OUR BUSINESS MODEL IS CHALLENGING."

of our key metrics is our PAC/LVP ratio, which all quality subscription companies understand. Internally, we think the PAC/LVP ratio is a little overstated as it uses the average contribution dollar and omits the cost of our fixed overhead. It is useful to show the potential before we are fully at scale and that is why we report it, BUT it is flawed because it does not account for the cash required to operate our fixed expenses.

For these reasons, we are most concerned with the internal rate of return (IRR) for incrementally adding an average pet. We calculate the IRR by understanding our cost to acquire an average new pet and the free cash flows that we anticipate will be generated over the average pet's life. We have previously stated that, at operational scale (650,000 to 750,000 pets), our target fixed expenses should equal 5%-6% of revenues. If we are able to achieve a consistent 70% gross margin, 10% variable expenses and 5%-6% for fixed expenses, our discretionary margin would be 14%-15%. In the

next few years and before hitting scale if we can achieve 7%-8%, our IRR should be in the neighborhood of 40%-50% (see graph G).

Unfortunately, we do not have a 40%-50% IRR for the average incremental pet today. Candidly, we have taken a temporary step backward in the last two quarters with our inadequate pricing and our currently outsized fixed expenses. That being said, we believe that these results are achievable based on our performance in more mature markets. Lots of execution ahead!

Please remember we have over 1.2 million price categories where we monitor our PAC/LVP and therefore our IRR by category. They will not have the same results. As we try to accelerate some channels and categories, some will scale well for a long time, others will have diminishing returns. It is our responsibility to understand when to put our foot on the accelerator, when to coast, and when to slam on the brakes.

G

Months	68	Next few years								
Churn	1.47%	year	0	1	2	3	4	5	6	
LVP	570	Months	6	12	12	12	12	12	2	68
LVP/PAC	5X	DM	\$24.35	\$48.71	\$48.71	\$48.71	\$48.71	\$48.71	\$8.12	
DM	8.1%	PAC	-\$114							IRR
ARPU	\$50.11	FCF	-\$89.65	\$48.71	\$48.71	\$48.71	\$48.71	\$48.71	\$8.12	47%

LVP = Lifetime Value of a Pet  
DM = Discretionary Margin

PAC = Pet Acquisition Cost  
ARPU = Average Revenue Per Pet (Unit)

37.1.



## Market comparables

Prior to and since going public we have been asked a set of questions, all with a similar theme: Why are you being covered by internet analysts? Why are you being covered by animal health analysts? Are you not just an insurance company? What are the market comparables to Trupanion?

The answer to all of these questions is that we are not easily put into a box. Our product is a catastrophic health insurance product. For this, we internally believe our challenges are not similar to a typical health insurance company and the complexity of offering our product is just another barrier to entry. We live in the animal health world, this is where 70% of the team comes from and it is necessary that we understand the needs of veterinarians and pet owners, but we are not a pharmaceutical, laboratory or distribution company. We also are not a SAAS company with a high gross margin. We are a monthly recurring revenue business that requires us to be a low-cost operator, with a high value proposition, and a focus on delivering a positive member experience with a low acquisition cost.

I have mentioned several companies in this letter that I admire, but I don't mention them to drive valuation comparisons. They inspire me, and as a business, we aspire to some parts of their business model but I am not trying to suggest they are market comparables.

Our business model is a direct-to-consumer monthly subscription service and this is how we manage the business.

## Methods of valuation

It would be disingenuous for us to talk about comparables without talking about valuation methods. My opinion on these topics probably isn't relevant to the marketplace, but I'm going to give it anyway:

- Multiple of earnings is not very relevant when a company is losing money. If investors are currently expecting/requiring dividends, we are not the right investment right now. However, as I mentioned earlier, we expect to achieve cash flow positive in the next 12 months and achieve scale in the next five years.
- Multiple of EBITDA is applicable for many growth companies if the capitalized portion of the P&L is similar to other comparable investments. We do not capitalize our growth; in fact, we capitalize only a small portion of our technology spend today and we expect this will be reducing as we scale our fixed expenses, G&A and technology to 5%-6% of revenues.
- EBITDA and GAAP puzzle me at times. If we purchased a book of business from a competitor, the purchase would be capitalized. For example, if we purchased a competitor with 50,000 pets at a price of \$300 per pet, the purchase price would be \$15 million. With GAAP accounting, the purchase would have little effect on our EBITDA and income in the year we purchased

the business, and the following year, the casual observer would only see our increased revenue from the additional 50,000 pets and the corresponding profits. Hold with me... this is where it gets interesting. If in the same year, we chose not to purchase the competitor's pets for \$300 per pet, but instead grew organically by 50,000 pets at \$150 per pet, our EBIDTA or income would have a -\$7.5M hit. EBIDTA is supposed to be a proxy on cash and GAAP accounting... well-intended as it is, it does not always lead us to the best investment decisions. The cash decision is obvious, it is better to grow organically at \$150 a pet vs. paying \$300 per pet. Needless to say, we like to manage our business based on cash.

- We are cash-in/cash-out every month. We are not a company that makes money on the float. There are insurance companies that do that very well if you are looking for a return on equity type of investment in your portfolio.
- Discounted cash flow is how we internally view our long-term strategic choices. It is purely mathematical and although the inputs of terminal growth rates and weighted average cost of capital can move the valuation all over the chart, if you keep them constant, you can determine if your choices move the needle in the right direction.

## Deployment of your capital short-term

Over the next few years we will be deploying your capital in our foundation, member experience, growth and scale. Specifically, we intend to invest in:

- Our Territory Partner program to increase the number of active hospitals recommending Trupanion. We have a long way to go to earn the trust of the 28,000 veterinary hospitals throughout North America.
- Building and deploying technologies that will improve our member experience and lower our operating costs.
- Data to improve our ability to price accurately and fairly among all of our categories. This is at the core of what sets us apart. Our members need to know that they are always getting the best deal.
- Cost-effectively adding more pets.

"WITH THE NORTH AMERICAN MARKET PENETRATION AT APPROXIMATELY 1%, WHILE WESTERN EUROPE RANGES BETWEEN 5% AND 25%, WE HAVE DECADES OF RUNWAY AHEAD."

## Deployment of your capital long-term

As mentioned previously, we use our IRR to determine if adding an incremental pet is the best use of our shareholders' money. With the North American market penetration at approximately 1% while Western Europe ranges between 5% and 25%, we have decades of runway ahead. Remember, at our average revenue per pet, every 1% of penetration equals about \$1 billion in revenue. If at scale we cannot get a consistent return healthier than the average shareholder, we could return the cash in the way of dividends. If we have extra capital and our share value is significantly below our discounted cash flow value, we could re-purchase shares. These are theoretical scenarios; however, I expect we will continue to see growth opportunities for years to come and continue to re-invest to capture more of the available market.

## The team

Every CEO says they have a great team. Instead of me saying it to you, I invite you to visit our Seattle office so you can meet them yourself, experience our environment, and hang out with our 200+ dogs and a few fearless cats.

Our progress to date would not have been possible without the support and cooperation from our Board. For years, Chairman Murray

Low has set the tone, leading by example with incredible character, self-awareness and drive to help build something great.

It's also important to me to call out Dan Levitan. Dan is the co-founder of Maveron, the preeminent consumer-focused venture capital firm. Partnering with Dan and Maveron has proven to be one of the best decisions that I have ever made.

I would like to take this opportunity to say thank you to:

- The amazing companies that I named in this letter: Costco, Netflix, Pandora, OpenTable, TCI, and Starbucks - thank you for being an inspiration.
- Veterinarians and your staff: thank you for believing and trusting that we could be different.
- Our employees who live and breathe our values, passionately serve our members, and have the confidence to be themselves at work.
- Our Territory Partners who day after day walk through the doors of veterinary hospitals, trying to earn their trust.
- Existing shareholders: we thank you for entrusting us with your investment.
- To those responsible, loving pet owners that have Trupanion: thank you for taking care of your buddy and choosing us. We hope you are lucky enough to never need to call us, but if you do, we will be there for you.

APPROX →  
2% IN '18



For those truly long-term investors who have not purchased TRUP, I encourage you to educate yourself on our company and visit our team in Seattle.

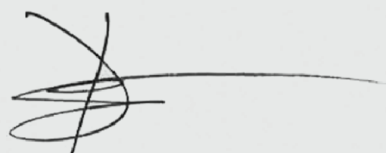
I will leave you with an excerpt of a letter a fellow board member gave to me recently:

*"I have always been attracted to the low cost operator in any business and when you can find a combination of (1) an extremely large business, (2) a more or less homogeneous product, and (3) a very large gap in operating costs between the low cost operator and all of the other companies in the industry, you have a really attractive investment situation. That situation prevailed twenty five years ago when I first became interested in the company, and it still prevails."*

Letter to Mr. George D. Young  
From Warren Buffett  
July 22<sup>nd</sup>, 1976

Thank you,

*Darryl Rawlings, Founder & Chief Executive Officer*

A handwritten signature in black ink, consisting of a stylized 'D' followed by a horizontal line extending to the right.

## 5 YEAR REFLECTION

When I re-read the 2014 shareholder letter (and the 2015, 2016, and 2017 letters) and review our five-year report card, I feel good about our progress so far. That said, we have a long way to go to become the company we aspire to be. That is why we are on mile 9 versus mile 26!

With a 30,000-foot perspective, I would describe our first five years as relatively predictable with important highlights, failures, learnings and departures.

### 5 YEAR REPORT CARD

REVENUE & PET GROWTH	In our inaugural letter dated April 2015, we target 650,000 to 750,000 pets in 5 years or by Q2 of 2020. Certainly no guarantees, but we are tracking to achieve this.	A-
ADJUSTED OPERATING MARGIN (AOM)	Goal is to be at 15% by Q2 of 2020. Fixed expenses are scaling, but we need to watch this metric based on cash flow as we have been capitalizing some of our IT spend. Also, our subscription cost of goods (what we spend paying veterinary invoices) has been tracking 200 basis points higher than our plan.	B
IRR	Tracking nicely	A
FREE CASH FLOW POSITIVE	Our stated goal was to be free cash flow positive in Q2 of 2016. We achieved this goal. Our subsequent goal was to remain free cash flow positive while spending as much of our discretionary profits (AOI) as possible acquiring additional pets with IRRs between 30% and 40% for a single average pet. We achieved these goals.	A+
PATENTED SOFTWARE THAT ENABLES US TO PAY VETERINARIANS DIRECTLY WITHIN MINUTES, ELIMINATING THE TRADITIONAL MODEL IN WHICH A PET OWNER HAS TO PAY FOR THEIR SERVICES OUT OF POCKET AND WAIT FOR A REIMBURSEMENT	Software and member experience is going very well. Would have hoped to be further ahead on the number of deployments.	B
PRICING BY SUB-CATEGORY	Making good progress, particularly in the last 2 years, but a little behind where I would have expected we would be 5 years ago.	B
ACTIVE HOSPITALS	We have added approximately 700 new hospitals each year.	B
SAME STORE SALES	Better than expected and it appears to be scalable.	A
NUMBER OF TERRITORY PARTNERS	More in total, meaning we have added more 2nd and 3rd Coca-Cola trucks (Territory Partners) than previously anticipated, but we are behind in the total number of markets covered from what I would have expected.	B

**TABLE 1. KEY METRICS**

YEAR	2014	2015	2016	2017	2018
REVENUE	\$115.9M	\$146.9M	\$188.2M	\$242.7M	\$304.0M
YEAR-OVER-YEAR CHANGE	38%	27%	28%	29%	25%
ADJUSTED OPERATING INCOME (AOI)	\$0.9M	\$3.6M	\$14.8M	\$23.4M	\$31.9M
ADJUSTED OPERATING MARGIN (AOM)	1%	2%	8%	10%	10%
PET ACQUISITION COST (PAC)	\$11.1M	\$14.8M	\$14.7M	\$18.4M	\$23.7M
INTERNAL RATE OF RETURN (NEW PETS) *	N/A	N/A	31%	35%	37%
FREE CASH FLOW **	(\$16.4M)	(\$15.3M)	\$3.1M	\$6.5M	\$8.3M

\*See Table 4 for the IRR calculation for a single average pet.

\*\*2018 free cash flow of \$8.3 million reflects free cash flow of (\$44.3) million, adjusted to exclude the \$52.5 million used to purchase our building.

### 5 YEAR HIGHLIGHTS:

- Claims automation was an unexpected surprise. Claims automation and an increase in same store sales occurred because of our commitment to our software.
- Same store sales is a metric that we use when thinking about penetration rates per veterinary clinic. Same store sales are higher in veterinary hospitals with our software, an Account Manager and a Territory Partner.
- In our commitment to be the low cost provider by eliminating frictional costs, we purchased our building. By owning our building and eliminating rent, we reduce frictional costs by 100 basis points, meaning we save 1% of revenue. At the same time, we were approved to contribute portions of the building over time to our surplus (the cash we need on hand if every cat and dog were to be hit by a car on the same date, which is equal to revenue divided by 4.8). This frees up cash we would normally need to put into surplus, which means we have more cash on hand to grow the business.

### 5 YEAR LEARNINGS:

At ground level, along the way we've had our share of execution mistakes, but I would describe them as typical execution and growing pains. We've had no significant misses.

### IN 2015, WE MADE STUMBLES WITH:

- Onboarding new colleagues
- Lack of execution on educating pet owners about the benefits of our approach and value proposition compared to competition
- Sub-category pricing
- Fixed expenses — should have targeted a lower spend

**IN 2016:**

- Our dogged focus on financials led to operational compromises: we grew too cautiously; didn't execute on as many tests as desired; put significant strain on ops team. Culture took a back seat; team members didn't feel heard.
- Our growth surpassed human bandwidth to handle failed payments (solution was to upgrade the systems and tools).
- Biggest disappointment was Nirvana — not only did we not make forward progress, we took a small step backward.

**IN 2017:**

- I slowed down the team and hurt alignment when poorly describing why something is important to the organization.
- There was not enough progress on Nirvana.
- We were spending money on things people don't care about (e.g; postage, snail mail); need lower frictional costs.
- We need to be better at trusting one another — a prerequisite for innovation, nimbleness and growth; we have too much cynicism around our "how."
- Some team members don't have a clear path to higher compensation if they stay in their same roles.

**5 YEAR DEPARTURES:**

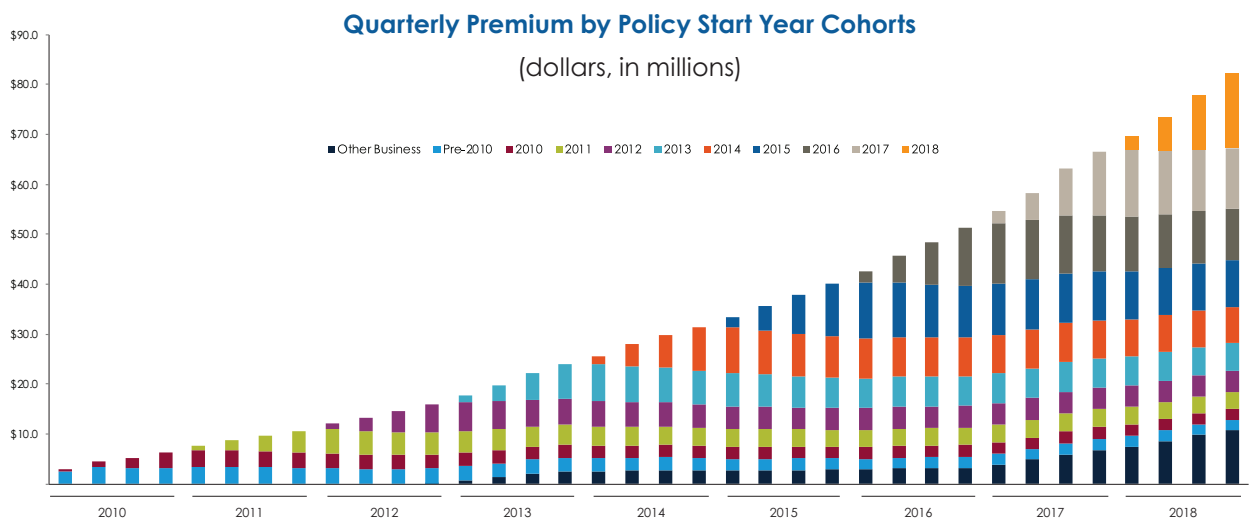
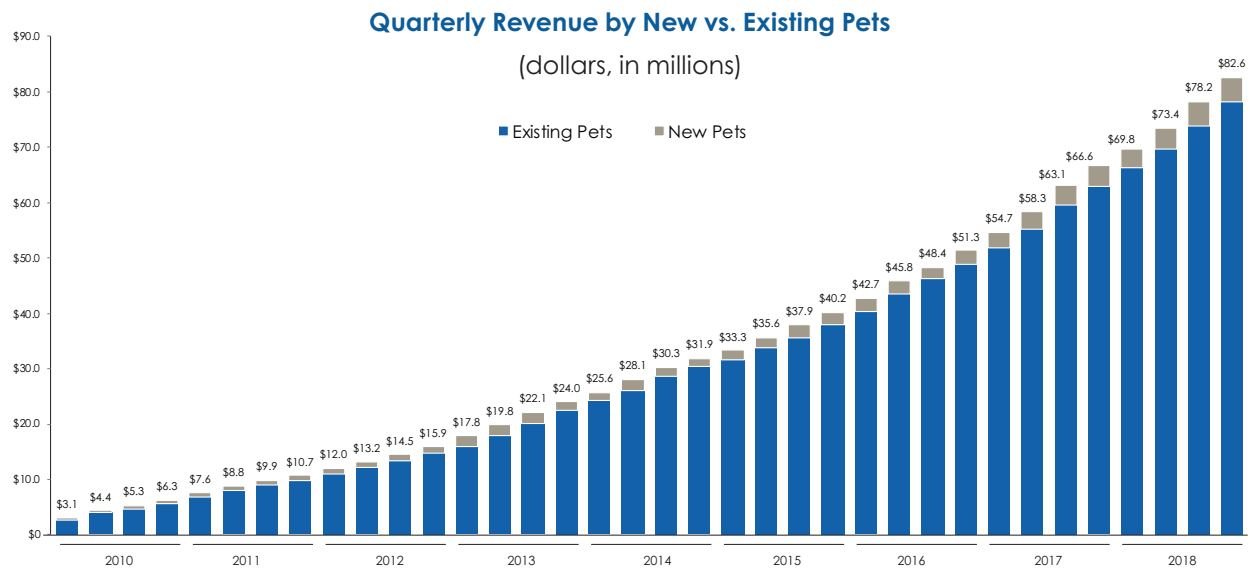
- In 2014, I implied that we would target IRRs greater than 40% in the future. In our 2017 shareholder letter, we stated that we intend to target our IRR for a single average pet to be between 30% and 40%. We came to this decision based on the industry's low penetration rate and large addressable market. Said another way, targeting higher IRRs at this stage of the category's growth feels wrong. We want to be more aggressive for at least the next 5-10 years.

In short, although execution is hard for any company, we are fortunate that we live in a world where we solve a complex problem in a large, under-penetrated market, with a direct-to-consumer monthly recurring revenue business model. These three attributes of our business hide many of our short-term tactical mistakes. In other words, our business model makes us look good!

For me, I am less concerned with wins and losses over a short period of time or in a particular subject. I am more focused on monitoring our progress in pursuit of long-term goals. We're always juggling, always measuring, always learning. Two steps forward and one step back is progress.

## 2018 IN REVIEW

As I mentioned earlier, 2018 was a good and consistent year. We kept digging our moats and building our team as we attempted to advance the ball on our five strategic initiatives (AOM expansion, increasing conversion rates, automated claims, same-store sales, Nirvana), which we believe will help us in the long term. In some areas we made more progress than others, though overall I am pleased.



We ended the year with over 520,000 total enrolled pets and an adjusted operating income of approximately \$32 million (the cash remaining after we spent almost \$214 million paying veterinary invoices, nearly \$38 million in variable expenses supporting our members 24/7 and approximately \$20 million on fixed expenses, which includes our investments in technology as well as general administration costs). When you take the total money we received from the 520,000 plus total enrolled pets, our financials broke down as follows, as a percentage of revenue:

**TABLE 2. KEY MARGINS**

	2018
REVENUE	100%
LESS: PAYING VETERINARY INVOICES	70%
LESS: VARIABLE EXPENSES	13%
LESS: FIXED EXPENSES	7%
= ADJUSTED OPERATING MARGIN (AOM) (PROFITS BEFORE SPENDING ON PET ACQUISITIONS)	10%

The Pet Acquisition team, led by Margi Tooth, our Chief Revenue Officer, spent approximately \$24 million of our AOI enrolling over 120,000 new subscription pets. We anticipate that we will earn an approximate 37% IRR on our pet acquisition spend (as calculated in this letter on a single average pet basis). Our free cash flow after acquiring these pets was approximately \$8 million (excluding the building purchase). As the following chart demonstrates, we have been improving our key financial measures since becoming a public company in 2014!

**TABLE 3. FINANCIAL PERFORMANCE 2012-2018**

YEAR	ENROLLED PETS	REVENUE	YOY REVENUE GROWTH	ADJUSTED OPERATING INCOME	INVESTED CAPITAL TO ACQUIRE NEW PETS	IRR ON AN AVERAGE PET	CASH, SHORT TERM INVESTMENTS, OUR BUILDING ASSETS, MINUS DEBT	EARNINGS (NET LOSS)
2012	127,704	\$55.5M	50%	\$3.0M	\$6.7M	N/A	\$5.1M	(\$8.1M)
2013	182,497	\$83.8M	51%	\$4.3M	\$8.4M	N/A	\$7.9M	(\$8.2M)
2014	232,450	\$115.9M	38%	\$0.9M	\$11.1M	N/A	\$60.6M	(\$21.2M)
2015	291,818	\$147.0M	27%	\$3.6M	\$14.8M	N/A	\$43.2M	(\$17.2M)
2016	343,649	\$188.2M	28%	\$14.8M	\$14.7M	31%	\$48.8M	(\$6.9M)
2017	423,194	\$242.7M	29%	\$23.4M	\$18.4M	35%	\$54.4M	(\$1.5M)
2018	521,326	\$304.0M	25%	\$31.9M	\$23.7M	37%	\$134.7M	(\$0.9M)

\*2018 cash, short-term investments, our building assets, minus debt factors in the purchase of our headquarters building in August 2018, which consisted of \$46.4 million of building and improvements, \$15.8 million of land and improvements, and \$3.0 million of lease-related intangible assets.

**TABLE 4. 2018 IRR CALCULATION FOR A SINGLE AVERAGE PET**

<b>MONTHS</b>	<b>71.4</b>	<b>AOM</b>	<b>10.50%</b>
<b>MONTHLY CHURN</b>	<b>1.40%</b>	<b>ARPU</b>	<b>\$53.44</b>

<b>YEAR</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	
<b>MONTHS</b>	<b>6</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>5.4</b>	<b>71.4</b>
<b>AOI</b>	<b>\$34</b>	<b>\$67</b>	<b>\$67</b>	<b>\$67</b>	<b>\$67</b>	<b>\$67</b>	<b>\$30</b>	<b>\$401</b>
<b>CAPITAL CHARGE</b>	<b>\$(3)</b>	<b>\$(7)</b>	<b>\$(7)</b>	<b>\$(7)</b>	<b>\$(7)</b>	<b>\$(7)</b>	<b>\$(3)</b>	<b>\$(40)</b>
<b>PAC</b>	<b>\$(164)</b>							<b>IRR</b>
<b>FCP</b>	<b>\$(134)</b>	<b>\$61</b>	<b>\$61</b>	<b>\$61</b>	<b>\$61</b>	<b>\$61</b>	<b>\$27</b>	<b>37%</b>

**AOM** = Adjusted Operating Margin

**PAC** = Pet Acquisition Cost

**ARPU** = Average Revenue Per Pet (Unit)

**FCP** = Free Cash Flow Per Pet

**AOI** = Adjusted Operating Income

In search of value, one cannot look at revenue growth and IRR in aggregate. It's very important that we look at it on a per share basis. Although revenue grew 25% year over year, because we had a capital raise to purchase our building, revenue only grew 17% on a per share basis. Our adjusted operating income (AOI) grew as evidenced 28% year over year per share. Our balance sheet is much stronger this year as evidenced by our cash, short term investments, building assets minus debt, which increased 133% year over year on a per share basis.

**TABLE 5. GROWTH PER SHARE**

<b>YEAR</b>	<b>TOTAL SHARE COUNT PLUS OPTIONS &amp; WARRANTS GRANTED</b>	<b>REVENUE PER SHARE</b>	<b>YOY GROWTH</b>	<b>ADJUSTED OPERATING INCOME PER SHARE</b>	<b>YOY GROWTH</b>	<b>CASH, SHORT TERM INVESTMENTS, OUR BUILDING ASSETS, MINUS DEBT PER SHARE</b>	<b>YOY GROWTH</b>	<b>EARNINGS (LOSS) PER SHARE*</b>
<b>2012</b>	<b>22,467,205</b>	<b>\$2.47</b>	<b>53%</b>	<b>\$0.13</b>	<b>-7%</b>	<b>\$0.23</b>	<b>-30%</b>	<b>\$(9.76)</b>
<b>2013</b>	<b>24,889,316</b>	<b>\$3.37</b>	<b>36%</b>	<b>\$0.17</b>	<b>31%</b>	<b>\$0.32</b>	<b>39%</b>	<b>\$(6.23)</b>
<b>2014</b>	<b>33,813,736</b>	<b>\$3.43</b>	<b>2%</b>	<b>\$0.03</b>	<b>-82%</b>	<b>\$1.79</b>	<b>459%</b>	<b>\$(1.64)</b>
<b>2015</b>	<b>34,138,237</b>	<b>\$4.31</b>	<b>26%</b>	<b>\$0.11</b>	<b>267%</b>	<b>\$1.27</b>	<b>-29%</b>	<b>\$(0.62)</b>
<b>2016</b>	<b>34,879,610</b>	<b>\$5.40</b>	<b>25%</b>	<b>\$0.42</b>	<b>282%</b>	<b>\$1.40</b>	<b>10%</b>	<b>\$(0.24)</b>
<b>2017</b>	<b>35,444,460</b>	<b>\$6.85</b>	<b>27%</b>	<b>\$0.66</b>	<b>57%</b>	<b>\$1.53</b>	<b>9%</b>	<b>\$(0.05)</b>
<b>2018</b>	<b>37,862,666</b>	<b>\$8.00</b>	<b>17%</b>	<b>\$0.85</b>	<b>28%</b>	<b>\$3.56</b>	<b>133%</b>	<b>\$(0.03)</b>

\*Loss per share is calculated using the GAAP basic weighted-average shares at year end.

In 2018, our outstanding shares, including options and warrants, increased 2,418,206 to 37,862,666. Of the increased share count, 86% was based on the capital raise used for the purchase of the building and the 14% balance was used for compensation.

For our performance in 2018, we calculated our increase in Trupanion's intrinsic value per share for compensation purposes to be 22.8% before stock grants. For compensation purposes, we try to calculate intrinsic value per share conservatively, grounding the model in history (generally using 3-year historical averages), rather than using forward-looking estimates for our assumptions. In accordance with our Intrinsic Value Incentive Plan, a portion of the intrinsic value growth is shared with our team members, with the remainder going to shareholders. Given our 22.8% intrinsic value per share growth in 2018, we shared 1.37% of this increase in value with the team, with the remaining 21.44% increase per share going to shareholders. Please see a full description of our Intrinsic Value Incentive Plan in the Compensation Discussion and Analysis section of our 2019 Proxy Statement.

At 1.37%, the total size of the grant pool in 2018 was 398,193 shares. 113,325 were allocated during the year for new hire grants, individual performance awards and board compensation, leaving 284,868 shares that were issued in Q1 2019 for our Performance Grant Program.

**TABLE 6. VETERINARY CLINIC METRICS**

YEAR	NUMBER OF TERRITORY PARTNERS	ESTIMATED NUMBER OF CLINICS WE ARE VISITING EVERY 60-90 DAYS	ESTIMATED AGGREGATE NUMBER OF FACE-TO-FACE VISITS	APPROXIMATE NUMBER OF ACTIVE CLINICS (PEAK FOR GIVEN YEAR)*	ENROLLMENTS PER ACTIVE CLINIC PER MONTH	NUMBER OF PARTNERED CLINICS WITH SOFTWARE & ACCOUNT MANAGER	ENROLLMENTS PER CLINIC WITH SOFTWARE PER MONTH
2012	34	15,000	262,000	5,300	0.87	n/a	n/a
2013	40	16,200	324,000	5,800	0.97	n/a	n/a
2014	58	15,400	404,000	6,400	1.01	n/a	n/a
2015	84	19,000	490,000	7,900	1.06	n/a	n/a
2016	105	21,300	577,000	8,100	1.00	n/a	n/a
2017	107	19,800	662,000	8,500	1.01	n/a	n/a
2018	123	20,200	751,000	9,700	1.04	2,908	1.70

\*We define an active hospital as a hospital to which we attribute at least one new pet enrolling in the previous 3 months.

We ended 2018 with 123 Territory Partners visiting 20,200 unique veterinary clinics. In total, we estimate that we made an additional 90,000 face-to-face visits during the year and, in aggregate, have made approximately 751,000 such visits since we entered the US market in 2008.

We increased the number of active clinics by 14% to 9,700. We now have our software in 3,516 clinics and paid \$53.5 million dollars directly to veterinarians — an increase of 32.6% over the prior year.

We've learned that we can be more successful when we partner with hospitals that have our software installed. A partnered hospital commits to having a "Go-To" employee in their hospital who consistently helps us in situations where we need additional information to pay invoices quickly and efficiently for our mutual clients. Of the 3,516 clinics that have our software installed, 2,908 are partnered with us in this way. Trupanion has also created a team of dedicated account managers to support these hospitals, and they touch base by phone on a regular basis to ensure we are consistently communicating with them. Our Territory Partners typically visit hospitals in their territories every 60 days, and having more frequent touchpoints than that has proven to improve customer experience.

We will provide more insights into these metrics at the Annual Shareholder Meeting this June in Seattle.

**TABLE 7. 2018 REPORT CARD ON OUR 5 KEY LONG-TERM INITIATIVES**

1	AOM EXPANSION	AOM is the fuel for our growth. We are tracking to hit 15% by the end of 2020.	A-
2	INCREASE CONVERSION RATES	Our conversion rate is calculated by taking the number of quotes online or over the phone divided by new enrollments. 2018 saw our blended conversion rate increase from 13% to 14%.	A-
3	AUTOMATED CLAIMS	4.7% of the invoices we paid with our software were fully automated. Average processing time was 16.5 seconds.	A
4	SAME STORE SALES	40%+ increase when our software is married to an inside account representative.	A
5	NIRVANA	Tactics and strategies were implemented with no improvements in the metric. Progress may take many more iterations.	C+



Every year there are things we screw up, things we knock out of the park and things we learn...often the hard way. Here is my list this year:

#### **2018 PROS:**

- In our 2014 letter we talked about being a low cost provider and eliminating frictional costs. This year we took the painful dilution to pay cash to buy our headquarters in Seattle. We expect this to provide a home base for our team over the next 10-20 years. Also, by owning this asset outright, we strengthened our balance sheet and eliminated our need to pay rent.
- In 2018, we invested \$3.3 million in TruUniversity, our training program. This was an 8% percent increase in our commitment to training over the prior year. Content has been improving and the delivery is becoming more efficient.
- Overall we had low turnover of team members. This was led by improvements in our 24/7 Contact Center.
- Territory Partners represented nine of our 25 highest compensated team members.
- We added 36 customer service-focused team members in the Philippines to take advantage of an opportunistic time zone for running a 24/7 operation. These dedicated team members are doing administrative tasks to help improve our customer experience.
- In last year's letter, I mentioned a team member in the Contact Center who I was proud of. She is now managing a team and her desk was relocated. Meet my new neighbor, Paisley!

#### **2018 CONS:**

- We did not recruit enough Territory Partners for new regions.
- Transparency and tracking of individual and department quarterly objectives lost some focus.
- More work needs to be done to link our gains in year over year changes in our intrinsic value to individual performance.
- Progress towards Nirvana (more on this below).



## 2018 TEACHINGS

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In the 2014 shareholder letter I talked about the importance of aligned and informed shareholders. It's important that you come away each year with a better understanding of our business. To that end, this year there are four topics I want to dive into.

### TOPIC 1 –

#### Nirvana

Nirvana is our very important and difficult goal of offsetting our cancellations by existing members adding pets or referring friends. All of these factors operate as a percentage of our existing members. In 2018, cancellations averaged 1.40% per month while referrals and added pets averaged 0.68% per month. We desire to have these offset so that we can grow organically with strong IRR, rather than spending money to only offset cancellations. At 1.40%, we will have 10,000 pets cancel per month when we have 714,286 subscription pets enrolled.

In 2018, we added a record 126,000 subscription pets. Unfortunately, we had approximately 67,000 pets cancel.

Nirvana has been on our 2020 goals since 2014. It was added to our 5 Key Strategic Initiatives in 2017 and yet, we have made no progress. We need to think differently if we are going to achieve Nirvana. With this in mind, TJ Houk, our Chief Member Experience Officer, and his team created and own this year's plan to drive our progress toward Nirvana. This team is doing a great job thinking about Nirvana differently and many of these changes started in Q4 of 2018.

We have a number of initiatives that focus on rethinking how we organize our teams, goals and communications. There is incremental investment in the Contact Center, with a focus on helping teams be more self-sufficient. Additional spend has been allocated to dedicated niche teams within our claims department, providing bespoke "white glove" service to members with their first claim. Additionally, we plan to communicate coverage summary reports with members when they enroll. The goal of a coverage summary report is to be more transparent with members about pre-existing conditions to avoid a negative claims experience. We plan to begin doing this on a test basis in 2019.

Improving the member experience by increasing the number of veterinary clinics that have our software installed so we can pay them directly within minutes — or seconds with claims automation — will continue to be a key focus over the next few years.

In addition to the initiatives described above, we also spent time in 2018 designing and developing an updated Trupanion subscription product that we plan to test in 2019. Led by Steve Weinrauch, our Chief Product Officer, the goal of the product and the test is to achieve higher conversion rates, higher ARPU and sustained or better retention rates, which we expect will further our progress toward Nirvana. All of these results drive higher intrinsic value and create moats. We will begin with a test in one state and, if not initially successful, we will keep iterating until we get it right.

Our 2020 goal is to limit monthly cancellations to 1.3%. Perfection is 1.0%. Cancellations in 2018 broke down into the following cohorts.

**TABLE 8. CHURN BY CANCEL REASON**

COHORT	TEAM	APPROXIMATE NUMBER OF CANCELLATIONS	AVERAGE MONTHLY CHURN	AVERAGE MONTHLY RETENTION RATE
90-day cancellation	Pet Acquisition	14,090	0.29%	99.71%
Rate renewal	Actuarial	4,193	0.09%	99.91%
Death	Member Experience	16,306	0.34%	99.66%
Failed Payment	Finance & Member Experience	9,722	0.20%	99.80%
General dissatisfaction	Member Experience & Product Design	22,784	0.48%	99.52%
<b>TOTAL CANCELLATIONS</b>		<b>67,095</b>	<b>1.40%</b>	<b>98.60%</b>

Another view of our monthly churn or “road to Nirvana,” is to look at the 1.40% by members who cancel without seeing a rate change compared to those that see a satisfactory rate change and those that see a higher change.

**TABLE 9. CHURN BY RATE CHANGE**

2018 CHURN	ACTIVE PETS AT YEAR END	NUMBER OF CANCELLED PETS	DISTRIBUTION	MONTHLY CHURN	MONTHLY RETENTION
NO RATE CHANGE	86,914	26,960	20.18%	2.79%	97.21%
RATE CHANGE < 20%	290,719	30,000	67.49%	0.93%	99.07%
RATE CHANGE > 20%	53,137	10,135	12.34%	1.69%	98.31%
<b>TOTAL</b>	<b>430,770</b>	<b>67,095</b>	<b>100.00%</b>	<b>1.40%</b>	<b>98.60%</b>

The above chart shows two areas of focus:

1. First, and currently our biggest opportunity, is to reduce the number of pets that cancel within the first year (particularly within their first 90 days), before they ever receive a rate change. We need to figure this out. Some people enroll their pet when they learn there is a problem and hope we can solve it financially for them. We cannot. The best we can do is enroll pets as early as possible so we can eliminate pre-existing conditions. Others enroll for a spay/neuter or other wellness activities. For these pet owners, we need to do a better job of educating them on the problem we solve and how we solve it. The last group are pet owners who get buyer's remorse or their partner does not support or understand why we exist. All of these items require more upfront education.
2. The second area of focus is to reduce the number of members that receive a change to their monthly cost that is greater than 20% per year. On its face this seems obvious and over-time, this is a very important long term goal, BUT this goal should not supersede our desire to get more pricing categories as accurate as possible first. Let me provide you with a detailed explanation on why I believe this is the appropriate prioritization.

## TOPIC 2 –

### Pricing by Category

**What is the problem Trupanion is solving?** Trupanion exists to help pet owners budget for unexpected veterinary costs. A “lucky” pet may have unexpected veterinary costs that only amount to \$500 over its lifetime, whereas an “unlucky” pet may see veterinary costs of \$50,000+, which makes it very difficult for a responsible, loving pet owner to budget.

**How does Trupanion's pricing model work?** Trupanion operates on a cost-plus model. This is where we understand the “average” cost before any potential inflation for each category of pet over their entire life and then add 30%. This results in Trupanion spending 70% of an average pet owner's monthly costs paying veterinary invoices for pets that are sick or injured. Said another way, we spend \$0.70 of every \$1.00 received in monthly costs toward veterinary invoices. This model is designed to spread the risk equally and fairly among the lucky, unlucky, and average pets. That is our pricing promise.

Let's share an example of how our cost-plus model works:

1. UNDERSTAND THE MONTHLY COST OF VETERINARY CARE TO TREAT ALL ACCIDENTS AND ILLNESSES FOR THE AVERAGE PET WITHIN A CATEGORY.	\$35.00
2. ADD 30% (15% FOR PROVIDING SERVICE TO OUR MEMBERS 24/7 AND 15% TO ENROLL MORE PETS AND PROFIT).	\$15.00
3. ADD THE TWO NUMBERS TOGETHER. THIS IS THE MEMBER'S MONTHLY COST.	= \$50.00

If we are really good at understanding the average lifetime cost for a category of pets, like Poodles in Brooklyn, NY, then on an annual basis we only need to monitor inflationary changes and pass those along to our members.

Typically, inflation-related adjustments would be between 5% and 10% per year. If we return to the monthly cost example set forth above, and the cost of veterinary care including referral and specialty care was trending up by 10% per year, then our members' monthly costs would be adjusted accordingly.

1. THE MONTHLY COST OF VETERINARY CARE + INFLATION.	\$35.00 + 10% = \$38.50
2. ADD 30%.	\$16.50
3. ADD THE TWO NUMBERS TOGETHER. THIS IS THE MEMBER'S ADJUSTED MONTHLY COST.	= \$55.00

Other key points to note about our pricing structure:

- Members' monthly rates are locked in for a minimum of 12 months.
- A member's monthly cost is not impacted by their individual pet's claim history.
- Over the last 10+ years, monthly rates have increased an average of 6% per year.

**How do we determine the right monthly cost for a pet?** To achieve fair and accurate pricing, when a pet enrolls, we look at the following factors to help us determine the typical or “average” health care costs for that particular pet:

- Age at enrollment
- Breed
- Gender
- Location/local cost of veterinary care
- Chosen deductible

Currently, these are some of the categories we have chosen to observe to ensure we share risk fairly. One day we may add additional categories, such as indoor vs. outdoor cats or the quality of food being fed.

The key point to understand is that we do not, have not and will not dictate veterinary costs.

#### **How we learn/get better over time:**

When we enrolled our first pet in 2000, we only had one geographical category across all of Canada. For illustrative purposes, we will use the following cost categories: 1 is the lowest and 5 is the highest.

To start, Canada's average cost was a 3.

CANADA
Cost Category 3

Over time, we learned that the underlying costs in Toronto were on average higher than other areas of Canada while those in Winnipeg were lower. We used this data to ensure we lived up to our pricing promise. We lowered monthly costs for our existing and new members in Winnipeg and raised them in Toronto. The rest of Canada remained the same as before.

WINNIPEG	CANADA	TORONTO
Cost Category 2	Cost Category 3	Cost Category 4

In the above example, the swing in underlying cost was +/- 20% on average. Having monthly costs decrease by 20%+ is easy for one to handle or budget for. But for those in Toronto, receiving an increase of 20% or more is much tougher to handle. In fact, when you add the 20%+ to the 5%-10% we typically see for annual inflation, those in Toronto received a 30%+ year over year change to their monthly cost. This is not an ideal situation, but it is the right thing to do.

#### **Let me explain why:**

Our pricing promise is to spend \$0.70 of every \$1.00 we receive paying veterinary invoices for our members. This is our value proposition. If a sub-category of pets, say pet owners in Winnipeg, are paying the same monthly cost as the rest of Canada (including Toronto), yet their cost of care is 20% lower than the rest of Canada (40% lower than Toronto), then they would not be receiving the same value.

WINNIPEG	REST OF CANADA	TORONTO
50% value	70% value	90% value
100 pets @ Cost Category 2 = 200	100 pets @ Cost Category 3 = 300	100 pets @ Cost Category 4 = 400
AVERAGE COST ACROSS CANADA: $(200+300+400)/300 =$		Cost Category 3

Over time, fewer pet owners from Winnipeg would be enrolling, while Toronto would grow faster. Even though we are not yet as effective in educating pet owners about our value proposition as we'd like to be, they feel it.

WINNIPEG	REST OF CANADA	TORONTO
50% value	70% value	90% value
25 pets at Cost Category 2 = 50	100 pets at Cost Category 3 = 300	175 pets at Cost Category 4 = 700
AVERAGE COST ACROSS CANADA: $(50+300+700)/300 =$		Cost Category 3.5

If an insurance company kept all the monthly costs the same across Canada, then the average cost would increase from 3 to 3.5 and continue to increase as more pets would be enrolling from the Toronto area.

WINNIPEG	REST OF CANADA	TORONTO
40% value	60% value	80% value
10 pets at Cost Category 2 = 20	60 pets at Cost Category 3 = 180	150 pets at Cost Category 4 = 600
AVERAGE COST ACROSS CANADA: $(20+180+600)/300 =$		Cost Category 3.63

In this hypothetical, things would only continue to get more and more unbalanced. The value proposition in Winnipeg would be so bad that the only pets that would remain would be the "unlucky" pets causing the average cost in Winnipeg to rise from 2 to 2.75. Soon we'd see the number of enrolled pets in Canada drop from 300 to 205. The average monthly cost increases (before inflation) 26% to 3.78 from 3.0.

WINNIPEG	REST OF CANADA	TORONTO
40% value	60% value	80% value
5 pets at Cost Category 2.75 = 13.75	50 pets at Cost Category 3.25 = 162.5	150 pets at Cost Category 4 = 600
AVERAGE COST ACROSS CANADA: $(13.75+162.5+600)/205 =$		Cost Category 3.78

What this situation shows us is that pet owners in Winnipeg and the rest of Canada are subsidizing those pet owners in Toronto, which is not fair. Fewer pets are enrolled in Canada, which is not good for veterinarians, pet owners, or Trupanion.

Having the same value proposition of 70% for each category is not just the right and fair thing to do, it provides the best and healthiest results.

WINNIPEG	REST OF CANADA	TORONTO
70% value	70% value	70% value
100 pets @ Cost Category 2 = 200	100 pets @ Cost Category 3 = 300	100 pets @ Cost Category 4 = 400
AVERAGE COST ACROSS CANADA: $(200+300+400)/300 =$		Cost Category 3

Over the next several years, we will continue to home in on variances across neighborhoods.

Once we learned that Toronto's costs were higher, we didn't stop there. We soon learned that Toronto is not a single Toronto. There was as much variation between the different neighborhoods within and surrounding Toronto as there was between Toronto and Winnipeg. Variations among neighborhoods can be dramatic throughout North America. For example, Los Angeles has 510 neighborhoods where household income, home prices, general cost of living, and, not surprisingly, veterinary costs vary dramatically. Think of Beverly Hills in comparison to Watts, both located in Los Angeles and only 12 miles apart, but vastly different in regards to demographics.

Remember, Trupanion is here to help pet owners budget. 81% of our current members live in neighborhoods where the average household income is under \$100k. We need to make sure we are treating everyone fairly. Our job is to understand the underlying cost for a sub-category. When we get this right, year over year changes remain small, manageable, and easy to budget for.

WINNIPEG	CANADA				TORONTO			
Cost Category 2	Cost Category 3				Cost Category 4			

NEIGHBORHOOD COST CATEGORIES							
1	5	3	2	2	3	5	4
3	2	2	1	4	5	1	5
4	2	3	5	3	2	2	1
4	3	5	5	4	1	4	5
2	1	4	2	5	1	3	5
1	3	5	2	2	4	1	3
3	2	4	1	2	2	1	5
2	1	5	3	3	4	5	1

### TOPIC 3 –

#### Alignment with Regulators

In the 2014 shareholder letter that is included at the beginning of this letter, I included the handwritten update that, in addition to loving pet owners, veterinarians and their co-workers, Trupanion Territory Partners, Trupanion employees and Trupanion shareholders, the departments of insurance are additional constituents with whom we desire to align our interests. To be clear, I have always felt that we are aligned with the departments of insurance and my omission of them previously was an oversight.

Let's start by explaining our alignment. The departments of insurance are mandated to:

1. Make sure all consumers are treated fairly, without being misled and with no one group receiving preferential treatment;
2. Ensure that the underlying value proposition of the policies being sold is reasonable to both the consumer and insurance company; and
3. Ensure that the insurance company is adequately capitalized if a disproportionate number of insureds have a claim within the same time period.



Trupanion has, from its beginning, strived to:

1. **Provide comprehensive coverage** through a single product that covers all medical issues if a pet becomes sick or injured. This has always included the items most likely to happen to certain breeds. We pay a percentage of the veterinarian's actual invoice. We don't penalize a pet for becoming unlucky. We accomplish this by understanding the underlying cost for the average pet, then adding a 30% margin. We do this by breeds, neighborhoods, age at enrollment and a few other factors.
2. **Provide a high value proposition.** We purchased our own underwriting company in 2008 so we could eliminate frictional costs and increase the value proposition to our members, while achieving a reasonable margin (15% AOM when we hit between 650,000 and 750,000 pets).
3. **Be well capitalized.** We hold cash and short-term investments that equal our revenue divided by 4.8. These reserves meet the requirements for a category of insurance called inland marine. Medical insurance for cats and dogs currently lies within inland marine, which has other lines of insurance that are considerably more volatile. As our category continues to grow, I hope and expect our industry eventually will get its own category designation that should require reserve capital closer to 10:1, better reflecting the risk of our coverage.

We believe that we are highly aligned with the departments of insurance. Their mandates and our values overlap. The fact that we are the only company that owns a mono-line underwriter and that we, as a public company, have further transparency, has us well positioned to be seen by regulators as the "experts" in our field. It certainly helps that many regulators are pet owners who appreciate that our product provides pets like theirs with a high value proposition (as a reminder, the NAIC industry average loss ratio for the "Special Property" category that includes the inland marine line of business is 56%, whereas we target 70%). We have, by necessity and by choice, preferred to have a seat at the table, taking extra time to build relationships with regulators when the opportunity presents itself. I believe that the more the departments of insurance understand our values, product design, desired member experience and value proposition, the more they like and support us.

Going back to my earlier omission, I believe we started off with very strong relationships, but I should have done a better job communicating internally our desire to over-communicate with the departments of insurance, as this would have resulted in better/deeper relationships with them. This should have been included in my first shareholder letter as well as in our internal communications. Years ago, and particularly between 2011 and 2014, we did not have sufficient focus on deepening relationships with regulators, nor did we provide the team with appropriate resources to do so. The task of managing these relationships moved to team members who were inadequately trained and underresourced, and we began to under-communicate and became reactive. We made some mistakes and, quite frankly, did not adequately prioritize the importance of complete compliance with the applicable insurance regulators. Over the last few years, we have paid some fines for these mistakes, and we will likely pay some additional fines for these previous mistakes. Although I am certainly not thrilled to pay them, I believe they are justified and appropriate.



## TOPIC 4 –

### Internal Rate of Return

In the 2014 shareholder letter, I noted that our business model is, “to spend X to acquire a new member and have the discretionary income to return substantially more than X over the life of the subscription.” I go on to say, “for these reasons we are most concerned with IRR for incrementally adding an average pet.” Basically, our business model is designed to generate greater and greater sums of operating cash that we can reinvest at returns that are far greater than what's readily available to most shareholders.

In the 2017 shareholder letter, I included examples of how our allowable PAC spend should expand while maintaining the same internal rate of return. Even after doing this, I'm still leaving a lot of people confused. So, here is our fifth attempt (WD 5) to provide clarity. This example compares our 2016 and 2018 invested capital. I chose to compare 2016 and 2018 because they offer a good illustration of two years during which PAC is quite different.

#### **So, let's compare 2016 and 2018's invested capital.**

In 2016, we spent \$14.7 million (which translated to \$12.4 million in net acquisition spend after you back out \$2.1 million in sign-up fees and \$0.2 million related to our other business segment) to acquire 100,692 new cats and dogs, with an average monthly revenue per pet (ARPU) of \$48.81. Assuming that the pets act like our average pet in 2016 with a constant 7.9% adjusted operating margin and an average duration of 71.4 months, we calculate the IRR of a single average pet in this cohort to be 31%.

In 2018, we spent \$23.7 million (which translated to \$20.7 million in net acquisition spend after you back out \$2.6 million in sign-up fees and \$0.4 million related to our other business segment) to acquire 126,182 new cats and dogs, with an average monthly revenue per pet (ARPU) of \$53.44. Assuming that the pets act like our average pet in 2018 with a constant 10% adjusted operating margin and an average duration of 71.4 months, we calculate the IRR of a single average pet in this cohort to be 37%.

On the surface, the Pet Acquisition Cost (PAC) spend in 2016 at \$123 appears better than the \$164 in 2018, BUT that would be mathematically incorrect if one is concerned with value creation! Because both the ARPU and margin are larger in 2018 and the pay-back period is reduced from 36 to 32 months, the 2018 IRR calculation of 37% is six percentage points better than the 31% in 2016.

Put simply, spending \$24 million at a 37% IRR is better than spending \$15 million at a 31% IRR.

Over the next 5-10 years, our goal is to spend greater and greater sums of our self-generated discretionary capital with IRRs in the 30% to 40% range for a single average pet.

In Walter Isaacson's biography of Leonardo da Vinci, the author draws a comparison between Steve Jobs' ability to merge engineering and art and Leonardo's fascination with combining science and art. This comparison had me thinking about Trupanion. In my mind, Trupanion marries math with love.

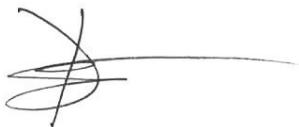
The math comes from our value proposition and the simplicity of our business model. The love comes from the people on our team and in our member community. We all have unconditional love for pets.

For years, Trupanion's biggest impediments to growth have been cash and/or opportunities. Today, it's people and culture. We know that execution — our biggest risk — comes down to people and culture. And we need to be thoughtful about bringing in the right mix of talent, heart, and fearlessness to move the company forward in a way that preserves and strengthens our unique culture and commitment to customer service while achieving ambitious and innovative goals.

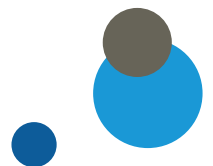
I wrote about Kuyashii in the 2017 shareholder letter and often use it as a sign-off on companywide communications when we need some inspiration. A few years ago, I watched a Netflix documentary about chef and Los Angeles restaurant owner, Niki Nakayama. Ms. Nakayama wanted to become a world-class chef, but was raised being told only men could become successful chefs and restaurateurs. She used the words of her doubters as her energy to succeed. She explained in the documentary that there is a specific word in the Japanese language that describes this inspiration and determination, which is Kuyashii.

If you would like to gain additional insights into Trupanion, whether you are an existing shareholder or new to our story, I invite you to read our 2015, 2016 and 2017 shareholder letters, as well as our investor FAQ. Both can be found on our IR website at Investors.Trupanion.com. I also encourage you to come visit our Seattle Headquarters and attend our shareholder meetings on June 6th, 2019 and June 4th, 2020. If you'd like to visit, please reach out to [InvestorRelations@Trupanion.com](mailto:InvestorRelations@Trupanion.com).

Kuyashii,

A handwritten signature in black ink, consisting of a stylized 'D' followed by a horizontal line.

Darryl Rawlings  
*Founder & Chief Executive Officer*



## END NOTES

<sup>1</sup> In this letter and our other publicly available reports, we present certain non-GAAP measures, including adjusted EBITDA, variable expenses, fixed expenses, adjusted operating income, adjusted operating margin, acquisition cost, and free cashflow. These non-GAAP financial measures may not provide information that is directly comparable to that provided by other companies in our industry as other companies in our industry may calculate or use non-GAAP financial measures differently. In addition, there are limitations in using non-GAAP financial measures because they are not prepared in accordance with GAAP and exclude expenses that may have a material impact on Trupanion's reported financial results. 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. Trupanion urges its investors to review the reconciliation of its non-GAAP financial measures to the most directly comparable GAAP financial measures in its consolidated financial statements, and not to rely on any single financial or operating measure to evaluate its business. These reconciliations are included within our Supplemental Financial Information provided with the Q4 earnings release on Trupanion's Investor Relations website.

Our internal rate of return is calculated assuming the new pets we enroll during the year will behave like an average pet. Specifically, our 2018 calculation assumes adjusted operating income (calculated as the average monthly revenue for new pets of \$53.44 factored by the adjusted operating margin of 10.5%) for an average subscriber life of 71.4 months (calculated as the quotient obtained by dividing one by the churn rate, which equals one minus the average monthly retention rate of 98.60%).

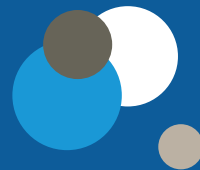
Because of varying available valuation methodologies, subjective assumptions and the variety of equity instruments that can impact a company's non-cash expenses, Trupanion believes that providing various non-GAAP financial measures that exclude stock-based compensation expense and depreciation and amortization expense allows for more meaningful comparisons between its operating results from period to period. Trupanion offsets sales and marketing expense with sign-up fee revenue in the calculation of net acquisition cost because it collects sign-up fee revenue from new members at the time of enrollment and considers it to be an offset to a portion of Trupanion's sales and marketing expenses. Trupanion believes this allows it to calculate and present financial measures in a consistent manner across periods. Trupanion's management believes that the non-GAAP financial measures and the related financial measures derived from them are important tools for financial and operational decision-making and for evaluating operating results over different periods of time.

## DISCLAIMER

This letter contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and section 27A of the Securities Act of 1933, as amended (Securities Act). All statements contained in this letter other than statements of historical fact, including statements regarding lifetime values of a pet, discounted cash flows and our intrinsic value model, future results of operations and financial position (including ARPU, AOM, AOI, IRR, PAC, and new pets enrolled), our business strategy and plans and our objectives for future operations, are forward-looking statements. The words "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "model," "plan," "potentially," "predict," "project," "target," "will," "would," 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 under the heading "Risk Factors" in our Annual Report on Form 10-K and other filings we make from time to time with the Securities and Exchange Commission. 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 letter 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.



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