Trupanion, Inc.

Fourth Quarter 2025 Earnings Conference Call

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CONFERENCE CALL PARTICIPANTS

John Barnidge, *Piper Sandler*

Russell Yuen, *William Blair*

Joshua Shanker, *Bank of America Merrill Lynch*

Jordan Bernstein, *Stifel*

Wilma Burdis, *Raymond James*

PRESENTATION

Operator

Good day, and welcome to the Trupanion Fourth Quarter 2025 Earnings Conference Call.

All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key, followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then one on a touchtone phone. To withdraw your question, please press star, then two. Please note, this event is being recorded.

I would now like to turn the conference over to Gil Melchior, Director of Investor Relations. Please go ahead.

Gil Melchior

Good afternoon, and welcome to Trupanion's fourth quarter and full year 2025 financial results conference call. Participating on today's call are Margi Tooth, Chief Executive Officer and President; and Fawwad Qureshi, Chief Financial Officer.

For ease of reference, we've included a slide presentation to accompany today's discussion, which will be made available on our Investor Relations website under our Quarterly Earnings tab.

Before we begin, please be advised that remarks today will contain forward-looking statements. All statements other than statements of historical facts are forward-looking statements. These include, but are not limited to, statements regarding our future operations, key operating metrics, opportunities and financial performance, pricing and veterinary industry inflation. These statements involve a high degree of known and unknown risks and uncertainties that could cause actual results to differ materially from those discussed. A detailed discussion of these and other risks and uncertainties are included in today's earnings release, as well as the Company's most recent reports, including Forms 10-K, 10-Q and 8-K, filed with the Securities and Exchange Commission.

Today's presentation contains references to non-GAAP financial measures that Management uses to evaluate the Company's performance, including without limitation, cost of paying veterinary invoices, variable expenses, fixed expenses, adjusted operating income, acquisition costs, internal rate of return, Adjusted EBITDA and free cash flow. When we use the term adjusted operating income or margin, it is intended to refer to a non-GAAP operating income or margin before new pet acquisition and development expenses. Unless otherwise noted, all margins and expenses will be presented on a non-GAAP basis, and excluding stock-based compensation expense and depreciation expense.

These non-GAAP measures are in addition to, and not a substitute for, measures of financial performance prepared in accordance with the U.S. GAAP. Investors are encouraged to review the reconciliations of these non-GAAP financial measures to the most directly comparable GAAP results, which can be found in today's press release.

Lastly, I would like to remind everyone that today's conference call is also available via webcast on Trupanion's Investor Relations website. A replay will also be available on the site.

I will now hand over the call to Margi.

Margi Tooth

Thanks, Gil, and thank you everyone for joining us this afternoon. Twenty twenty-five was a record year for the Company. I was especially pleased with the fourth quarter, which marked a strong close to the year and a solid launch pad for our next strategic plan. Over the past 60 months, we added over $900 million in revenue and generated $518 million in adjusted operating income. We ended the year with nearly one million pets protected under the Trupanion brand and have now paid over $3.5 billion in veterinary invoices on behalf of our members over our history, a testament to our mission and the need we serve in today's market.

I'd like to take a moment to thank our entire team for their efforts. The strength of our mission and our commitment to each other reinforce our confidence as we move on to our next strategic plan.

Turning to our 2025 highlights. We ended the year with nearly $1 billion in Subscription revenue and delivered approximately 15% annual Subscription adjusted operating margin, reflecting the strength and consistency of our model. Our performance translated into $152 million of adjusted operating income, which funded $83 million of pet acquisition and investments and development spend during the course of the year to support long-term growth. The increase of 33% year-on-year in adjusted operating income reflects meaningful progress in aligning pricing with the value we deliver.

These actions directly translated into a substantial improvement in per pet margins and lifetime value while continuing to honor our commitment to our member value proposition, which we believe remains sustainably the highest in the industry over the life of the pet. Our ongoing commitment to our pricing promise and to a strong member experience has been reflected in steadily improving retention. Retention is a key driver of long-term growth in adjusted operating income and that commitment paid off in 2025, with trailing 12-month retention improving in every single quarter.

We saw a similar strengthening in new pet acquisition, with gross pet adds also accelerating throughout 2025 and ending Q4 up 8% year-on-year. Stronger retention and stepped-up acquisition together drove subscription net pet growth of 50% in Q4 and 10% for the full year. As operating margins improved, we intentionally leaned further into new pet acquisition, reflecting our confidence that today's higher per pet margin and lifetime value profile support a more aggressive posture. This resulted in a blended Q4 2025 IRR of 23%, while our full year blended IRR was 30%.

From our strong financial footing, we expect another year of consistent revenue growth with margins at our annual operating target. Combined, this translates into meaningful growth in AOI that we can reinvest with consistency and intention while continuing to generate substantial free cash flow. We expect to continue investing in our market reach by educating pet parents, redefining our message and rolling out targeted product enhancements all aimed at strengthening Trupanion's position in the animal health ecosystem.

Our Veterinary Channel, which remains our heartland for distribution, continues to play a critical role in educating pet parents about the value of medical insurance. This is most notably supported by our long-standing Territory Partner Model, with nearly 200 TPs in the field every day, whose close partnerships with veterinary teams help bring the Trupanion value proposition to life. More broadly, awareness of pet medical insurance continues to rise as pet parents increasingly seek coverage earlier, reflecting a clearer understanding of the true cost of care and a stronger desire to be financially prepared.

This growing demand reinforces our focus on reaching pet parents earlier in the decision-making journey and often even before they first visit the veterinarian. Doing so will require sustained investment in brand awareness and education with returns that build over time. Though still early, we're encouraged by the role brand spend can play in helping facilitate the movement of pet parents through the sales funnel, and we will continue to test and refine our approach to drive maturing leads, conversion and retention over time.

Against this backdrop, Trupanion's model directly addresses a growing need for reliable, sustainable coverage for unexpected veterinary care. Our commitment to our mission remains unchanged, helping ensure pets receive the care they need and that veterinarians can practice the medicine they're trained to deliver.

With that, I'll turn it over to Fawwad.

Fawwad Qureshi

Thanks, Margi, and good afternoon everyone. Today I will share additional details around our fourth quarter performance, as well as provide our outlook for the first quarter and full year 2026. Total revenue for the quarter was $376.9 million, up 12% year-over-year. Within our Subscription business, revenue was $261.4 million, up 15% year-over-year. Total subscription pets increased 5% year-over-year to over 1,096,000 pets as of December 31. This includes approximately 63,000 pets in Europe.

Average monthly retention for the trailing 12 months was 98.34%, up versus the fourth quarter last year, which was 98.25%. The Subscription business cost of paying veterinary invoices was $180.8 million, resulting in a value proposition of 69.1%. This compared to 70% in the prior year period. This improvement more than offset adverse development from prior periods of $0.9 million, or approximately 30 basis points of revenue.

As a percentage of Subscription revenue, variable expenses were 8.7%, down from 9.2% a year ago. Fixed expenses as a percentage of revenue were 5.6%, up from 5.5% in the prior year period. Combined, we saw fixed and variable spending at 14.4% of revenue in Q4, an improvement from 14.6% in the prior year period. We have continued to drive efficiencies in fixed and variable spending consistent with our expectations.

Our Subscription business delivered adjusted operating income of $43.1 million, an increase of 23% from last year, and contributed 96% of our total AOI for the quarter. Subscription adjusted operating margin was 16.5%, up from 15.3% in the prior year, and represents approximately 120 basis points of margin expansion. Similar to last quarter, this marks a new company record for both Subscription AOI and Subscription AOM.

Now I'll turn to our Other Business segment, which is comprised of revenue from other products and services that have a lower margin profile than our Subscription business. Our Other Business revenue was $115.4 million for the quarter, an increase of 5% year-over-year. We expect growth for this segment to continue to decelerate as we are no longer enrolling new pets in the majority of U.S. states for our largest partner in this segment.

Adjusted operating income for this segment was $1.9 million, or 1.6% of revenue. In total, adjusted operating income was $45 million in Q4, ahead of our expectations and up 26% from Q4 last year. We deployed $21.6 million of this AOI to acquire approximately 65,200 new subscription pets. Excluding the pets that are underwritten through an MGA structure, this translated into an average pet acquisition cost of $320 per pet in the quarter, up from $261 in the prior year period.

We invested $1.8 million in the quarter in development costs. Non-cash expenses in the quarter included $9.4 million in stock-based compensation, as well as a $1.1 million goodwill impairment charge related to our European businesses. As a result, net income for the quarter improved to $5.6 million, or $0.13 per basic and diluted share as compared to a net income of $1.7 million, or $0.04 per basic and diluted share in the prior year period.

In terms of cash flow, operating cash flow was $29.3 million in the quarter compared to $23.7 million in the prior year period. Capital expenditures totaled $3.9 million, up from $1.9 million in Q4 of last year. As a result, free cash flow was $25.3 million, up from $21.8 million last year. For the full year of 2025, we continued to strengthen our balance sheet as free cash flow increased to $75.4 million, 5.2% of total revenue, and an increase of 95% year-over-year. We ended the year with $370.7 million in cash and short-term investments and a total debt balance of $111.8 million, a reduction of $17.1 million versus last year.

Our financial position continues to strengthen. Last quarter we announced a new debt facility with PNC Bank. We are happy to share that in February and subsequent to yearend, our largest insurance entity, APIC, paid an extraordinary dividend of $15 million to our operating company. This follows the $26 million extraordinary dividend we announced in May last year and is a continued illustration of the strong capitalization of APIC and our ability to fund our growth.

Now I'll turn to our outlook. For the full year of 2026, we expect total revenue in the range of $1.55 billion to $1.582 billion. We expect Subscription revenue to be between $1.117 billion and $1.137 billion, representing approximately 14% year-over-year growth at the midpoint. We expect total adjusted operating income to be in the range of $173 million to $187 million, or 19% year-over-year growth at the midpoint. This assumes veterinary inflation in line with current trends.

For the first quarter of 2026, total revenue is expected to be in the range of $376 million to $382 million. Subscription revenue is expected to be between $265 million to $268 million, representing approximately 14% year-over-year growth at the midpoint. Total adjusted operating income is expected to be in the range of $38 million to $41 million. This represents approximately 27% growth year-over-year at the midpoint. As a reminder, our revenue projections are subject to conversion rate movements predominantly between the U.S. and Canadian currencies. For our first quarter and full year guidance, we used a 73% conversion rate in our projections.

Before handing it over to Margi, I want to take a moment to talk about AOI and underscore its importance to our business model. Historically, the majority of AOI was reinvested in PAC, and we anticipate this will continue. When we think about where to place the next marginal investment dollar, in addition to PAC, we have a range of choices, including new strategic initiatives such as Landspath, our food initiative, opportunities to accelerate growth such as international, investments in technology to strengthen our competitive advantage in areas like claims automation and improved member experience, and financial investments such as paying down debt.

We look at AOI as a measure of profitability. It provides a versatile base of reinvestable dollars that we can align to drive the greatest overall return for the Company.

Let me now pass it back to Margi.

Margi Tooth

Thanks, Fawwad. Before we open the call up for questions, I want to briefly reflect on the foundation we're carrying into our next strategic plan. Since 2021, the business generated over $500 million in adjusted operating income and grew at a compound annual growth rate of 22%. As we enter our next 36-month plan, we're doing so with strong momentum. We intend to invest aggressively against the opportunity to strengthen pet acquisition and retention strategies to place the Trupanion brand in more households than ever before. We expect to deploy capital with discipline, balancing growth, cash flow and the strength of our balance sheet as we work to build our adjusted operating income over time. You can expect to learn more about our plan in my forthcoming shareholder letter.

From an outcomes perspective, the objective of our plan is very clear, to deliver sustainable growth in adjusted operating income and intrinsic value creation that continues to compound over time. We enter this next phase with confidence in a business model that has proven resilient time and again. To realize our full potential, we will continue to raise the bar and thoughtfully scale both our business and our team to match the opportunity ahead.

Stepping back, in an underpenetrated market where just 4% of pet parents have insurance, Trupanion has grown to support over one million pets and generate over $1 billion in revenue. The strength of our financial foundation is what allows us to invest more confidently, funding our growth in pets to drive high internal rates of return, creating a profitable, well-capitalized, and increasingly cash-generative business. In an underpenetrated global market, we are well-positioned for the opportunities ahead.

With that, we're happy to answer your questions.

Operator

We will now begin the question-and-answer session. To ask a question, you may press star, then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the key. If at any time your question has been addressed and you would like to withdraw your question, please press star, then two. We ask that you limit yourself to one question and one follow-up. At this time, we will pause momentarily to assemble our roster.

The first question today comes from John Barnidge with Piper Sandler. Please go ahead.

John Barnidge

Thank you, and good afternoon. Appreciate the opportunity. My first question would be focus—you talked about brand spend. Can you talk about some successes that you've had in reaching pet parents in different ways and how maybe that'll be accelerated going forward? Thank you.

Margi Tooth

Yes, thanks, John. For us, brand spend is really about how do we put the Trupanion brand in front of all pet parents as we're kind of really in that position now to step up given our current run rate. It's really in areas where we are seeing existing pet parents in the veterinary profession and also outside of that.

While we've concentrated our brand spend in the vet space, what we're seeing is people moving through the funnel to conversion quicker over time, and we're seeing some encouraging results from that process. We're also expanding in areas where pet parents go prior to getting to the vets when they're looking for pets, when they're starting to research what pets are right for them. Doing some more general direct-to-consumer information, education gathering, which is then also helping to bring them into our funnel from a general awareness perspective.

As the category continues to expand because more pet parents are facing a challenge with the cost of veterinary care today, we want to be in position to go to them where they are, and we're starting to see that move through the funnel. In some areas, that's awareness of Trupanion, and some it's just bringing them further and further down, which is reflected in the numbers that you see in terms of pet count in the quarter with our gross pet adds up 8% and net pet for the quarter at 50%.

John Barnidge

Appreciate that. Then, Fawwad, was there any favorable reserve development in that really impressive loss ratio or vet service cost ratio you reported? Thank you.

Fawwad Qureshi

Yes, we had a little bit of adverse development when you look at just Q4 standalone, so about 30 basis points. If you dollarize it, it's about $900,000. Yes, very happy about loss ratio. Obviously, it's been a journey to get to the full year number of 70.5, and then within the quarter lower because we have the first half, second half seasonality. Yes, if not for that, it would have been even a little bit lower.

Operator

The next question comes from Brandon Vazquez with William Blair. Please go ahead.

Russell Yuen

Hey, everyone. This is Russell on for Brandon. Thanks for taking the questions. Maybe I'll start by asking you to kind of level set us on your '26 guidance. What is the high end, the low end kind of baked in terms of things like gross adds, commercial strategy and what exactly are the puts and takes? Maybe any color you can kind of give on price versus volume that you're contemplating into the guide?

Fawwad Qureshi

Yes, there's a couple of things underpinning the guidance. Yes, as you mentioned, pricing. As we exited the year, pricing was still the more dominant contributor to overall revenue growth. We expect that'll continue as we go into 2026. But with the gross adds increasing, and we saw them come up nicely in the quarter at 8.4%, followed by 3.6% the quarter before, we're starting to see that shift. When you look at full year '26, we still expect pricing to play the larger role. But if you compare pricing '26 versus '25, we expect it to be lower. Similarly, if you compare pet count contribution to revenue, '26 to '25, we expect it to be higher.

From a loss ratio perspective, obviously that's the biggest driver from a financial performance standpoint. We're carrying forward the assumptions from what we exited the year, so largely in line. We haven't seen a significant abatement of inflation. Obviously, it's something we look at pretty carefully.

Then from a spend perspective, I'm very happy to see the leverage. We had committed to fixed expense coming down in second half, and we saw that happen, coming from 6.2% down to 5.6% yearend, both Q3 and Q4. Just diligent expense management, overall variable. Again, happy in the quarter, it came down from 14.6% to 14.4%. We're seeing those efficiencies and the productivity investments we've made. We expect those to continue. Then that'll lead to margin expansion. Those are primarily the largest drivers of guidance.

Russell Yuen

That's very helpful. Thank you. Then maybe on leads, previously you've mentioned a focus on lead conversion towards breeders specifically and maybe some other exploratory methods. Can you talk a little bit about what you're seeing in terms of conversion and where you're seeing the most success? Have you seen any change in demographic or economic quality of lead inbounds given macro pressures?

Margi Tooth

Yes, in terms of the channels we operate in, primarily the Vet channel continues to be our heartland. That's always the channel that we kind of lead off of when we think about our acquisition strategy. Breeder, shelter, members referring their friends, they all combine to support the overall funnel. When you have more exposure to the brand that helps pull somebody through a little bit more. I would say that across the board, we're seeing encouraging results. Some move quicker than others, and the team leans into that. The more that we're able to invest, the more we can learn, which is great, because we're in a position now where we can be really bullish.

I think in terms of the demographic, we're absolutely starting to speak to different pet parents. We think in the market right now, given where the macro conditions, given where vet costs are, we have an opportunity not only with the existing Trupanion product that we have today, we're also looking at optimizing that broadly for the new pet parents coming through that we're starting to talk to. That also will show up in the new product that we plan to launch over the course of the next 36 months, which will echo the Trupanion brand, but give us that extra reach within the market that we're seeing with our lead volume today.

Operator

The next question comes from Josh Shanker with Bank of America. Please go ahead.

Joshua Shanker

Yes, thank you very much. Good afternoon, everybody. I was just curious—retention's improving. Maybe on the margin, I might hope it would be improving a little quicker. Usually at yearend, you're going to give disclosure in the annual letter by cohort. Can you talk about—you might say that all three are improving, where the improvement really is coming and where it's lagging?

Margi Tooth

Yes, thank you for the question, Josh. The retention across the board is looking really healthy. We were pleased to see every single quarter in the year that that improved and increased across the cohorts. To specifically hit on that question, the middle bucket, which I refer to as the middle bucket, is those receiving rate increases of under 20%. A lot more of our members have moved into that cohort over the course of the last year. We know that that's a stronger cohort. That has been improving.

The over 20% bucket, which still has a good portion of our members in, has been improving consistently for the last couple of years because there has been so much activity in that space. The team has done a very good job of understanding the pain points, the confusion or challenges that members have, and they are able to articulate the value proposition, which is a cost-plus model, and the reasons for those increases.

That's been great. The area that we still have opportunity is the area we've always had opportunity, which is in our first year. As we grow quicker, and you can see those pet adds coming through, we will have plenty of opportunity once again to lean into the different tactics that the teams have got lined up to be able to drive that number higher as well.

Joshua Shanker

Thank you. You said that you have lots of uses for cash flow other than PAC. You mentioned Landspath. We don't really have a great granularity in that. Can you talk about Landspath a little bit and why we should be confident that that's a good use of your funds?

Fawwad Qureshi

Yes, I can take that question. I think it's exactly the point. AOI is a pool of capital, and now we have—I think companies always had different places to put it. Now we have more channels. I think Landspath is still in the early stages. A lot of it is building the infrastructure to be able to test and then ultimately deliver the product. Yes, the return's there. We haven't disclosed specifics on our expectations for that. But longer term, we think that'll be a very meaningful contributor to margin.

The unique economics of that business are quite favorable. Yes, that's a potential use of cash. I think the others that I talked about, technology has been hugely important to us. When we think about claims automation going north of 60%, we expect that to rise over the course of the three years. That drives efficiency straight to the bottom line. It's a big part of why we're seeing the margin expansion we are.

Continued investments in technology have pretty good ROIs for us. Then there's financial investments as well. We had the opportunity to pay off some of our debt using the proceeds from the first extraordinary dividend that we got in the middle of last year. That can be an effective use of cash. It lowers our cost of capital. The overall debt structure lowered our cost of capital.

We look at AOI as a pool of money that we generate organically from the business. Then we look across that portfolio and try to find the best mix of channels and where we want to make those investments. Yes, we will continue to do that. I think it's a good position for us to be in, especially coming off a record year for margin, but also a record year for total dollars.

Margi Tooth

If I can just add as well from a Landspath perspective, specifically thinking about how does it blend in with what we're doing. The whole premise of Landspath is that this is a portion control food that we believe will help improve the health and well-being of a pet. When we dovetail that with the insurance component of what we offer, we believe that we can help pet parents not only have a bundle of pet care with their food on a monthly subscription basis and their insurance, but also if we see benefits coming through from having fed that food to your pet, then we will be able to pass that saving back to a pet parent, which in turn increases our lifetime value of that member, but also retention, refer a friend and that flywheel.

The other component about Landspath is it is sold through the veterinarian. That's very different from other foods out there, which allows the veterinarian to benefit from that additional income that we know that they've lost through revenue. We know that there is a lot of discussion in the industry right now about revenue. This is a time where we think we can add even more support to an industry that needs it.

Operator

The next question comes from Jon Block with Stifel. Please go ahead.

Jordan Bernstein

Great. Jordan Bernstein here on for Jon. Some of our checks would indicate the need for a lower-priced insurance plan out there for pet owners, even hearing this morning from some industry peers, of a tighter pet owner budget out there. To that end are there any updates you can provide on the go-to-market strategy for a lower-priced plan? I think the latest thought would be one Trupanion-branded lower-priced offering, or is the Company thinking of a two-pronged approach with the PHI, Furkin offerings kind of remodeled.

Margi Tooth

Yes, thanks for the question, Jordan. There's a couple of things here. I think as we look at where we are today as a product, as a brand, first and foremost, we're really pleased with the results coming out of the quarter that shows that the efforts we've been making from a brand perspective holistically are really starting to move the needle, both in terms of overall growth of pet adds, which were up 8% in the quarter, and the net pet growth, which was up 50%.

That brand spend is starting to really resonate, both at lead, convert and keep level, which we've seen in those numbers. We're seeing that, as I mentioned, we're pulling through a new consumer as well. What we're looking to do is both broaden the existing Trupanion offering, which will change the price point for some people, still honoring our value proposition over the life of the pet, but just helping to broaden it, as well as looking at this newer product offering.

It won't be released over the next few quarters, but it's absolutely part of our 36-month plan. Our expectation is that we will be able to leverage the brand, as you mentioned, through direct payment, through the value proposition, through the trust that we've created in the veterinary industry to offer a product that we believe there's a really big gap in the market for. We'll share more details when we're ready about that. We're excited about it. We're making good progress in our thinking around that. Yes, there's an opportunity to be had, and we will absolutely be aggressive when that time comes.

Jordan Bernstein

Great, thanks for all that color. Just one quick question, and hear you on all the great acceleration on gross adds on the year of your growth, especially exiting 4Q. But just on the internal rate of return, the guardrail there was set at 30%. It's been breached to the downside for the second straight quarter, 28% in 3Q, and now 23% in 4Q. I believe the metric's been down for seven straight quarters sequentially. Now when should investors expect to return to the greater than 30%—some of that's been beginning to pay off on that line item.

Margi Tooth

Yes, a couple of things. Like I said, we're pleased. We believe that that investment is absolutely starting to pay off. Kind of a couple of things. We're assuming a margin for the IRR is at 12.5%. We've just entered—exited the year of 15%. There's already a difference in the margin there. It's a blended metric too. The core Trupanion product is higher from an IRR point of view.

If we take a step back, the reason we're investing so much more is we feel really good about the position we're in. We've increased our lifetime value of a pet 35% year-over-year. We're able to lean into pet acquisition far more aggressively than historically, because not only do we have the adjusted operating income there, we're seeing that retention start to improve, which drives that tenure, which increases that lifetime value.

The newer cohort of pets have a higher margin per pet. It gives us that confidence. We will continue to be confident because we have this really strong financial background behind us now, which we can push forward with. In a market that absolutely is crying out for solutions of how to help pet parents budget the unexpected (phon), over time, we're still committed to very high lifetime returns. We're really pleased where we ended the quarter and we're happy with that momentum.

Operator

As a reminder, if you would like to ask a question, please press star, then one to join the question queue. The next question comes from Wilma Burdis with Raymond James. Please go ahead.

Wilma Burdis

Hey, good evening. Looking at the '26 guide, it looks like the Subscription revenue was in line with my model, but the Other revenue, seemed like the runoff might be accelerating a little bit there. I just want to see if that's the case. Then also the adjusted operating income looks pretty strong. Maybe you can kind of walk us through all of those different impacts going into '26. Thanks.

Fawwad Qureshi

Yes, hi, Wilma. Thanks for the question. Yes, on the other business, yes, it's been trending pretty consistently down. I think as we've mentioned in the past, from a pet count perspective that decline started quite a while ago, really at the back half of 2023. It's been pretty steady. Obviously we expect revenue ultimately to turn negative from a year-over-year standpoint. It's still up because of pricing. Not a significant change. The margin profile for that business is loss sensitive. It doesn't affect us significantly. We don't expect that there'll be a significant change in the trend line. But obviously we expect that business to ultimately go away.

Then in terms of the AOI, yes, it really comes down to a couple of things. I think pricing will still lead the way as we look at 2026. Gross adds starting to accelerate. We saw that in the second half of the year. We think there's an upside from expense management and just overall productivity and efficiency. That's really the combination of those things. What could go against us obviously would be inflation. It's something that we pay close attention to, but right now we feel good about AOI growing faster than revenue.

Wilma Burdis

Thank you. Then I think that leads into my next question, actually. I know you normally see veterinarians raising their prices early in the year in January. Just curious if you're seeing anything there that changes your mind on the 15% type inflation you've been expecting every year. Thanks.

Margi Tooth

Yes, hi, Wilma. From our perspective, there's nothing that we've seen here today that would anticipate us changing our current assumptions. We do watch it obviously like hawks. I think we've seen slight softening and I would say it's softening off a high level. We do know the industry is under a lot of pressure right now so we're going to continue to monitor it and we will adjust when we see a need to.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over for any closing remarks.

Margi Tooth

Yes, thank you. I'd just like to say that before we sign off, I wanted to recognize the team for the really strong execution and results we've delivered this year. Pricing is aligned. We've achieved our target margin with strong free cash flow generation. Retention is improving and growth in adds are accelerating. We are in great financial position with so much opportunity ahead and we really look forward to updating everyone in the coming months on our progress. Thank you for your time today.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.