TRUPANION, INC.
Form 10-Q
November 09, 2018

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

or

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

For the transition period from ____ to ____

Commission File Number: 001-36537

TRUPANION, INC.

(Exact name of registrant as specified in its charter)

Delaware	**83-0480694**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

6100 4th Avenue S, Suite 200
Seattle, Washington 98108
(855) 727 - 9079

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o No

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

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if smaller reporting company)	Smaller reporting company	o
		Emerging growth company	x

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. x

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

As of November 1, 2018, there were approximately 33,419,934 shares of the registrant's common stock outstanding.

TRUPANION, INC.
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Note About Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of 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 Quarterly Report on Form 10-Q other than statements of historical fact, including statements regarding our future results of operations and financial position, our business strategy and plans and our objectives for future operations, are forward-looking statements. The words “believe,” “may,” “will,” “potentially,” “estimate,” “target,” “continue,” “anticipate,” “intend,” “could,” “would,” “project,” “plan” and “expect,” and similar expressio convey uncertainty of future events or outcomes, are intended to identify forward-looking statements.

These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in Part II. Item 1A. “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely on forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. We undertake no obligation to update publicly any forward-looking statements for any reason, except as required by law.

Unless otherwise stated or the context otherwise indicates, references to “we,” “us,” “our” and similar references refer to Trupanion, Inc. and its subsidiaries taken as a whole.

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
TRUPANION, INC.
Consolidated Statements of Operations
(in thousands, except share data)
(unaudited)

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Revenue	$78,164	$ 63,118	$221,316	$176,122
Cost of revenue:				
Veterinary invoice expense	54,303	43,453	156,196	123,649
Other cost of revenue	10,117	7,858	27,959	21,160
Gross profit	13,744	11,807	37,161	31,313
Operating expenses:				
Technology and development	2,299	2,471	6,761	7,196
General and administrative	4,174	4,017	13,242	12,274
Sales and marketing	6,365	4,862	18,005	13,323
Total operating expenses	12,838	11,350	38,008	32,793
Operating income (loss)	906	457	(847)	(1,480)
Interest expense	336	124	887	370
Other (income) expense, net	(628)	(99)	(1,071)	(1,239)
Income (loss) before income taxes	1,198	432	(663)	(611)
Income tax (benefit) expense	(7)	26	(11)	54
Net income (loss)	$1,205	$ 406	$(652)	$(665)
Net income (loss) per share:				
Basic	$0.04	$ 0.01	$(0.02)	$(0.02)
Diluted	$0.03	$ 0.01	$(0.02)	$(0.02)
Weighted average shares of common stock outstanding:				
Basic	33,129,416	30,037,282	31,376,239	29,500,958
Diluted	36,385,360	33,113,981	31,376,239	29,500,958

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	$1,205	$406	$(652)	$(665)
Other comprehensive income (loss):				
Foreign currency translation adjustments	77	193	(242)	317
Net unrealized gain on available-for-sale debt securities	—	1	—	9
Other comprehensive income (loss), net of taxes	77	194	(242)	326
Comprehensive income (loss)	$1,282	$600	$(894)	$(339)

See accompanying notes to the consolidated financial statements.

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

	September 30, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$34,677	$25,706
Short-term investments	39,422	37,590
Accounts and other receivables	31,985	20,367
Prepaid expenses and other assets	4,184	2,895
Total current assets	110,268	86,558
Restricted cash	1,400	600
Long-term investments, at fair value	3,545	3,237
Property and equipment, net	69,998	7,868
Intangible assets, net	8,084	4,972
Other long-term assets	6,580	2,624
Total assets	$199,875	$105,859
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$2,163	$2,716
Accrued liabilities and other current liabilities	12,006	7,660
Reserve for veterinary invoices	14,216	12,756
Deferred revenue	32,848	22,734
Total current liabilities	61,233	45,866
Long-term debt	8,604	9,324
Deferred tax liabilities	1,002	1,002
Other liabilities	1,174	1,233
Total liabilities	72,013	57,425
Stockholders' equity:		
Common stock: $0.00001 par value, 100,000,000 shares authorized; 34,171,653 and 33,415,668 shares issued and outstanding at September 30, 2018; 30,778,796 and 30,121,496 shares issued and outstanding at December 31, 2017	—	—
Preferred stock: $0.00001 par value, 10,000,000 shares authorized; no shares issued and outstanding	—	—
Additional paid-in capital	217,833	134,511
Accumulated other comprehensive loss	(334)	(92)
Accumulated deficit	(83,436)	(82,784)
Treasury stock, at cost: 755,985 shares at September 30, 2018 and 657,300 shares at December 31, 2017	(6,201)	(3,201)
Total stockholders' equity	127,862	48,434
Total liabilities and stockholders' equity	$199,875	$105,859

See accompanying notes to the consolidated financial statements.

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

	Nine Months Ended September 30,	
	2018	**2017**
Operating activities		
Net loss	$(652)	$(665)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	3,027	3,208
Stock-based compensation expense	3,553	2,564
Gain on sale of equity method investment	—	(1,036)
Other, net	(237)	243
Changes in operating assets and liabilities:		
Accounts and other receivables	(11,592)	(10,164)
Prepaid expenses and other assets	(549)	(297)
Accounts payable, accrued liabilities, and other liabilities	3,849	2,122
Reserve for veterinary invoices	1,484	1,639
Deferred revenue	10,133	9,075
Net cash provided by operating activities	9,016	6,689
Investing activities		
Purchases of fixed maturity investment securities	(29,567)	(20,704)
Maturities of fixed maturity investment securities	27,405	15,878
Purchases of other investments	(3,000)	—
Acquisition of lease intangibles, related to corporate real estate acquisition	(2,959)	—
Proceeds from sale of equity method investment	—	1,402
Purchases of property and equipment	(55,856)	(2,247)
Other	(852)	(2,762)
Net cash used in investing activities	(64,829)	(8,433)
Financing activities		
Proceeds from public offering of common stock, net of offering costs	65,690	—
Proceeds from exercise of stock options	2,872	2,082
Shares withheld to satisfy tax withholding	(1,839)	(1,170)
Proceeds from exercise of warrants	300	—
Proceeds from debt financing, net of financing fees	9,189	2,420
Repayment of debt financing	(10,000)	—
Other financing	(535)	(412)
Net cash provided by financing activities	65,677	2,920
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash, net	(93)	436
Net change in cash, cash equivalents, and restricted cash	9,771	1,612
Cash, cash equivalents, and restricted cash at beginning of period	26,306	24,237
Cash, cash equivalents, and restricted cash at end of period	$36,077	$25,849
Supplemental disclosures		
Noncash investing and financing activities:		
Issuance of common stock for cashless exercise of warrants	$3,000	$—
Issuance of common stock for acquisition of corporate real estate	$9,640	$—
Purchases of property and equipment included in accounts payable and accrued liabilities	$165	$531

Property and equipment acquired under lease	$917	$689

See accompanying notes to the consolidated financial statements.

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TRUPANION, INC.
Notes to the Consolidated Financial Statements (unaudited)
1. Nature of Operations and Significant Accounting Policies
Description of Business and Basis of Presentation

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

The financial data as of December 31, 2017 was derived from the Company's audited consolidated financial statements. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and, in management's opinion, have been prepared on the same basis as the audited financial statements and include all adjustments, consisting of normal recurring adjustments, necessary for the fair presentation of the Company's financial position, results of operations, comprehensive (loss) income, and cash flows for the interim periods. These unaudited interim consolidated financial statements should be read in conjunction with the Company’s audited financial statements included in the Company’s Annual Report on Form 10-K, filed with the U.S Securities and Exchange Commission (SEC) on February 13, 2018 (the 2017 10-K). The Company's accounting policies are described in Note 1 to the audited financial statements included in the 2017 10-K. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the full fiscal year or any other interim period.

Follow-on Common Stock Offerings

In June 2018, the Company completed a follow-on public offering (the June 2018 follow-on public offering) whereby the Company sold 2,090,909 shares of common stock (inclusive of 272,727 shares of common stock sold by the Company pursuant to the full exercise of the underwriters' option to purchase additional shares) at a price to the public of $33.00 per share. The Company received aggregate net proceeds from the June 2018 follow-on public offering of $65.7 million, after deducting underwriting discounts and commissions and offering expenses payable by the Company. The proceeds were primarily used to lower expenses through the purchase of real estate consisting of properties in use as corporate offices and leased to third parties. In addition, in August 2018, the Company issued 303,030 shares of common stock via a private placement to an accredited investor as a portion of the purchase price of the real estate. See Note 6, Acquisition of Corporate Real Estate.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from such estimates. See Note 1 to the audited financial statements included in the 2017 10-K for additional discussion of these estimates and assumptions.

Acquisition of Real Estate

The Company’s real estate acquisition was determined to be an asset acquisition, with the purchase price allocated based on relative fair value of the assets acquired. Additionally, acquisition-related expenses were capitalized as part of the purchase price.

The Company assessed fair value based on Level 3 inputs within the fair value framework, which included estimated cash flow projections that utilized appropriate discount rates, capitalization rates, renewal probability and available market information, which included market rental rates and market rent growth rates. Estimates of future cash flows were based on a number of factors including historical operating results, known and anticipated trends, and market and economic conditions.

The fair value of tangible assets of the acquired property considers the value of the property as if it were vacant. The fair value of acquired “above- and below-” market leases was based on the estimated cash flow projections utilizing discount rates that reflected the risks associated with the leases acquired. The amount recorded was based on the present value of the difference between (i) the contractual amounts to be paid pursuant to each in-place lease and (ii) management’s estimate of fair market lease rates for each in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the extended term for any leases with below-market renewal options. Other intangible assets acquired included amounts for in-place lease values that were based on the Company’s evaluation of the specific characteristics of each tenant’s lease. Factors considered include estimates of

carrying costs during hypothetical expected lease-up periods, market conditions and costs to execute similar leases. In estimating carrying costs, the Company included estimates of lost rents at market rates during the hypothetical expected lease-up periods, which were dependent on local market conditions. In estimating costs to execute similar leases, the Company considered leasing commissions, legal and other related costs.
The results of operations related to our ownership of the building are included in the Company’s Consolidated Statements of Operations from the date of acquisition.

Rental Income

The Company records rental income within general and administrative expense in the Consolidated Statements of Operations. The Company recorded rental income of $0.4 million for the three and nine months ended September 30, 2018.

The following table summarizes the Company's future rental payments from non-cancellable leases in place as of September 30, 2018 (in thousands):

Year ending December 31:	
2018	$497
2019	1,972
2020	1,224
2021	1,210
2022	1,173
2023	1,210
Thereafter	3,238
Total rental payments	$10,524

Accumulated Other Comprehensive Loss

There were no reclassifications out of accumulated other comprehensive loss during the three and nine months ended September 30, 2018 and 2017.

Income Taxes

On December 22, 2017, the U.S. government enacted the Tax Cuts and Jobs Act (Tax Act), making broad and complex changes to the Internal Revenue Code. The Company has made significant judgments and estimates in accordance with its interpretation of the Tax Act. As additional guidance on the Tax Act becomes available, the Company may adjust its interpretation of the requirements, which may result in a material change to income tax benefit or expense in the period in which the adjustment is made.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) amending the accounting for leases. The ASU requires recognition of lease assets and liabilities for operating leases on the consolidated balance sheets. This ASU is effective for fiscal years beginning after December 15, 2018 including interim periods within that reporting period, with early adoption permitted. The Company plans to adopt this guidance as of January 1, 2019 and is currently evaluating the impact the ASU will have on its consolidated financial statements pursuant to the purchase of real estate described in Note 6.

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, Disclosure Update and Simplification, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. This final rule is effective on November 5, 2018, for interim filings submitted thereafter. The SEC has provided relief to registrants that file Form 10-Q shortly after the final rule’s effective date, allowing presentation changes to take effect in the subsequent interim period. As such, the Company plans to adopt this guidance as of January 1, 2019 and is currently evaluating the impact the ruling will have on its consolidated financial statements.

2. Net Income (Loss) per Share

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Basic earnings per share:				
Net income (loss)	$1,205	$ 406	$(652)	$ (665)
Shares used in computation:				
Weighted average shares of common stock outstanding	33,129,416	30,037,282	31,376,239	29,500,958
Basic earnings per share	$0.04	$ 0.01	$(0.02)	$ (0.02)
Diluted earnings per share:				
Net income (loss)	$1,205	$ 406	$(652)	$ (665)
Shares used in computation:				
Weighted average shares of common stock outstanding	33,129,416	30,037,282	31,376,239	29,500,958
Stock options	2,663,375	2,618,567	—	—
Restricted stock awards and units	236,932	919	—	—
Warrants	355,637	457,213	—	—
Weighted average number of shares	36,385,360	33,113,981	31,376,239	29,500,958
Diluted earnings per share	$0.03	$ 0.01	$(0.02)	$ (0.02)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options	3,647	480,360	3,234,932	4,118,884
Restricted stock awards and restricted stock units	—	—	439,798	234,758
Warrants	—	—	480,000	810,000

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3. Fixed Maturity Investments

Long-term investments are classified as available-for-sale and short-term investments are classified as held-to-maturity. The following table summarizes the amortized cost, gross unrealized holding gains and losses, and estimates of fair value of fixed maturity investments (in thousands) as of September 30, 2018 and December 31, 2017:

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of September 30, 2018				
Long-term investments:				
Foreign deposits	$2,545	$ —	$ —	$2,545
Municipal bond	1,000	—	—	1,000
	$3,545	$ —	$ —	$3,545
Short-term investments:				
U.S. Treasury securities	$6,646	$ —	$ (3)	$6,643
Certificates of deposit	439	1	—	440
U.S. government funds	32,337	—	—	32,337
	$39,422	$ 1	$ (3)	$39,420

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
As of December 31, 2017				
Long-term investments:				
Foreign deposits	$2,237	$ —	$ —	$2,237
Municipal bond	1,000	—	—	1,000
	$3,237	$ —	$ —	$3,237
Short-term investments:				
U.S. Treasury securities	$5,783	$ —	$ (4)	$5,779
Certificates of deposit	690	1	—	691
U.S. government funds	31,117	—	—	31,117
	$37,590	$ 1	$ (4)	$37,587

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

	September 30, 2018	
	Amortized Cost	Fair Value
Available-for-sale:		
Due after one year through five years	$3,545	$3,545
	$3,545	$3,545

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

4. Other Investments

Investment in Variable Interest Entity

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

Investment in Joint Venture

In September 2018, the Company acquired a non-controlling equity interest in a joint venture, whereby it has committed to licensing certain intellectual property and contributing up to $2.2 million AUD upon the achievement of specific operational milestones over a period of at least four years from the agreement execution date.

5. Fair Value

Investments

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

	As of September 30, 2018			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	$1,400	$1,400	$—	$—
Money market funds	4,741	4,741	—	—
Fixed maturities:				
Foreign deposits	2,545	2,545	—	—
Municipal bond	1,000	—	1,000	—
Investment in variable interest entity	3,000	—	—	3,000
Total	$12,686	$8,686	$1,000	$3,000

	As of December 31, 2017			
	Fair Value	Level 1	Level 2	Level 3
Assets				
Restricted cash	$600	$600	$—	$—
Money market funds	5,167	5,167	—	—
Fixed maturities:				
Foreign deposits	2,237	2,237	—	—
Municipal bond	1,000	—	1,000	—
Total	$9,004	$8,004	$1,000	$—

The Company measures the fair value of restricted cash, foreign deposits, and money market funds based on quoted prices in active markets for identical assets. The fair value of the municipal bond is based on either recent trades in inactive markets or quoted market prices of similar instruments and other significant inputs derived from or corroborated by observable market data. The estimated fair value of the Company's investment in the variable interest entity is a Level 3 measurement, and is based on market interest rates, the assessed creditworthiness of the entity, and the estimated fair value of the entity's common stock. As of September 30, 2018, the Company estimates that the purchase price approximates the fair value. Short-term investments are carried at amortized cost and the fair value is disclosed in Note 3, Investment Securities. The fair value of these investments is determined in the same manner as for available-for-sale securities and is considered a Level 1 measurement.

Fair Value Disclosures

The Company's other long-term assets balance included $3.1 million of notes receivable as of September 30, 2018 and $2.5 million of notes receivable as of December 31, 2017, recorded at its estimated collectible amount. The Company estimates that the carrying value of the note receivable approximates its fair value. The estimated fair value represents a Level 3 measurement within the fair value hierarchy, and is based on market interest rates and the assessed creditworthiness of the third party.

The Company estimates the fair value of its long-term debt based upon rates currently available to the Company for debt with similar terms and remaining maturities. This is a Level 3 measurement. Based upon the terms of the debt, the carrying amount of long-term debt approximated fair value at September 30, 2018 and December 31, 2017.

6. Acquisition of Corporate Real Estate

In June 2018, the Company entered into a Real Estate Purchase and Sale Agreement (Real Estate Purchase Agreement) with Benaroya Capital Company, L.L.C to purchase certain properties (Properties) as defined within the Real Estate Purchase Agreement, located at 6100 Fourth Avenue South, Seattle, Washington, which is the site of the Company's corporate headquarters. The purchase closed in August 2018 and the Company paid consideration consisting of $55.0 million in cash and 303,030 shares of common stock with an estimated fair value of $9.6 million. The issued shares carry registration rights (as to which the Company filed a registration statement on Form S-3, File No. 333-226752) and are subject to a lock-up period that continues to and includes June 25, 2020. The fair value of the issued shares was estimated as of the closing date for the real estate acquisition using the Black-Scholes option pricing model and the following assumptions:

Assumptions	**August 9, 2018 Fair Value**	
Risk free interest rate	2.5	%
Expected volatility	36.72	%
Expected life (years)	1.88	
Expected dividend yield	—	%

The purchase price was allocated to the following assets based on estimates of their relative fair value (in thousands):

Building and improvements	$46,379
Land and improvements	15,833
Lease-related intangible assets	2,959

The building, building improvements, and land are recorded within property and equipment, net, on the consolidated balance sheet. The properties are generally carried at cost less accumulated depreciation and amortization. The Company computes depreciation and amortization using the straight-line method over the estimated useful lives of the assets. The Company believes the useful lives of the building and building improvements is 39 years and the land improvements will be depreciated over a useful life of 10 years. The lease-related intangible assets relate to in-place lease agreements and will be amortized over a weighted-average useful life of 5.1 years. Amortization is expected to be approximately $0.5 million in each of the five succeeding years.

7. Debt

In June 2018, the Company amended its credit agreement, increasing its borrowing capacity from $30.0 million to $50.0 million, extending the maturity date to June 2021, and increasing the required amount of restricted cash. The facility is secured by any and all interests in the Company's assets that are not otherwise restricted. Interest on the revolving line of credit is payable monthly at the greater of 4.5%, or 1.25% plus the prime rate (6.50% at September 30, 2018). The credit agreement includes other ancillary services and letters of credit of up to $4.5 million, and requires a deposit of restricted cash of $1.4 million. As of September 30, 2018, the Company was in compliance with all financial and non-financial covenants required by the credit agreement.

Borrowings on the revolving line of credit are limited to the lesser of $50.0 million and the total amount of cash and securities held by the Company's insurance subsidiaries (American Pet Insurance Company and Wyndham Insurance Company (SAC) Limited Segregated Account AX). As of September 30, 2018, available borrowing capacity on the line of credit was $28.9 million, with an outstanding balance of $0.4 million for ancillary services and letters of credit, and borrowings under the facility of $8.8 million, recorded net of financing fees of $0.2 million.

8. Commitments and Contingencies

Litigation

From time to time, the Company is subject to litigation matters and claims arising from the ordinary course of business. The Company records a provision for a liability relating to legal matters when it is both probable that a material liability has been incurred and the amount of the loss can be reasonably estimated. At this time, the Company does not believe any such matters to be material individually or in the aggregate. These views are subject to change following the outcome of future events or the results of future developments.

Obligation to Purchase Additional Preferred Stock of Variable Interest Entity

In connection with its July 2018 investment in a variable interest entity (see Note 4), the Company agreed to invest an additional $4.0 million in equity of the variable interest entity, contingent upon the exercise of this option by the variable interest entity.

9. Reserve for Veterinary Invoices

The reserve for veterinary invoices is an estimate of the future amount the Company will pay for veterinary invoices that are dated as of, or prior to, its balance sheet date. The reserve also includes the Company's estimate of related internal processing costs. The reserve estimate involves actuarial projections, and is based on management's assessment of facts and circumstances currently known, and assumptions about anticipated patterns, including expected future trends in the number of veterinary invoices the Company will receive and the average cost of those veterinary invoices. The reserve is made for each of the Company's segments, subscription and other business, and is continually refined as the Company receives and pays veterinary invoices. Changes in management's assumptions and estimates may have a relatively large impact to the reserve and associated expense.

Reserve for veterinary invoices

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

	Nine Months Ended September 30,	
Subscription	**2018**	**2017**
Reserve at beginning of year	$11,059	$8,538
Veterinary invoices during the period related to:		
Current year	139,504	113,833
Prior years	364	(85)
Total veterinary invoice expense	139,868	113,748
Amounts paid during the period related to:		
Current year	128,233	104,501
Prior years	9,836	7,533
Total paid	138,069	112,034
Non-cash expenses	497	306
Reserve at end of period	$12,361	$9,946

The Company's reserve for the subscription business segment increased from $11.1 million at December 31, 2017 to $12.4 million at September 30, 2018. This change was comprised of $139.9 million in expense recorded during the period less $138.1 million in payments of veterinary invoices. The $139.9 million in veterinary invoice expense incurred includes an adjustment of $0.4 million to the reserves relating to prior years, which is the result of ongoing analysis of recent payment trends. For the nine months ended September 30, 2017, the Company decreased prior year reserves by $0.1 million as a result of analysis of payment trends.

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

Other Business	**Nine Months Ended September 30, 2018**	**2017**
Reserve at beginning of year	$1,697	$983
Veterinary invoices during the period related to:		
Current year	16,632	10,074
Prior years	(304)	(173)
Total veterinary invoice expense	16,328	9,901
Amounts paid during the period related to:		
Current year	14,822	8,786
Prior years	1,348	789
Total paid	16,170	9,575
Non-cash expenses	—	—
Reserve at end of period	$1,855	$1,309

The Company's reserve for the other business segment increased from $1.7 million at December 31, 2017 to $1.9 million at September 30, 2018. This change was comprised of $16.3 million in expense recorded during the period less $16.2 million in payments of veterinary invoices. The $16.3 million in veterinary invoice expense incurred includes a reduction of $0.3 million to the reserves relating to prior years, which is the result of ongoing analysis of recent payment trends. For the nine months ended September 30, 2017, the Company decreased prior year reserves by $0.2 million as a result of analysis of payment trends.

Reserve for veterinary invoices, by year of occurrence

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

Subscription	**As of September 30, 2018**
Year of Occurrence	
2016	$408
2017	1,179
2018	10,774
	$12,361

Other Business	**As of September 30, 2018**
Year of Occurrence	
2017	$ 44
2018	1,811
	$ 1,855

10. Stock-Based Compensation and Stockholders' Equity

Stock-based Compensation

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Veterinary invoice expense	$153	$101	$421	$260
Other cost of revenue	96	69	277	172
Technology and development	58	57	167	166
General and administrative	634	503	1,708	1,416
Sales and marketing	358	165	980	550
Total stock-based compensation	$1,299	$895	$3,553	$2,564

As of September 30, 2018, for all employees, the Company had 564,647 unvested stock options and 439,798 unvested restricted stock awards and restricted stock units that are expected to vest. Stock-based compensation expense of $3.6 million related to unvested stock options and $8.0 million related to unvested restricted stock awards and restricted stock units, expected to be recognized over a weighted average period of approximately 2.1 years and 2.7 years, respectively.

Stock Options

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

	Number Of Options	Weighted Average Exercise Price per Share	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2017	4,006,399	$ 7.16	$ 88,578
Granted	—	—	
Exercised	(695,452)	4.19	22,213
Forfeited	(76,015)	15.26	
Outstanding as of September 30, 2018	3,234,932	$ 7.61	$ 90,967
Exercisable as of September 30, 2018	2,666,951	$ 5.88	$ 79,606

As of September 30, 2018, stock options outstanding and stock options exercisable had a weighted average remaining contractual life of 4.9 years and 4.2 years, respectively.

Restricted Stock Awards and Restricted Stock Units

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

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested shares as of December 31, 2017	256,842	$4.77
Granted	339,856	28.33
Vested	(136,330)	8.05
Forfeited	(20,570)	28.25
Unvested shares as of September 30, 2018	439,798	$22.20

Stockholders' Equity

In the June 2018 follow-on public offering, the Company sold 2,090,909 shares of common stock (inclusive of 272,727 shares of common stock sold by the Company pursuant to the full exercise of the underwriters' option to purchase additional shares) at a price to the public of $33.00 per share. The Company received aggregate net proceeds of $65.7 million, after deducting underwriting discounts and commissions and offering expenses payable by the Company. As a part of the purchase of real estate described in Note 6, an additional 303,030 shares of common stock were issued via a private placement during August 2018.

During the nine months ended September 30, 2018, 330,000 of the Company's outstanding warrants were exercised. As of September 30, 2018, warrants to purchase 480,000 shares of the Company's common stock at $10.00 per share remained outstanding. The warrants automatically convert to common stock in 2019.

11. Segments

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue:				
Subscription business	$67,421	$56,493	$192,805	$159,363
Other business	10,743	6,625	28,511	16,759
	78,164	63,118	221,316	176,122
Veterinary invoice expense:				
Subscription business	48,285	39,761	139,868	113,748
Other business	6,018	3,692	16,328	9,901
	54,303	43,453	156,196	123,649
Other cost of revenue:				
Subscription business	6,468	5,454	18,232	15,304
Other business	3,649	2,404	9,727	5,856
	10,117	7,858	27,959	21,160
Gross profit:				
Subscription business	12,668	11,278	34,705	30,311
Other business	1,076	529	2,456	1,002
	13,744	11,807	37,161	31,313
Technology and development	2,299	2,471	6,761	7,196
General and administrative	4,174	4,017	13,242	12,274
Sales and marketing:				
Subscription business	6,266	4,811	17,730	13,161
Other business	99	51	275	162
	6,365	4,862	18,005	13,323
Operating income (loss)	$906	$457	$(847)	$(1,480)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
United States	$63,517	$50,506	$178,957	$141,946
Canada	14,647	12,612	42,359	34,176
Total revenue	$78,164	$63,118	$221,316	$176,122

Substantially all of the Company's long-lived assets were located in the United States as of September 30, 2018 and December 31, 2017.

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

Overview

We provide medical insurance for cats and dogs throughout the United States, Canada and Puerto Rico. Our data-driven, vertically-integrated approach enables us to provide pet owners with what we believe is the highest value medical insurance for their pets, priced specifically for each pet's unique characteristics. Our growing and loyal member base provides us with highly predictable and recurring revenue. We operate our business similar to other subscription-based businesses, with a focus on maximizing the lifetime value of each pet while sustaining a favorable ratio of lifetime value relative to pet acquisition cost, based on our desired return on investment.

We operate in two business segments: subscription business and other business. We generate revenue in our subscription business segment primarily from subscription fees for our medical insurance, which we market to consumers. Fees are paid at the beginning of each subscription period, which automatically renews on a monthly basis. We generate revenue in our other business segment writing policies on behalf of third parties, where we do not undertake the marketing, and have more of a business-to-business relationship. Our other business segment consists of companies or organizations that choose to provide medical insurance for cats and dogs as a benefit to their employees or members, and contracts include multiple pets. The policies in our other business segment may be materially different from our subscription business. Our ultimate goal is to build the Trupanion brand by continuing to offer the highest value proposition in the industry and maintain strong alignment with the veterinary community. We believe our activities in our other business segment benefit the overall market for pet medical insurance by expanding upon product options and distribution models within other market niches.

We generate leads for our subscription business through both third-party referrals and direct-to-consumer acquisition channels, which we then convert into members through our website and contact center. Veterinary practices represent our largest referral source. We engage a national referral group of Territory Partners. These independent contractors are dedicated to cultivating direct veterinary relationships and building awareness of the benefits of our subscription to veterinarians and their clients. Veterinarians then educate pet owners, who visit our website or call our contact center to learn more about, and potentially enroll in, Trupanion. We pay Territory Partners fees based on activity in their regions. We also receive a significant number of new leads from existing members adding pets and referring their friends and family members. Our direct-to-consumer acquisition channels serve as important resources for pet owner education and drive new member leads and conversion. We continuously evaluate the effectiveness of our member acquisition channels and marketing initiatives based upon their return on investment, which we measure by comparing the ratio of the lifetime value of a pet generated through each specific channel or initiative to the related acquisition cost. We believe our patent-protected, proprietary software platform, Trupanion Express®, which allows direct invoicing by veterinarians, provides a significant strategic advantage.

Key Operating Metrics

The following table sets forth our key operating metrics for our subscription business and total pets enrolled for the nine-month periods ended September 30, 2018 and 2017 and each of the last eight fiscal quarters.

	Nine Months Ended September 30, 2018	2017
Total pets enrolled (at period end)	497,942	404,069
Total subscription pets enrolled (at period end)	416,527	359,102
Monthly average revenue per pet	$54.06	$51.67
Lifetime value of a pet (LVP)	$714	$701
Average pet acquisition cost (PAC)	$157	$141
Average monthly retention	98.61 %	98.61 %

	Period Ended Sept. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sept. 30, 2017	Jun. 30, 2017	Mar. 31, 2017	Dec. 31, 2016
Total pets enrolled (at period end)	497,942	472,480	446,533	423,194	404,069	383,293	364,259	343,649
Total subscription pets enrolled (at period end)	416,527	401,033	385,640	371,683	359,102	346,409	334,909	323,233
Monthly average revenue per pet	$54.55	$53.96	$53.62	$53.17	$52.95	$51.47	$50.50	$49.17
Lifetime value of a pet (LVP)	$714	$732	$727	$727	$701	$654	$637	$631
Average pet acquisition cost (PAC)	$155	$150	$165	$184	$151	$143	$128	$133
Average monthly retention	98.61 %	98.64 %	98.63 %	98.63 %	98.61 %	98.57 %	98.58 %	98.60 %

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

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

Monthly average revenue per pet. Monthly average revenue per pet is calculated as amounts billed in a given month for subscriptions divided by the total number of subscription pet months in the period. Total subscription pet months in a period represents the sum of all pets enrolled for each month during the period. We monitor monthly average revenue per pet because it is an indicator of the per pet unit economics of our business.

Lifetime value of a pet. Lifetime value of a pet (LVP) is a business operating metric that we believe reflects the lifetime value we might expect from a new subscription pet enrollment. We calculate LVP based on gross profit from our subscription business segment for the 12 months prior to the period end date excluding stock-based compensation expense related to cost of revenue from our subscription business segment, sign-up fee revenue and the change in deferred revenue between periods, multiplied by the implied average subscriber life in months. Implied average subscriber life in months is calculated as the quotient obtained by dividing one by one minus the average monthly retention rate. We monitor LVP to assess how much lifetime value we might expect from new pets over their implied average subscriber life in months and to evaluate the amount of sales and marketing expenses we may want to incur to attract new pet enrollments.

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

Average monthly retention. Average monthly retention is measured as the monthly retention rate of enrolled subscription pets for each applicable period averaged over the 12 months prior to the period end date. As such, our average monthly retention rate as of September 30, 2018 is an average of each month’s retention from October 1, 2017 through September 30, 2018. We calculate monthly retention as the number of pets that remain after subtracting all pets that cancel during a month, including pets that enroll and cancel within that month, divided by the total pets enrolled at the beginning of that month. We monitor average monthly retention because it provides a measure of member satisfaction and allows us to calculate the implied average subscriber life in months.

Non-GAAP Financial Measures

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

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

The following table reflects the reconciliation of net acquisition cost to sales and marketing expense (in thousands):

	Nine Months Ended September 30, 2018	2017
Sales and marketing expense	$18,005	$13,323
Net of sign-up fee revenue	(1,933)	(1,619)
Excluding:		
Stock-based compensation expense	(980)	(550)
Other business segment sales and marketing expense	(275)	(162)
Net acquisition cost	$14,817	$10,992

	Period Ended Sept. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sept. 30, 2017	Jun. 30, 2017	Mar. 31, 2017	Dec. 31, 2016
Sales and marketing expense	$6,365	$5,702	$5,938	$5,781	$4,862	$4,372	$4,089	$3,951
Net of sign-up fee revenue	(693)	(624)	(616)	(550)	(558)	(517)	(544)	(526)
Excluding:								
Stock-based compensation expense	(358)	(349)	(273)	(172)	(165)	(198)	(187)	(113)
Other business segment sales and marketing expense	(99)	(88)	(87)	(56)	(51)	(63)	(48)	(62)
Net acquisition cost	$5,215	$4,641	$4,962	$5,003	$4,088	$3,594	$3,310	$3,250

Components of Operating Results

General

We operate in two business segments: subscription business and other business. Our subscription business segment includes revenue and expenses related to monthly subscriptions for pet medical insurance, which we market to consumers. When we do not directly market and sell to consumers, we classify the related revenue and expenses in our other business segment.

Revenue

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

We generate revenue in our other business segment primarily from writing policies on behalf of third parties where we do not undertake the direct consumer marketing. This segment includes the writing of policies that may be materially different from our subscription.

Cost of Revenue

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

Veterinary invoice expense

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

Other cost of revenue

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

Operating Expenses

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

Technology and Development

Technology and development expenses primarily consist of personnel costs and related expenses for our technology staff, which includes information technology development and infrastructure support, third-party services and depreciation of hardware and capitalized software.

General and Administrative

General and administrative expenses consist primarily of personnel costs and related expenses for our finance, actuarial, human resources, regulatory, legal and general management functions, facilities, income and expenses related to owning our corporate headquarters building, and professional services.

Sales and Marketing

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

Factors Affecting Our Performance

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

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

Timing of initiatives. Over time we plan to implement new initiatives to improve our member experience, make modifications to our subscription plan and find other ways to maintain a strong value proposition for our members. These initiatives will sometimes be accompanied by price adjustments, in order to compensate for an increase in benefits received by our members. The implementation of such initiatives may not always coincide with the timing of price adjustments, resulting in fluctuations in revenue and gross profit in our subscription business segment.

Geographic mix of sales. The relative mix of our business between the United States and Canada impacts the monthly average revenue per pet we receive. Prices for our plan in Canada are generally higher than in the United States (in local currencies), which is consistent with the relative cost of veterinary care in each country. In addition, as our mix of business between the United States and Canada changes, our exposure to foreign exchange fluctuations will be impacted.

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

Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Revenue:				
Subscription business	$67,421	$56,493	$192,805	$159,363
Other business	10,743	6,625	28,511	16,759
Total revenue	78,164	63,118	221,316	176,122
Cost of revenue:				
Subscription business(1)	54,753	45,215	158,100	129,052
Other business	9,667	6,096	26,055	15,757
Total cost of revenue	64,420	51,311	184,155	144,809
Gross profit:				
Subscription business	12,668	11,278	34,705	30,311
Other business	1,076	529	2,456	1,002
Total gross profit	13,744	11,807	37,161	31,313
Operating expenses:				
Technology and development(1)	2,299	2,471	6,761	7,196
General and administrative(1)	4,174	4,017	13,242	12,274
Sales and marketing(1)	6,365	4,862	18,005	13,323
Total operating expenses	12,838	11,350	38,008	32,793
Operating income (loss)	906	457	(847)	(1,480)
Interest expense	336	124	887	370
Other (income) expense, net	(628)	(99)	(1,071)	(1,239)
Income (loss) before income taxes	1,198	432	(663)	(611)
Income tax (benefit) expense	(7)	26	(11)	54
Net income (loss)	$1,205	$406	$(652)	$(665)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Cost of revenue	$249	$170	$698	$432
Technology and development	58	57	167	166
General and administrative	634	503	1,708	1,416
Sales and marketing	358	165	980	550
Total stock-based compensation expense	$1,299	$895	$3,553	