Trupanion / MOI Global Wide-Moat Investing Summit / June 25, 2018

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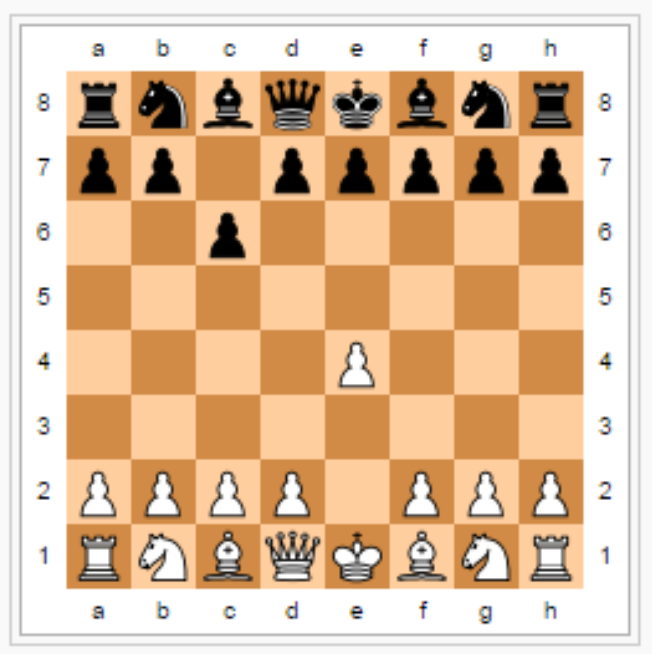
Caro-Kann Strategy

- Chess opening against the king's pawn opening.
- A strong position and pawn structure make Caro-Kann Defense more solid and robust than many alternatives while creating a strong likelihood of Black winning.



Caro-Kann Capital Investment Strategy: Special Situations and Compounders

- We look for mispriced securities due to lack of sellside coverage and buyside attention.
- We prefer companies with up to $1B market cap.
- Favorite investment patterns for special situations:
  - ✓ Spin offs
  - ✓ High growth business segment hidden by a larger struggling segment
  - ✓ Sum of the parts.
- Favorite business models for compounding machines:
  - ✓ Platform businesses with network effect
  - ✓ Flywheel business models
- Long bias: typically 80% to 100% net long.

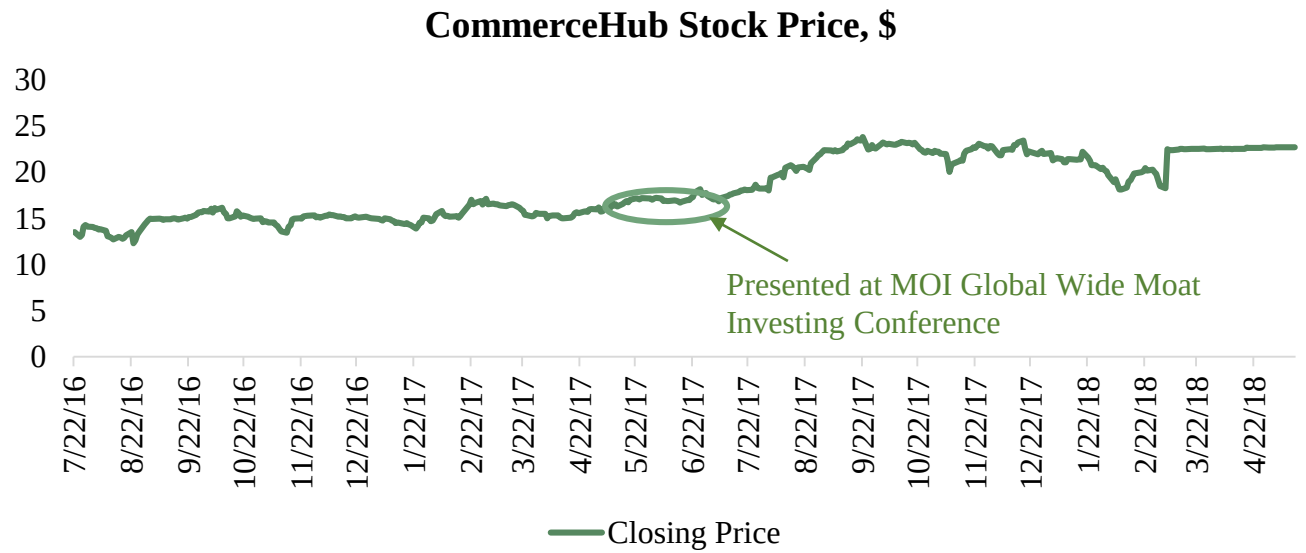
Involvement with Manual of Ideas

- This is the 3rd time I am presenting at MOI Global Conference as an instructor. It is a pleasure to be back!

- On June 15th 2017 I presented CommerceHub (ticker: CHUBK).

What Happened to CommerceHub Since I Presented at June 2017 Wide Moat Investing Conference

- We established position in November 2016 – January 2017 at less than $15.00.
- I presented CommerceHub at MOI Global Wide Moat Investing Conference on June 15, 2017. CHUBK closed at $16.93 that day.
- Subsequently we increased our position on a few occasions when stock market volatility presented attractive opportunity to increase our exposure.
- In March 2018 two PE firms (GTCR and Sycamore Partners) announced that they will acquire CHUBK at $22.75 per share. Transaction closed in late May 2018.
- Return = ***~34%*** since the presentation in ***less than 12 months***.

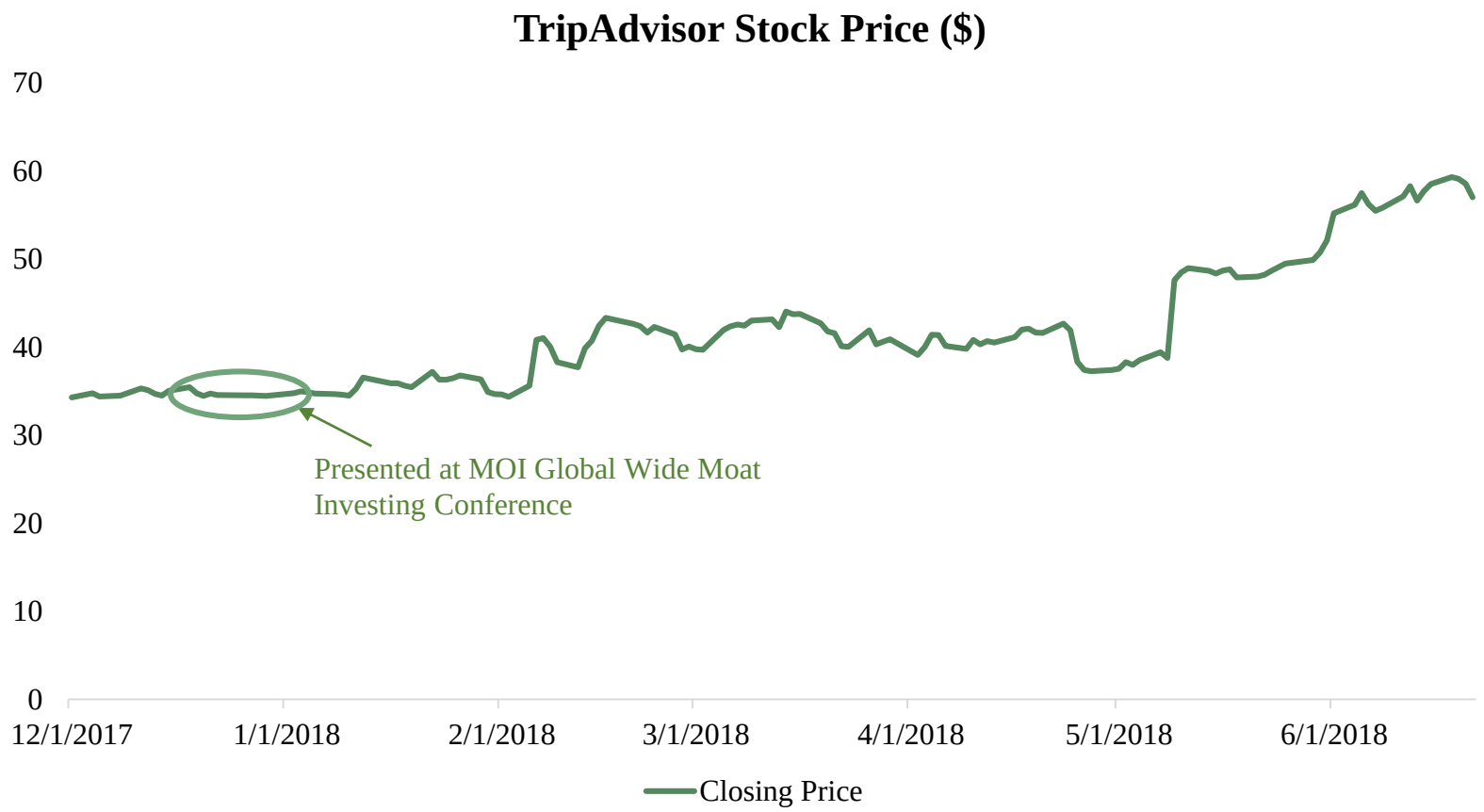


Involvement with Manual of Ideas (2)

- On December 19th 2017 I presented TripAdvisor (ticker: TRIP).

TripAdvisor Shares Are Up ~63% since Presented at December 2017 Best Ideas Conference

- I presented TripAdvisor at MOI Global Best Ideas Investing Conference on December 19, 2017. TRIP closed at $34.77 that day.
- Return = ***~63%*** since the presentation in ***~6 months***.

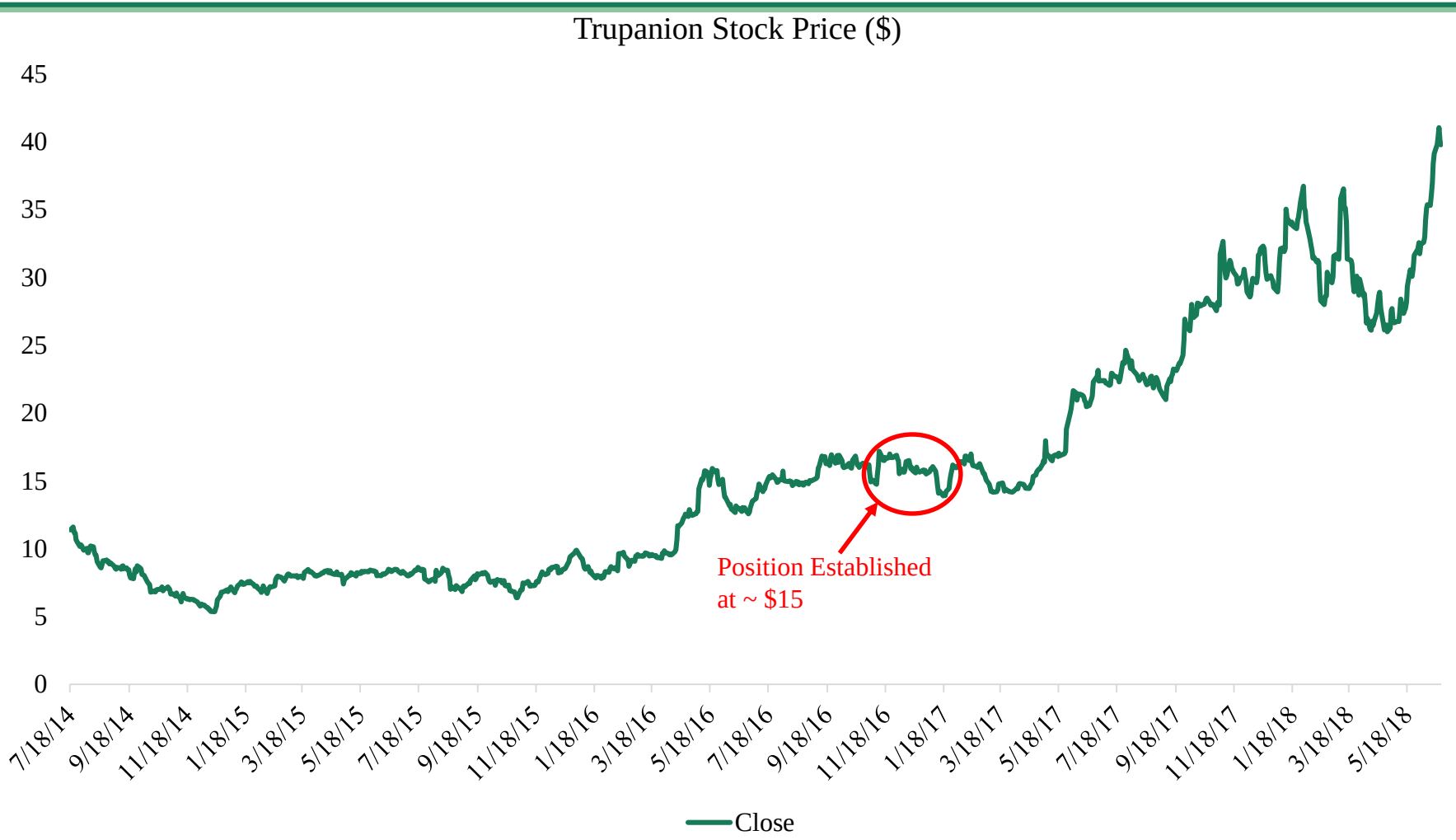


Let's Start with a Quote

"I have always been attracted to the low cost operator in any business and when you can find a combination of (1) an extremely large business, (2) a more or less homogeneous product, and (3) a very large gap in operating costs between the low cost operator and all of the other companies in the industry, you have a really attractive investment situation. That situation prevailed twenty five years ago when I first became interested in the company, and it still prevails."
Letter to Mr. George D. Young from Warren Buffett
July 22nd, 1976

With This Quote in Mind Let Me Introduce You the Idea I am Presenting Today …

Trupanion: Price History Since IPO



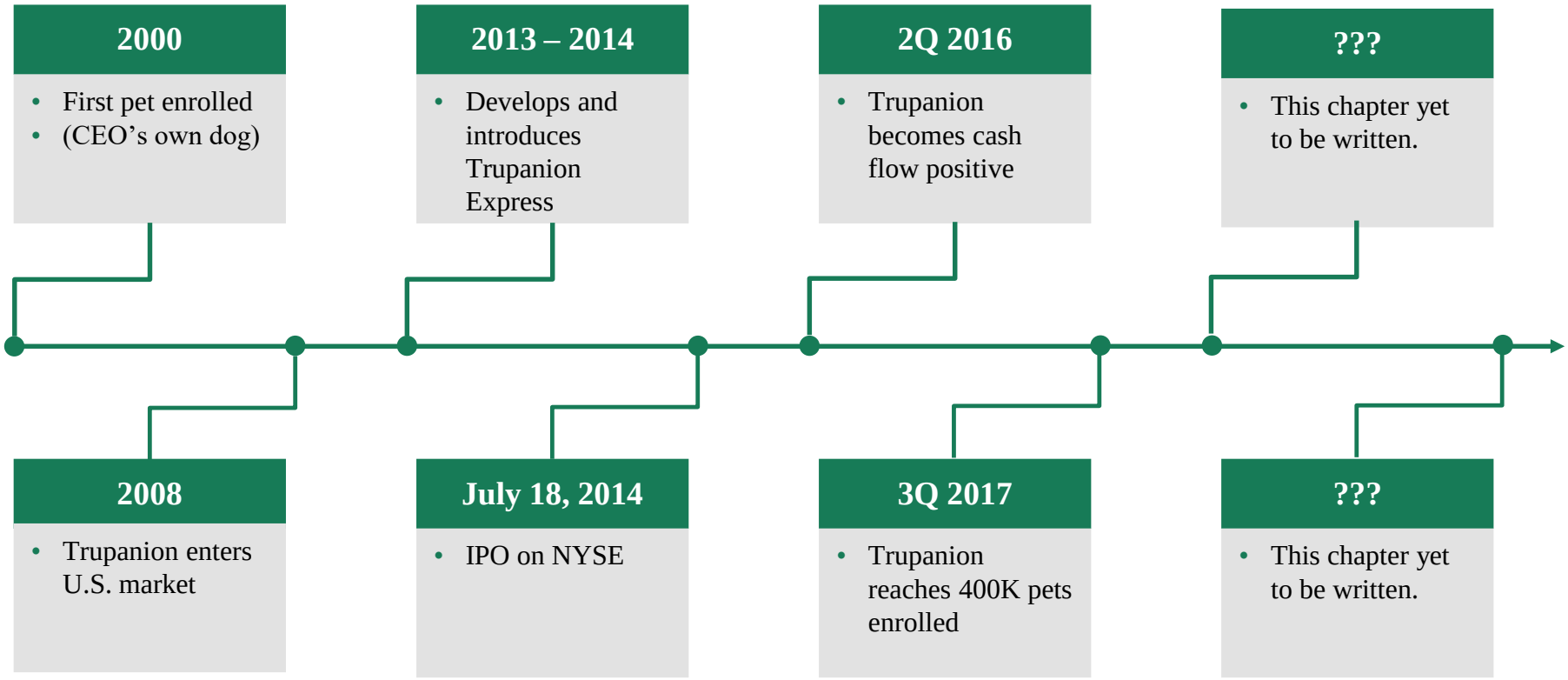
Trupanion: 30 Second Pitch

- A founder – CEO who is an intelligent fanatic Founder.
- Strong alignment of management with shareholders:
  - CEO's equity stake is worth more than 160x (not a typo!) than his executive compensation in 2017.
- Moat based on proprietary data and virtuous cycle flywheels.
- Massive under-penetrated market with a multi year or even multi decade growth runway.
- Product with the best customer value proposition.
- Mission-driven culture.

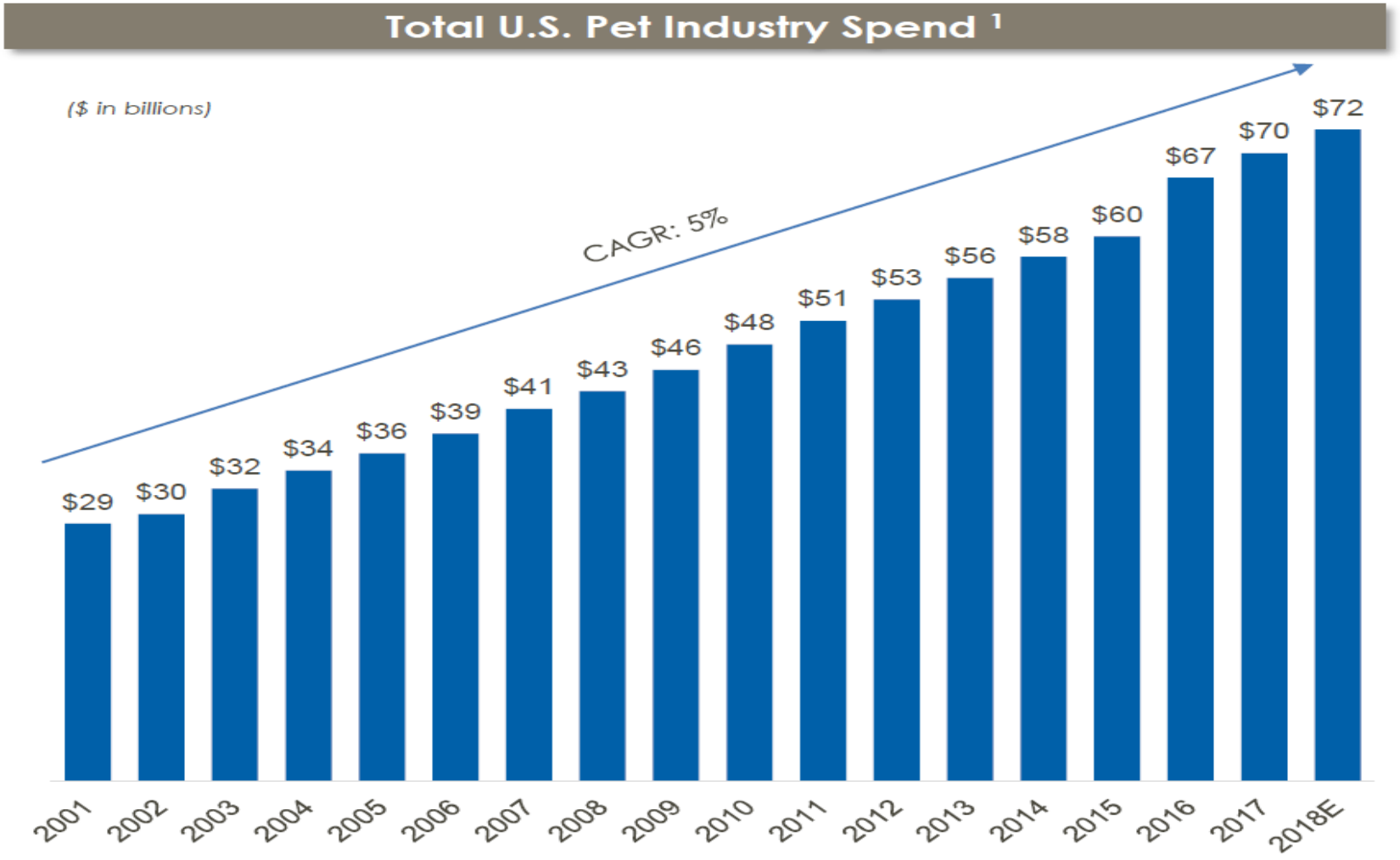
What Does Trupanion Do?

- Trupanion sells medical insurance for dogs and cats.

Trupanion History: from Humble Beginnings to IPO



Pet Owners Spent $70B on Their Pets in 2017
And Those Expenses Are Growing



1 Source: APPA US Pet Industry Spending Figures & Future Outlook.

Costumes on Halloween Alone Cost ~$500M!

- On a typical Halloween alone pet owners spend ~$500M on costumes!

- So propensity to spend is *definitely* there. We LOVE our pets!

Penetration of Medical Pet Insurance in North America Is Extraordinary Low

- Today it is somewhere between 1.5% and 2%.
- Let's compare it to other developed countries.
  - ✓ France = 5%.
  - ✓ Denmark = 5%.
  - ✓ Netherlands = 8%.
  - ✓ Norway = 14%.
  - ✓ U.K. – 25%.
  - ✓ Sweden – 40%.

Why Is Medical Pet Insurance Not More Common?

- There is no reason to believe that pet owners in North America love their pets less than Europeans!
- As we saw, Americans spend ~$70B on their pets, including $500M on Halloween costumes alone!
- It is unlikely to be a money issue…

What Is the Answer Then?

- The answer is somewhat surprising.
- While the U.S. is ahead of almost any other country on the planet when we speak about almost any financial, technological, or consumer product innovation, it is actually quite behind many European countries when we speak about “comprehensive” medical insurance for pets as a product.
- For example, “comprehensive” medical insurance for pets came to the U.K. in the 1970s.
- However, until Trupanion launched its medical insurance in Canada in 2000 and in the U.S. in 2008, there were no “comprehensive” pet medical insurance offerings.

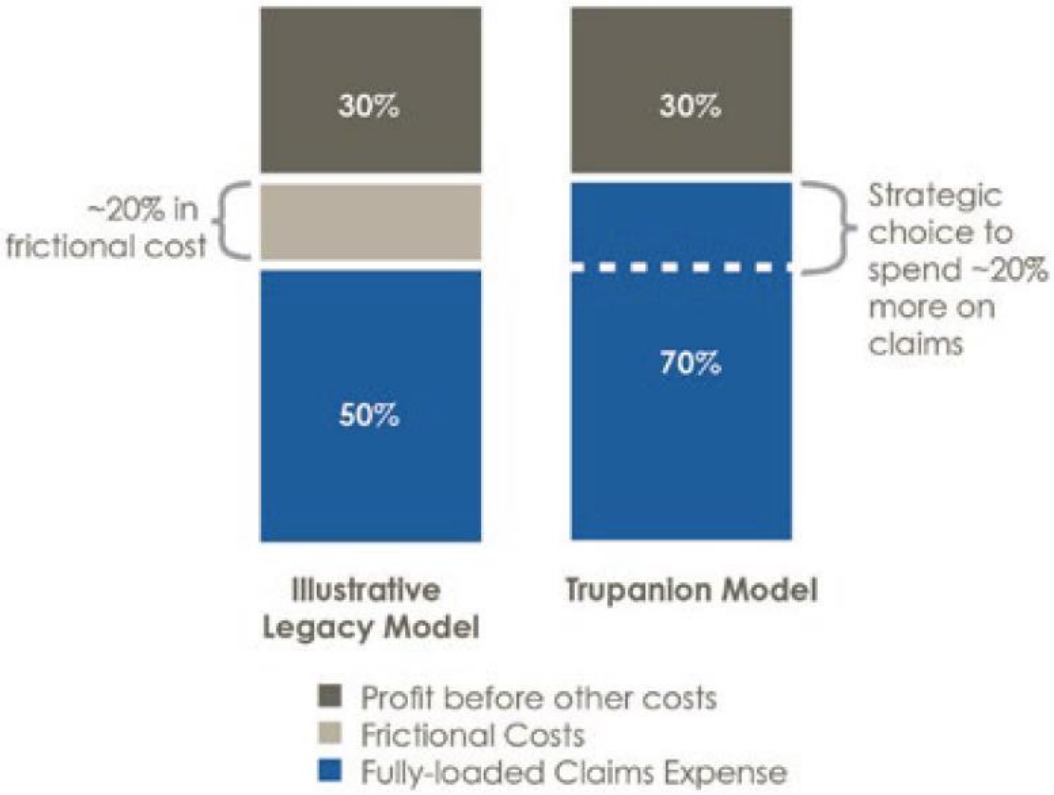
What Is "Comprehensive" Medical Insurance for Pets?
It is EXACTLY what Trupanion Offers!

- Trupanion solves an important pain point by allowing pet owners avoid massive medical bills if their loved pets get sick.
- Costs of healthcare can be *massive* and bills running $20K to $30K are not that unusual.
- Trupanion covers hereditary and congenital conditions (*i.e.*, those things most likely to happen to a pet).
- Trupanion does not raise rates because a pet has claims – *i.e.*, Trupanion does not penalize "unlucky" pets.
- No payout limits.
- This type of insurance did not exist in the U.S. for many years.
- Lack of a compelling offering and customer value proposition have led to low medical pet insurance penetration.

Customer Value Proposition

"The value of the Trupanion solution comes in the form of paying the industry's highest sustainable percentage between what pet owners pay in the way of monthly cost and what we pay in veterinary invoices for the "average pet"".
Source: 2014 Shareholder Letter.

Trupanion Pays in Claims 70 Cents out of Every Dollar Collected as Insurance Premiums.



Source: 2014 Trupanion Shareholder Letter.

Trupanion Customer Value Proposition Is Analogous to Costco Customer Value Proposition

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

Source: 2014 Trupanion Shareholder Letter.

Trupanion Offers "Pooling" of Risk for Its Customers and Charges a Fee for Doing So (1)

- Somewhat simplistically we can describe Trupanion as a risk pooling mechanism.
- All pets fall into one of three categories:
  - ✓ "lucky"
  - ✓ "average"
  - ✓ "unlucky".
- Trupanion charges its members healthcare costs for an "average" pet plus its mark-up of ~43%.
- The math is simple:
  - ✓ Trupanion collects $1.
  - ✓ Trupanion pays $0.70 in claims.
  - ✓ Mark-up = ($1 - $0.70) / $0.70 = ~43%.

Trupanion Offers "Pooling" of Risk for Its Customers and Charges a Fee for Doing So (2)

- It means that owners of "average" pets will "overpay" for healthcare by ~43% compared to paying out of pocket.
- Owners of "lucky" pets will overpay by even more.
- Only owners of "unlucky" pets are getting an "attractive" deal.
- Some buyside peers criticize Trupanion's value proposition because it lacks ROI.
- Indeed, *statistically* you are better off by putting money aside and ***not*** buying insurance.

Trupanion Offers "Pooling" of Risk for Its Customers and Charges a Fee for Doing So (3)

- However, this criticism is flawed for several reasons:
  - ✓ You have one or very few pets and you are not playing a repeated game 100 times.
  - ✓ You love your pet unconditionally.
  - ✓ Most people may not afford a $30K healthcare bill. The risk of ruin is too big to take that risk, and economic euthanasia is heart-breaking.

Trupanion Offers "Pooling" of Risk for Its Customers and Charges a Fee for Doing So (4)

"It is important to note that our members – responsible, loving pet owners – do not want a return on investment. Nobody in their right mind wants their pet to be "unlucky" or even "average"".

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

Source: 2014 Shareholder Letter.

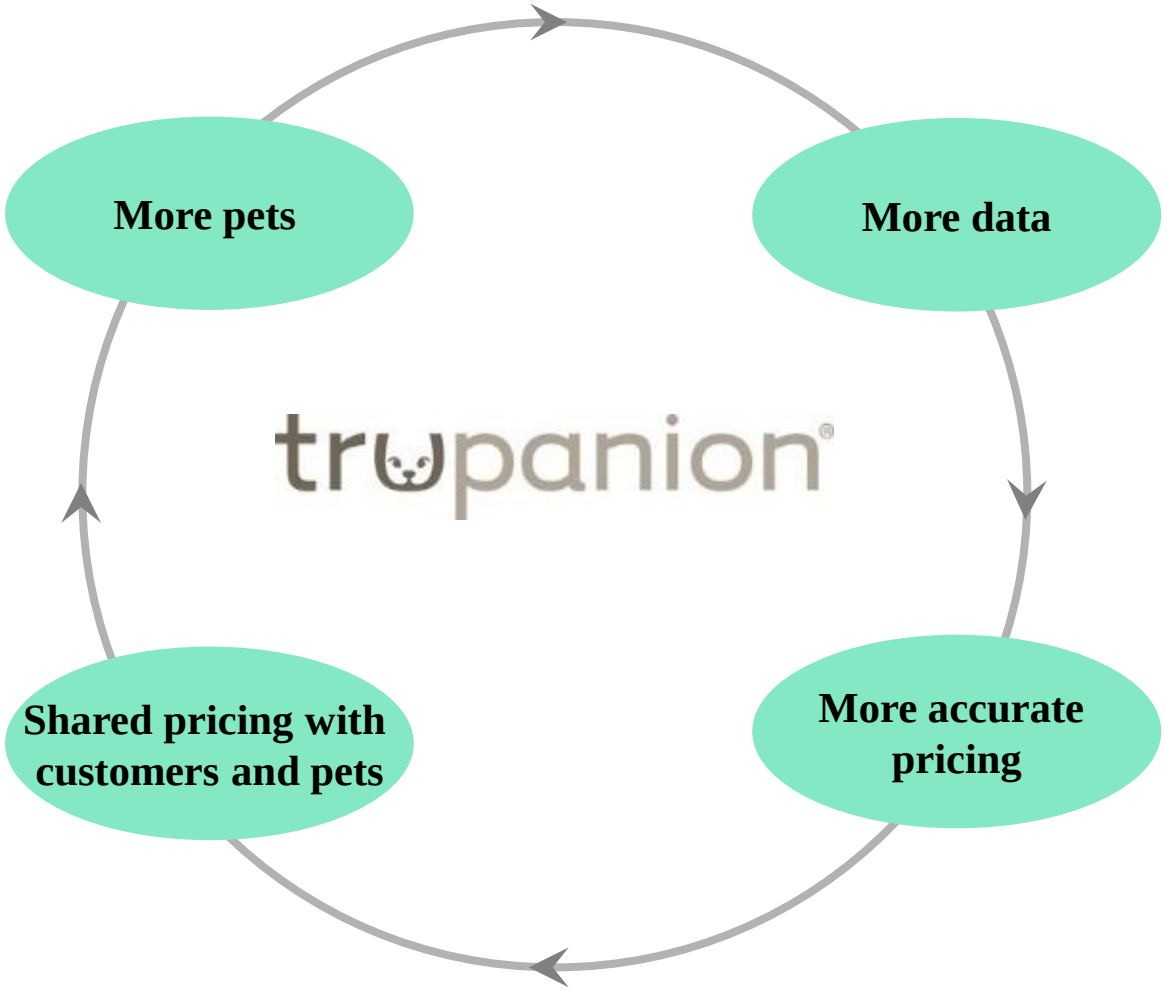
Trupanion Achieves Low Cost Advantage Through More Accurate Pricing Driven by Proprietary Data

- Trupanion's proprietary data is at the core of its moat.
- Over the past 18 years Trupanion developed its proprietary database that covers (includes) more than 8 millions pet months of information and over 1 million claims.
- Today Trupanion has over 1.2 million price categories.
- Examples of categories:
  - ✓ Dog
  - ✓ Golden retriever that is 4 years old
  - ✓ Bulldog in Manhattan.
- This proprietary data allows Trupanion to more accurately predict cost of healthcare.

Trupanion Chooses To Share Benefits of Its Cost Advantage Pricing with Customers and Their Pets

- Pricing accurately allows Trupanion to share its high value proposition with each pet owner.
- This reminds me **Nick Sleep of Nomad Investment Partnership** and his concept of **sharing scale economies with customers**.
  - ✓ Once a business becomes a low cost provider due to scale, it has a choice between keeping prices and making more money or share some of that cost advantage with its customer.
  - ✓ The latter is likely to lead to even more customers and even bigger scale.
  - ✓ The business that chooses to share such benefits with customers is ***more liked by customers*** and ***extremely difficult to compete with*** due to the **virtuous cycle**.

Trupanion Has Built Proprietary Data Flywheel + Virtuous Cycle Flywheel



Time as a Source of Moat

"Knowing what I know today, it would take me over 13 years to replicate our 15 years of data".

Source: 2014 Trupanion Shareholder Letter.

Trupanion Has a Philosophy of a Low Cost Provider

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

Source: 2014 Trupanion Shareholder Letter.

Trupanion Has Unique Go-to-Market Strategy:
Territory Partners

Territory Partner Model (1)

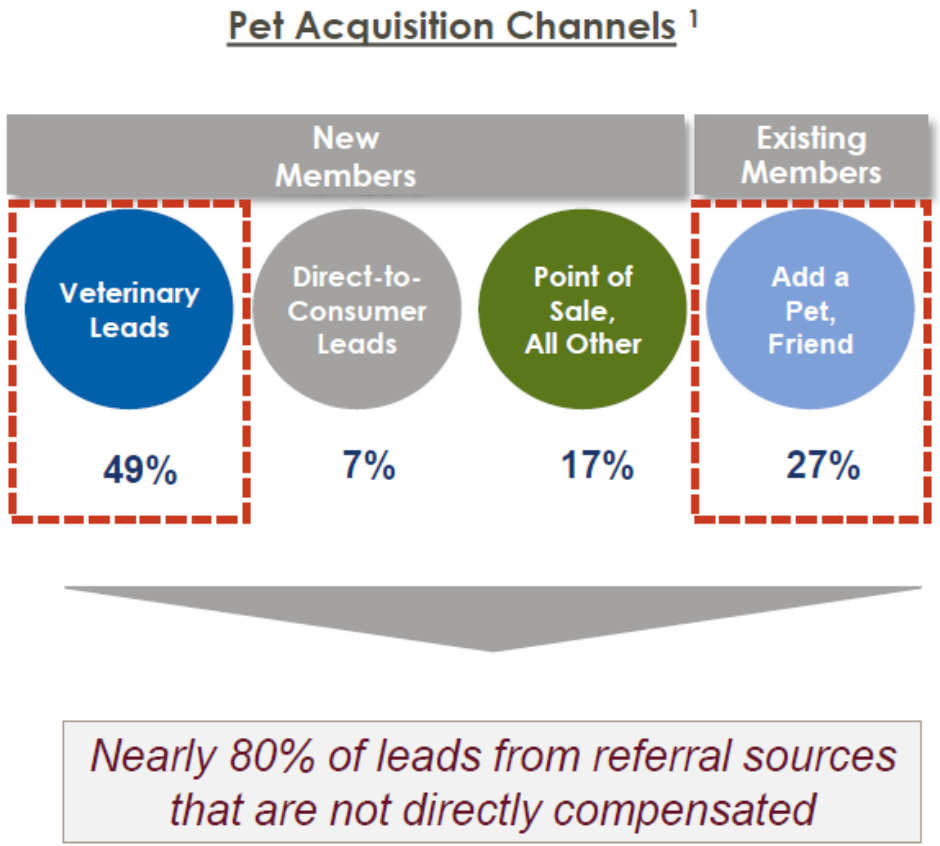
- Territory Partner model is based on the early Coca-Cola distributor model.
- A typical territory includes roughly 3 million people, 1.8 million cats and dogs, and 250 veterinary hospitals.
- Approximately 150,000 new puppies and kittens are purchased in each territory per year.
- Trupanion currently has 107 Territory Partners who visited 20,000 hospitals in 2017.
  - ✓ To put things in perspective, there are ~28,000 hospitals in North America today.
- Territory Partners goal is to build long-term relationships with ~250 veterinary hospitals in their territory.

Territory Partner Model (2)

"We believe that Trupanion remains the only company with a national footprint throughout the United States and Canada. Eighty-percent of hospitals are located within Territory Partner territories, with a target of visiting them every two months".

Source: 2016 Trupanion Shareholder Letter.

Channel Mix: Veterinary Leads Is the Key Channel



Source: 2018-05 Trupanion Investor Presentation.

Legacy Reimbursement Model Is Slow, Inefficient, and Customer Unfriendly

Source: 2014 Trupanion Shareholder Letter.

Welcome Trupanion Express! (1)

- Trupanion Express is a no-cost software solution that enables *direct* payment by Trupanion to veterinarians instead of legacy reimbursement model.
- The entire ecosystem benefits:
  - ✓ Win-win-win for all parties involved.
- Pet owners:
  - ✓ Out of pocket expenses are dramatically reduced as 90% of expenses are paid by Trupanion directly to a hospital.
- Veterinarians:
  - ✓ Can move forward with Plan A care for any sick pet.
  - ✓ Reduce non paid accounts receivable.

Welcome Trupanion Express! (2)

- Trupanion:
  - Collects additional proprietary data to further improve its pricing accuracy while maintain a strong relationship with supportive hospitals.
  - Gets improved referral and conversion rates.

- Trupanion spent ~$17M developing the technology.

Trupanion Express Direct Payment Removes Friction and Eliminates Pain Points

Source: 2014 Trupanion Shareholder Letter.

Trupanion Business Model: Simple, But Not Easy

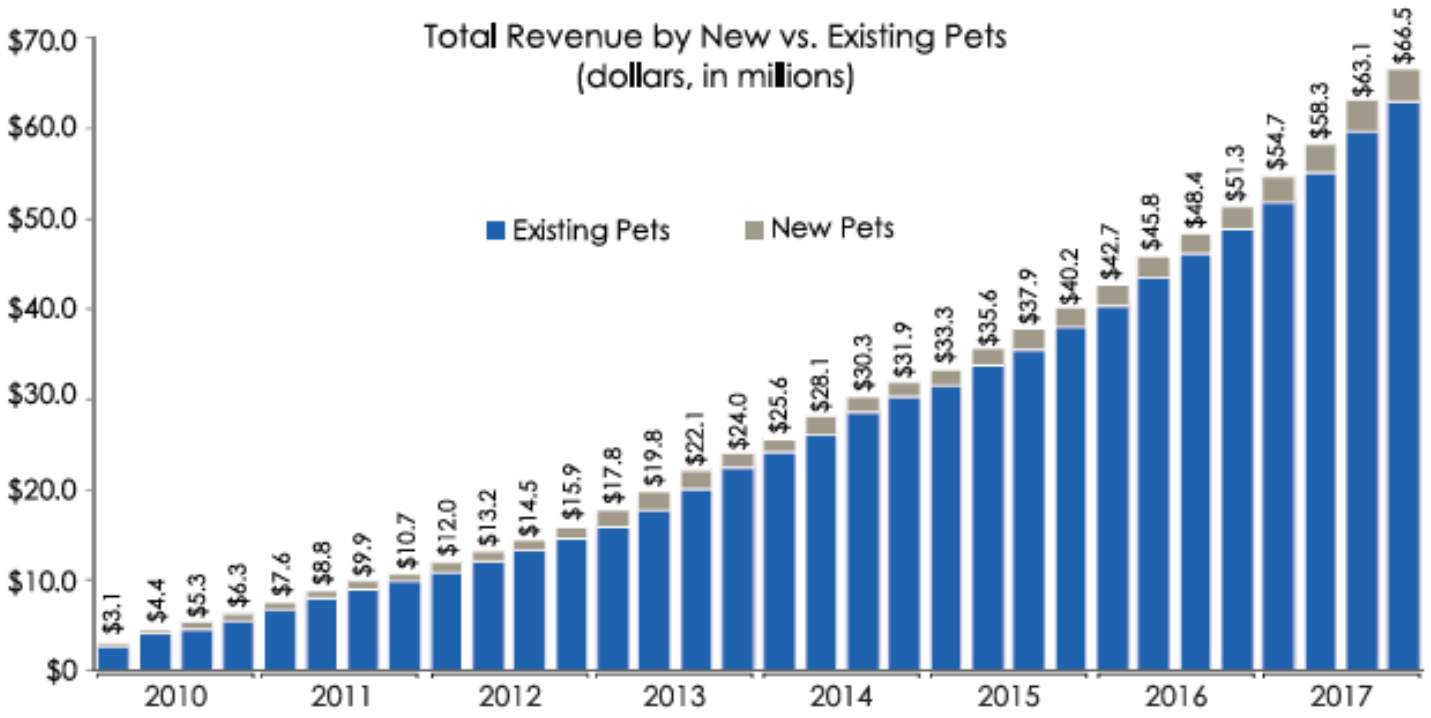
"Our business model is simple. But the execution of our business model is challenging. It requires focus, years of data, and a great team."

Source: 2014 Trupanion Shareholder Letter.

Trupanion Business Model: Consumer Subscription Business

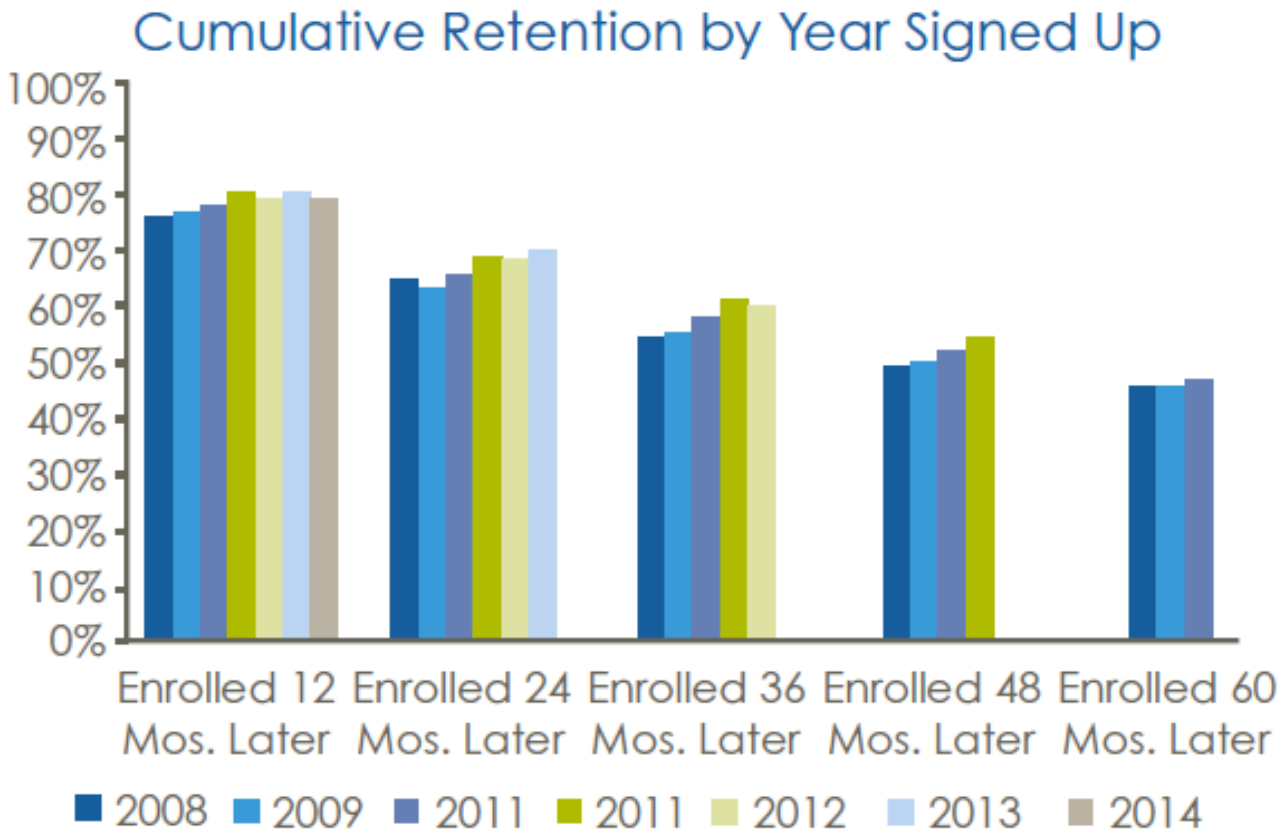
- Direct-to-consumer monthly subscription service.
- Monthly recurring revenue model.

Recurring Revenue Model Means Highly Predictable Revenue Stream Which Makes It Easier To Run the Business



Source: 2017 Trupanion Shareholder Letter.

Retention by Cohort Illustrates that Trupanion Customer Value Proposition Resonates with Customers



Source: 2015 Trupanion Shareholder Letter.

Trupanion: Key Financial Metrics to Understand Business Model

- Life Time Value of a Pet ("LVP").
- Pet Acquisition Costs ("PAC").
- LVP to PAC.
- IRR on marketing spend (*i.e.*, IRR on PAC).

IRR Is the Most Critical Metric

"We are most concerned with the internal rate of return (IRR) for incrementally adding an average pet."

Source: 2014 Trupanion Shareholder Letter.

Key Financial Metrics Today (1)

- 1Q 2018 LVP = $727.
- 1Q 2018 PAC = $165.
- 1Q 2018 LVP / PAC = 4.41x.
- IRR on marketing spend in 2017 = ~36%.

Key Financial Metrics Today (2)

- While LVP to CAC of ~4.41 and IRR of ~36% are very impressive …
- This does tell the full story.
- Trupanion is not even at scale yet …

How Will Trupanion's Financial Model Look at Scale?

- Scale = 650K to 750K enrolled pets (~446.5K as of 1Q 2018).
- 70% payout ratio (*i.e.*, every 70 cents are paid out as claims).
- 10% variable expenses.
- => 20% gross profit margin.
- Target fixed expense = 5% - 6% of revenue.
- Discretionary margin (*i.e.*, operating income before sales and marketing expense to acquire new pets) = 14% – 15%.

How Will Trupanion Achieve Scale?

- In other words, how will Trupanion get from ~446.5K insured pets *today* to 650K – 750K *at scale*?
- And how long will it take Trupanion to get there?
- The gap is 200K to 300K enrolled pets.

Trupanion Has Three Key Growth Drivers

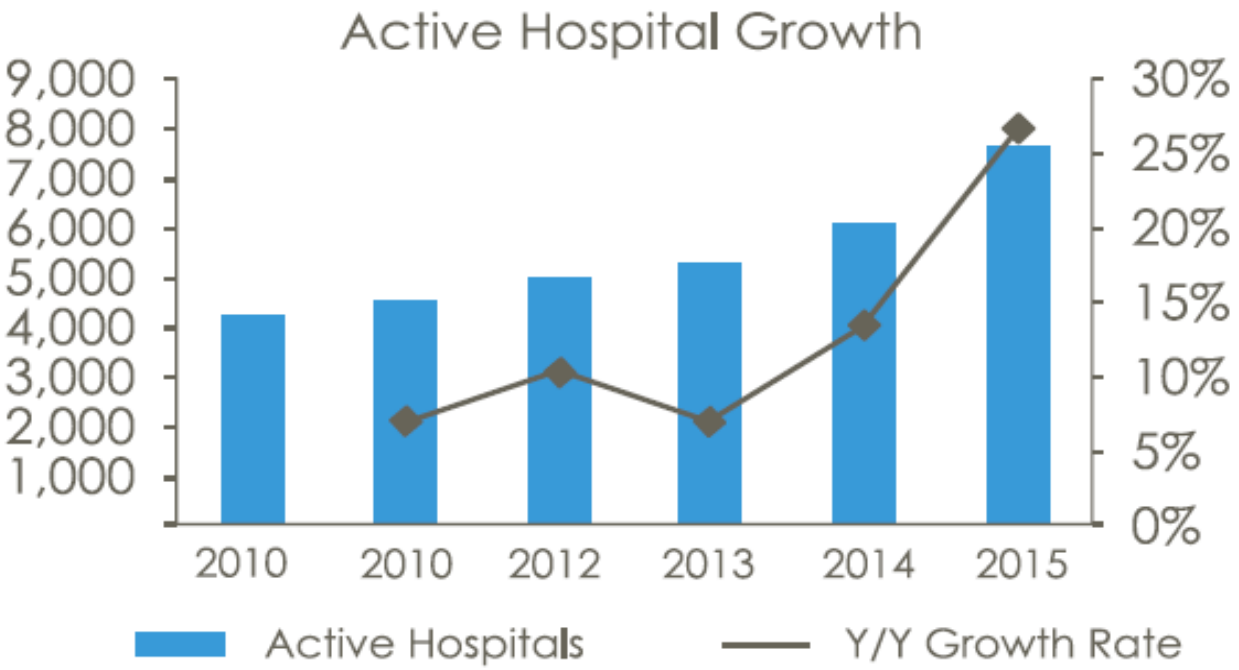
- #1: Active hospital growth.
- #2: Same Store Sales (“SSS”) growth.
- #3: Direct-to-Consumer channel.

What Is an Active Hospital?

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

Source: 2014 Trupanion Shareholder Letter.

Active Hospitals Growth



Source: 2015 Trupanion Shareholder Letter.

- Trupanion had over 8,100 active hospitals at the end of 2018.

#1: Active Hospital Growth

- There are ~28,000 hospitals in North America.
- In 2018 Trupanion had over 8,100 active hospitals.
- So the current penetration is ~29%.
- In more established markets (over 5 years), ~50% of hospitals are active, and that percentage is growing.
- Given its compelling customer value proposition and Trupanion Express, Trupanion should be able to get to 20,000 active hospitals.
- It may take 5, 10, or even 15 years but Trupanion is very well positioned to achieve that goal.

#2: Same Store Sales Growth (1)

- 2014 Trupanion Shareholder Letter: “A third area that disappointed me was our focus on increasing enrollments and same-store sales ahead of a more foundational goal of increasing enrollments by adding more active hospitals. It would be lovely to do both well, but we mixed up the priorities last year”.

- 2015 Trupanion Shareholder Letter: “In the coming year we will focus on adding more active hospitals and then increasing same-store sales in those hospitals.”

Same Store Sales Growth (2)

- 2016 Trupanion Shareholder Letter: "So far, Trupanion has not figured out a way to accelerate same-store sales growth beyond what happens naturally over time."
  - ✓ But small scale tests and experiments are encouraging.

- 2016 Trupanion Shareholder Letter: "These new initiatives are centered around providing partnering hospitals with more data and information previously unavailable to us and doing so with an increased frequency compared to our historical touchpoints."

Same Store Sales Growth (3)

- In 2017 Trupanion created **inside sales team** that works in addition to Territory Partners.
- Inside sales team has more touch points with hospitals.
- Inside sales team's main goal seems to be to increase SSS.
- According to recent management commentary SSS would be getting an increasing focus while the number of active hospitals will be growing slower than it used to for the next few years.
- Trupanion has not still figured out how to grow both active number of hospitals and SSS *at the same time*.

#3: Direct to Consumer Channel Growth

- While this channel has promise, Trupanion has not figured out how to grow in that channel *cost effectively*.

- Tests and experiments that Trupanion has run show that in areas where Trupanion has *density* (e.g., lots of active hospitals and high number of enrolled pets) direct-to-consumer channel can be effective.

- While the company is not there yet, there is no reason to believe that it will not get there in the next few years.

Let's Talk about Culture

"Culture Eats Strategy for Breakfast."

Peter Drucker

Trupanion's Values

1. We do what we say.
2. Simple is better.
3. We do not punish unlucky pets.
4. We're innovative and fun.
5. We love pets!

Role Models

- Costco
  - ✓ Customer is always getting the best deal regardless of what they are buying
- Starbucks
  - ✓ Starbucks values “social conscience”.
- TCI
  - ✓ Pioneering new valuation metrics (*i.e.*, EBITDA instead of net income).
- Netflix
- Pandora
- OpenTable

Role Models: Who Spoke at 2014 Territory Partners Conference

- 3- Day Conference for Territory Partners in 2014
  - ✓ Richard Galanti, Costco CFO
  - ✓ Howard Schultz, Starbucks CEO
  - ✓ David Loewe, Seattle Humane Society CEO
  - ✓ Kristin Hamilton, Koru CEO.

We Identified Other Cultural Elements Both Through a Day Spent at Headquarters and Communications

- #1: Taking great care of employees.
- #2: Everybody is important.
- #3: Education and empowerment.
- #4: Owner mentality and aligned incentives.
- #5: Frugality.
- #6: Getting the right shareholder base.

Taking Care of Employees

- Company has full-time dog walkers so that team members can bring their pets to the office (source: 2014 Letter).

- In January 2015 Trupanion launched its child care center for employees' children who are up to thee years old. It is available at no cost.

Everybody Is Equally Important

- Everybody has the same size desk and the same benefits regardless of whether they are hourly or salaried or their tenure with Trupanion.

- As part of my due diligence I spent entire day at Trupanion's HQ and I saw every top C level executive's desk, including CEO's. They are *indeed of the same size*.

Education and Empowerment (1)

- Trupanion places a very strong emphasis on education and empowerment of its employees and Territory Partners.
- In 2014 Trupanion launched Trupanion University (now called Tru-University).
- Initially it was open to current and prospective Territory Partners only and provided an extensive three-week training on Trupanion.
- In 2016 Trupanion extended it to new and existing team members (*i.e.*, employees).

Education and Empowerment (2)

- Now Tru-University is expanding its class offerings, and its courses range from a one-week introduction to the company, to classes on our culture, to in-depth training on specific topics.

- In 2016 Trupanion invested $2.9M in training and education.

- 2017 was a year of education at Trupanion: *every new and existing employee and Territory Partner attended TruUniversity*.

Owner Mentality and Aligned Incentives (1)

- Owner mentality and alignment of incentives start at the top.
- Trupanion's Founder and CEO owns ~7.20% of the company.
- His current equity stake is worth ~$88M.
- $88M compares *very favorably* to 2017 compensation of ~$556K.
  - His equity stake value is ~160x bigger than his compensation!
- However, in case of Trupanion owner mentality and aligned incentives ***do not stop at the top***.
- Each member of Trupanion's team (full-time and part-time) receives stock options in Trupanion.
- **So *EVERYBODY* is a shareholder**.

Owner Mentality and Aligned Incentives (2)

"Team participation in our equity program is another key priority of ours, aligning us all in our objective to maximize future value creation with limited dilution."

Source: 2015 Trupanion Shareholder Letter.

Owner Mentality and Aligned Incentives (3)

"Our intention is for each team member (full-time or part-time) to receive a new-hire stock grant."

Source: 2016 Trupanion Shareholder Letter.

Owner Mentality and Aligned Incentives:
Stock-Based Compensation Is Tied Closely to Value Creation

Table 3. Performance Grant Program*

YoY increase to intrinsic value @ the enterprise level	Overall company performance pool %	Net increase in intrinsic value per share
1 - 10%	0.0%	1 - 10%
11%	0.3%	10.7%
12%	0.3%	11.7%
13%	0.4%	12.6%
14%	0.4%	13.6%
15%	0.5%	14.5%
16%	0.6%	15.4%
17%	0.7%	16.3%
18%	0.8%	17.2%
19%	0.9%	18.1%
20%	1.0%	19.0%

Table 3. Performance Grant Program*

YoY increase to intrinsic value @ the enterprise level	Overall company performance pool %	Net increase in intrinsic value per share
21%	1.1%	19.9%
22%	1.3%	20.7%
23%	1.4%	21.6%
24%	1.6%	22.4%
25%	1.7%	23.3%
26%	1.9%	24.1%
27%	2.0%	25.0%
28%	2.2%	25.8%
29%	2.3%	26.7%
30%	2.5%	27.5%

Source: 2016 Trupanion Shareholder Letter.

Frugality (1)

- How did the company celebrate its IPO ?

Frugality (2)

"The traditional celebratory dinner was held picnic-style in Central Park while we dined on Shake Shack burgers. The rest of the office partied at home with champagne and cupcakes."

Source: 2014 Trupanion Shareholder Letter.

Having Right Shareholders Is Important (1)

- Let's start with a story.
- After Darryl Rawlings sold his cigar business, he started Trupanion.
- At that time he took money from 8 outside investors who invested $25K each.
- "Several years later, and before taking on any institutional investors, we agreed to pay $35,000 to each of the eight individuals and they kept 100% of their shares". *Source: 2014 Trupanion Shareholder Letter.*
- "It was very important then, as it is today, to repay shareholders and to do what we say". *Source: 2014 Trupanion Shareholder Letter.*

Having Right Shareholders Is Important (2)

"we strive to find long-term focused shareholders who understand our business on a deeper level. We are confident that these shareholders will be aligned with our values and best positioned to benefit from our strategy."

Source: 2015 Trupanion Shareholder Letter.

Having Right Shareholders Is Important (3)

"our goal is to increase the in-person attendance to our annual shareholder meetings in Seattle. We would like these meeting to one day have attendance representing 80%+ of our outstanding shares. We would like to have the meeting become an avenue for a two-way, lengthy conversation where our long-term, well-educated shareholders not only learn additional specifics about the company, but also build an understanding of our people and culture."

Source: 2016 Trupanion Shareholder Letter.

Having Right Shareholders Is Important (4)

- What does Trupanion do to get the right shareholders?

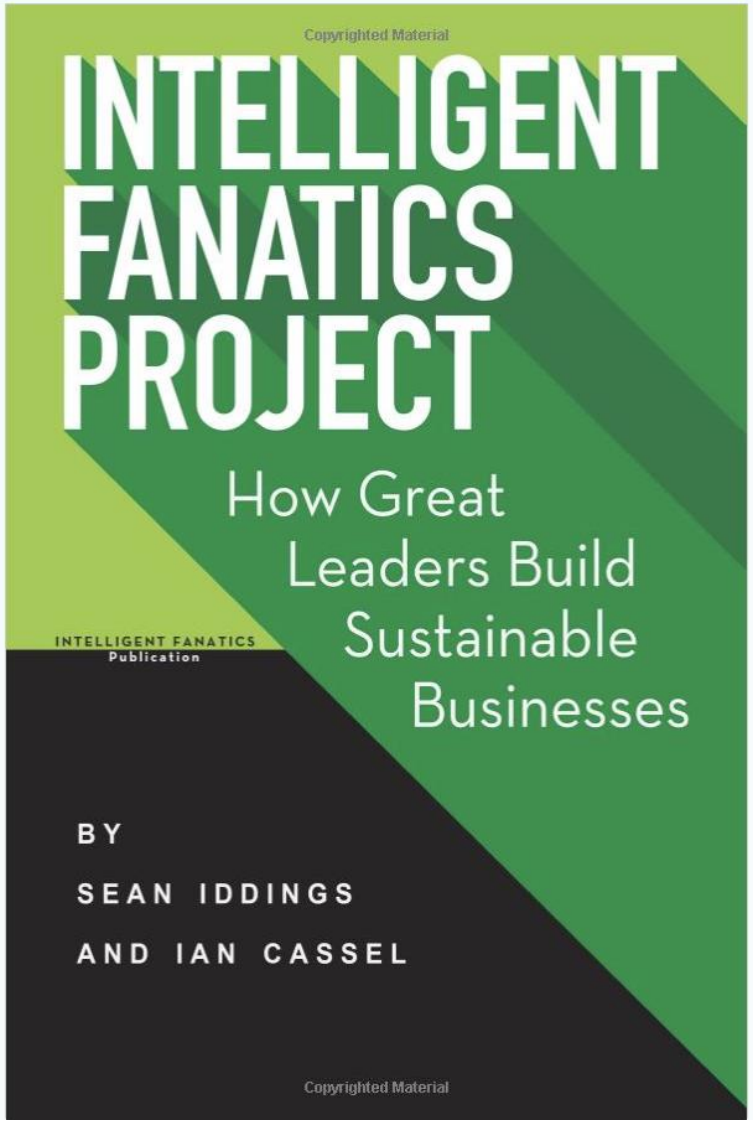
- #1: Incredible access to C-level executives. You can come and spend a day at the office and meet top executives, ask questions, and get to know the company, executives, and culture better. This is what we did!

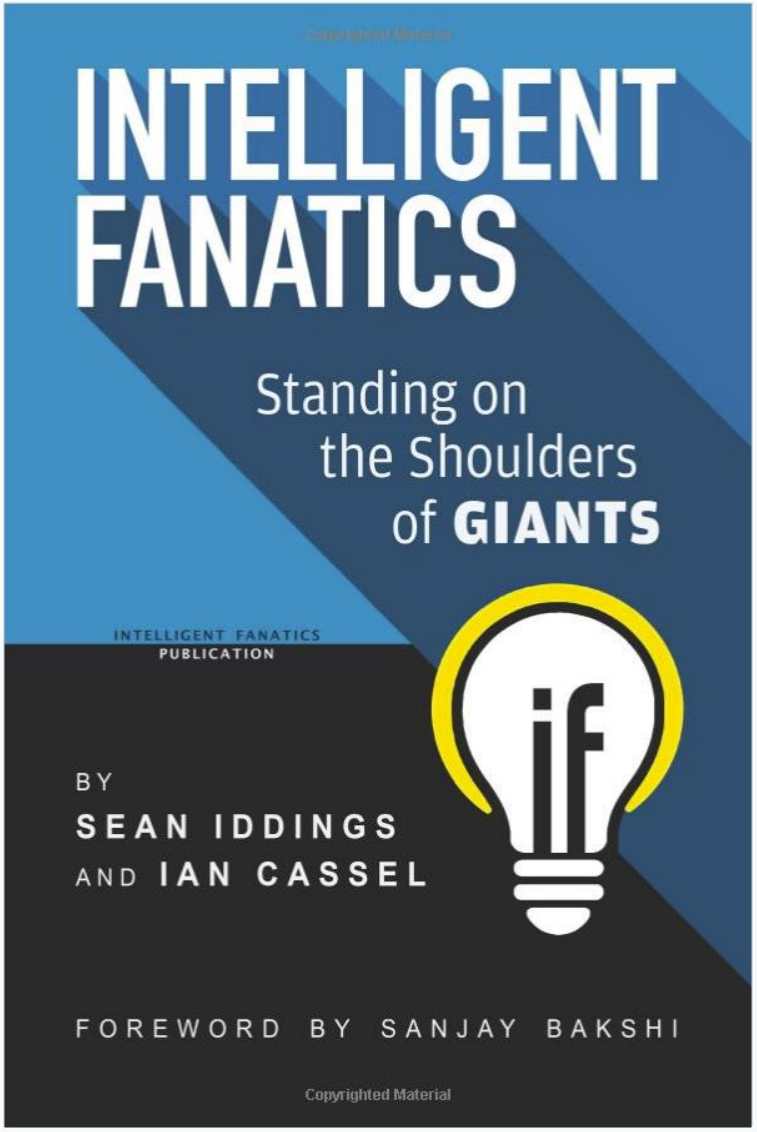
- #2: CEO hosts a Q&A session at Berkshire Hathaway annual shareholder meeting. Clearly, people who come to BRK meeting are very long-term focused investors, and this is exactly the type of shareholders Trupanion wants.

CEO Is An Intelligent Fanatic

- In our opinion, Darryl Rawlings is an **intelligent fanatic**.
- The term “intelligent fanatic” was introduced by Charlie Munger.
- Subsequently Professor Sanjay Baskhi popularized it.
- Sean Iddings and Ian Cassel studied several intelligent fanatics in their books *Intelligent Fanatics Project: How Great Leaders Build Sustainable Businesses* and *Intelligent Fanatics: Standing on the Shoulders of Giants*.
- In Trupanion we can see many character traits and organizational design features of leaders and companies profiled in those books.

Books About Intelligent Fanatics:
Darryl Rawlings Looks a Lot Like Their Characters





Capital Allocation (1)

- 2014 Letter: “we believe we raised more than enough money to carry us through to cash flow positive. We have no intention of going back to the markets to raise additional capital.”

- 2016 Letter: “Two abstract options we have considered are deploying capital toward a long-term, cost-effective new pet channel and paying up front for assets that would sit on our balance sheet and help lower ongoing frictional costs … it is possible that it may involve an equity capital raise and therefore result in dilution.”

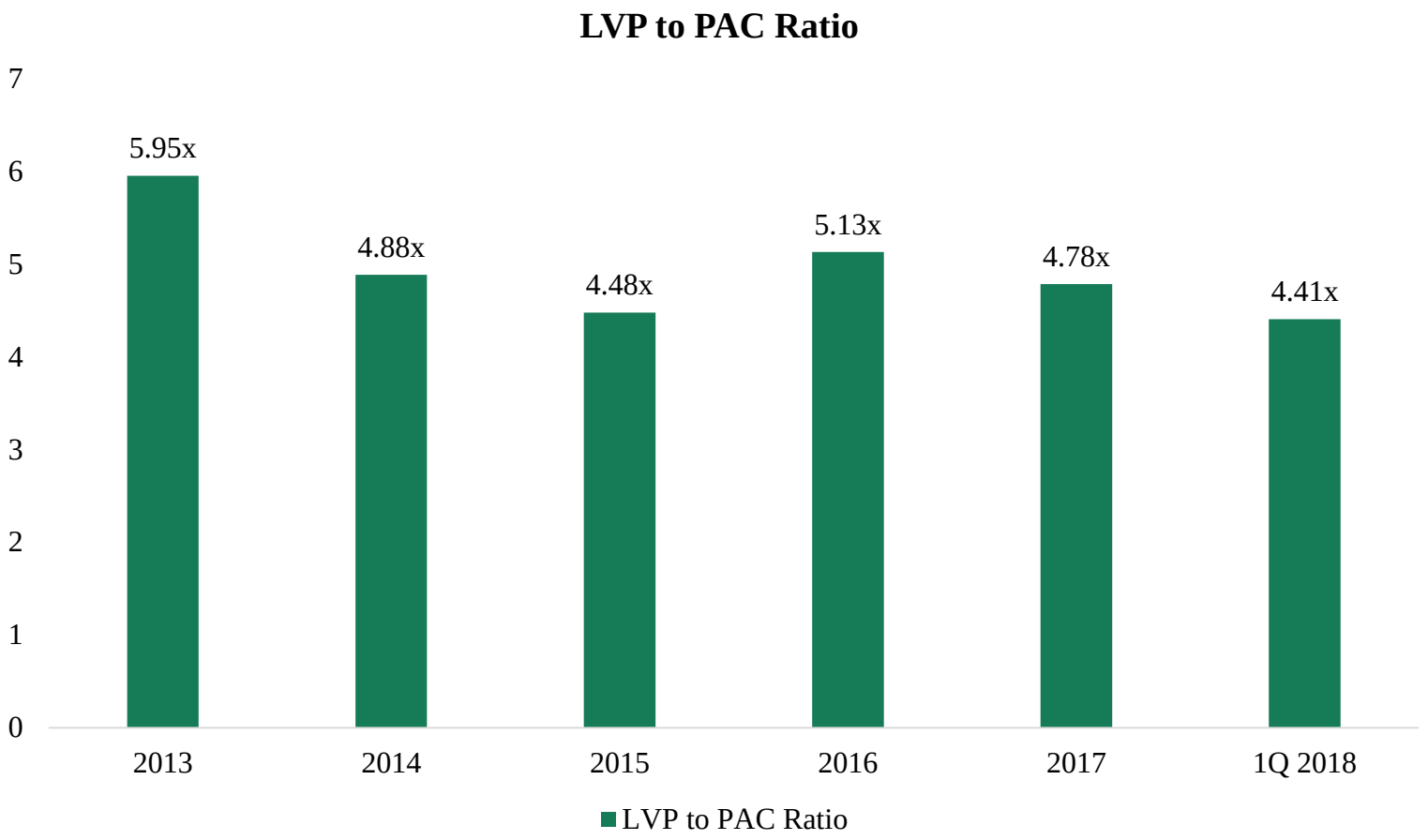
Capital Allocation (2)

- On June 20, 2018 Trupanion announced that it would be issuing 1,818,182 shares at $33 (compared to ~$40 market price).
- Trupanion will use the proceeds to acquire the building that it currently leases.
- The purchase price is ~$65M.
- So Trupanion is doing what CEO wrote in 2016 Letter it may do: “paying up front for assets that would sit on … balance sheet and help lower ongoing frictional costs”.

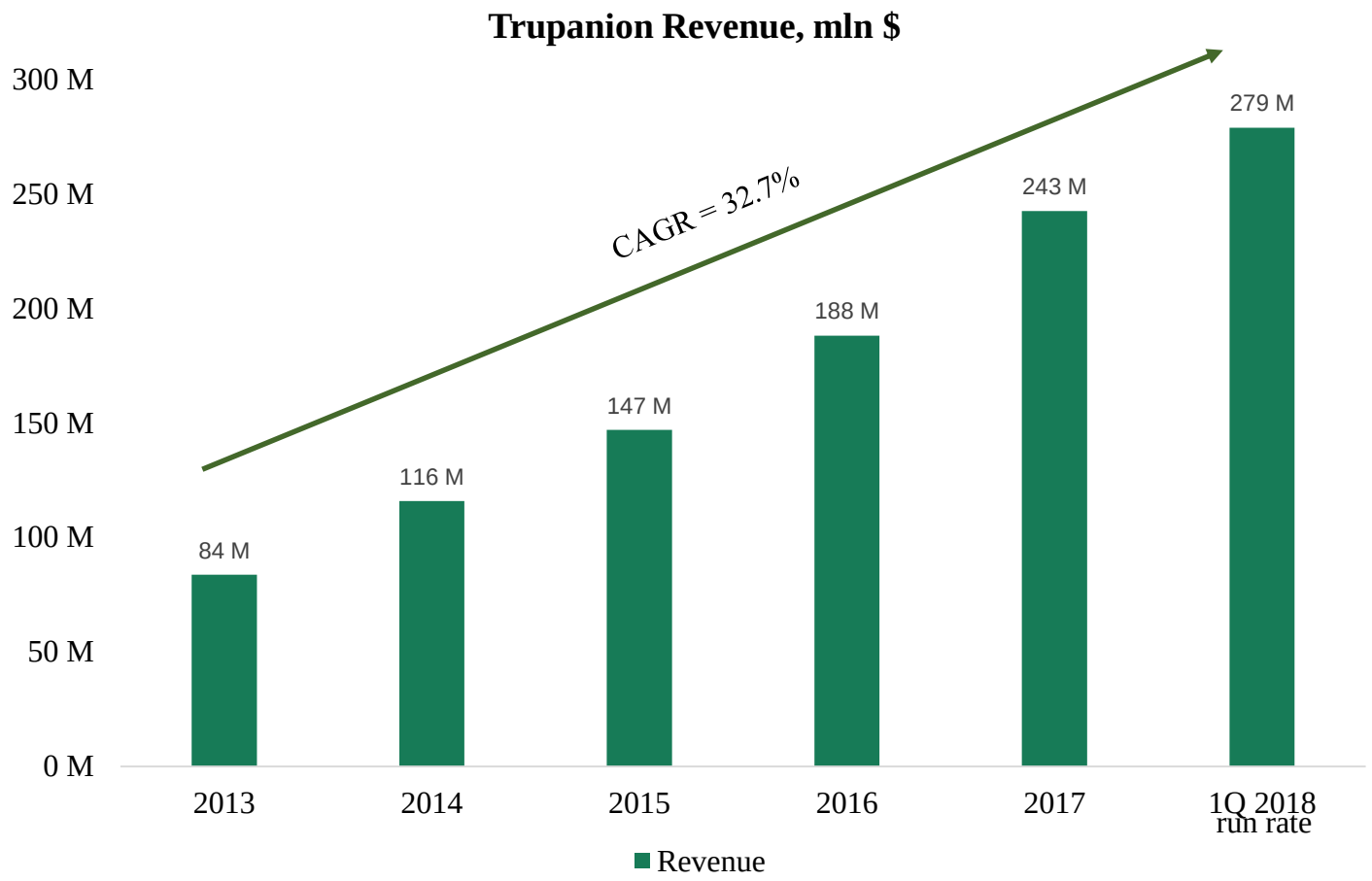
Capital Allocation (3)

- Purchasing the building will eliminate rental expense (~$2M).
- Plus Trupanion will able to lease the extra space and get rental income (~$2.5M to $3M).
- In addition, its insurance subsidiary will be able to put the building on its balance sheet which will allow it to release ~$60M of capital over the next 12 – 15 years.
- So there are benefits of buying a building. However, financing the purchase with selling shares does not strike us as a great capital allocation decision.
- We do **not** like this capital allocation decision.
- While this decision alone is not enough to make us exit our position and lose faith in management, we will be watching further capital allocation decisions very carefully.

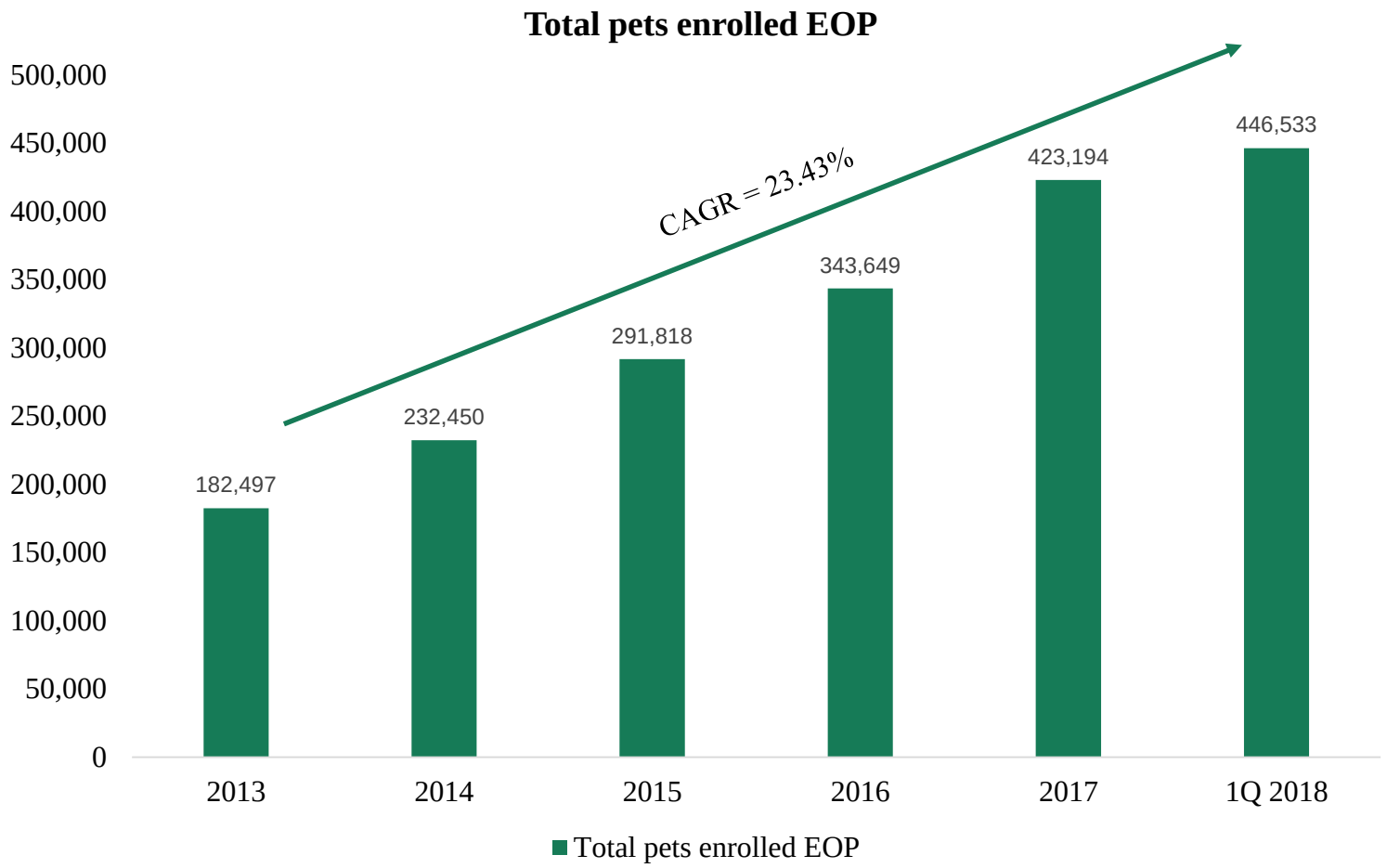
LVP to PACs


LVP to PAC Ratio
7
6
5
4
3
2
1
0
5.95x
4.88x
4.48x
5.13x
4.78x
4.41x
2013
2014
2015
2016
2017
1Q 2018
LVP to PAC Ratio

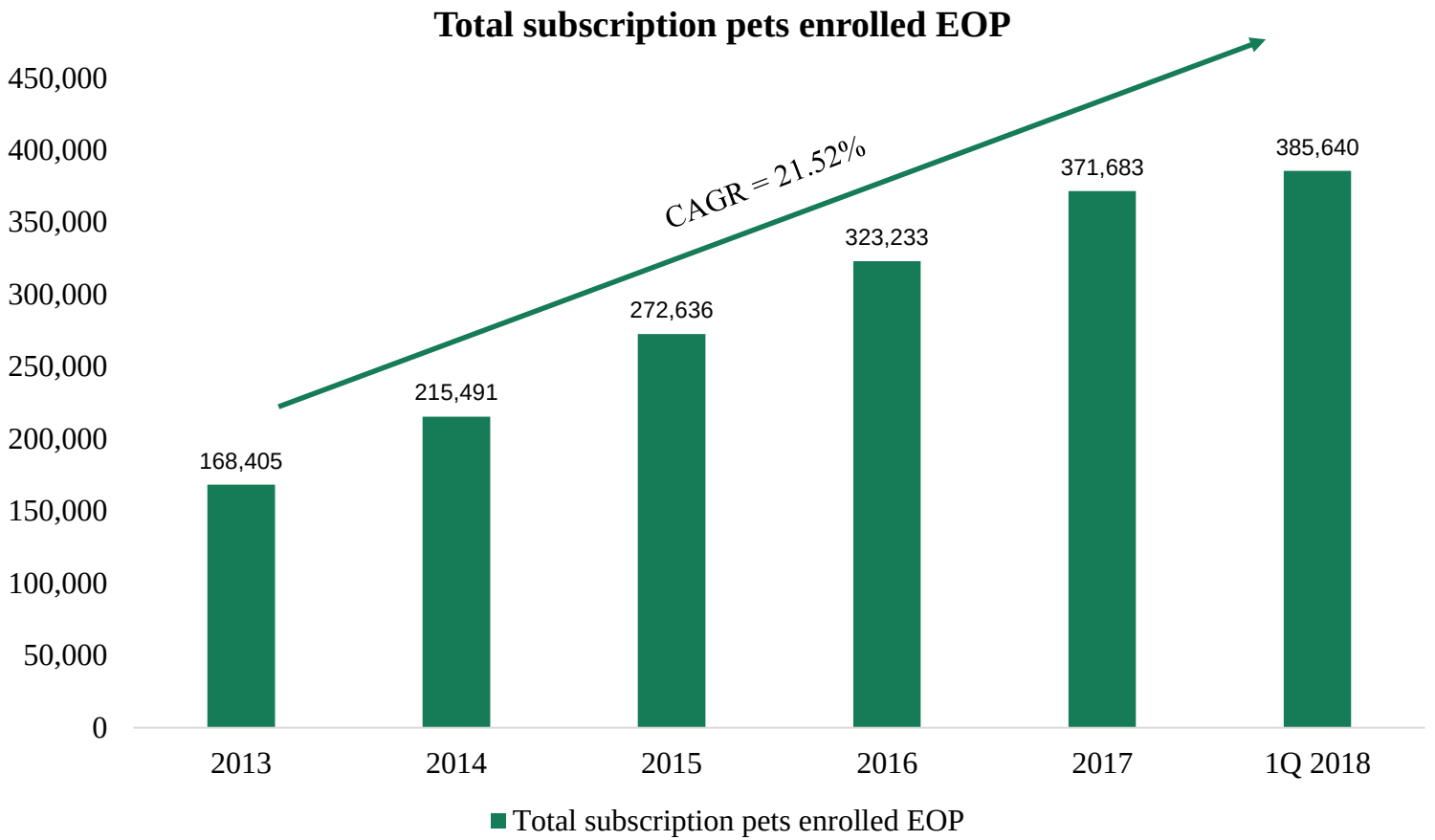
Trupanion Grew Revenue at ~32.7% CAGR Over the Past Four Years



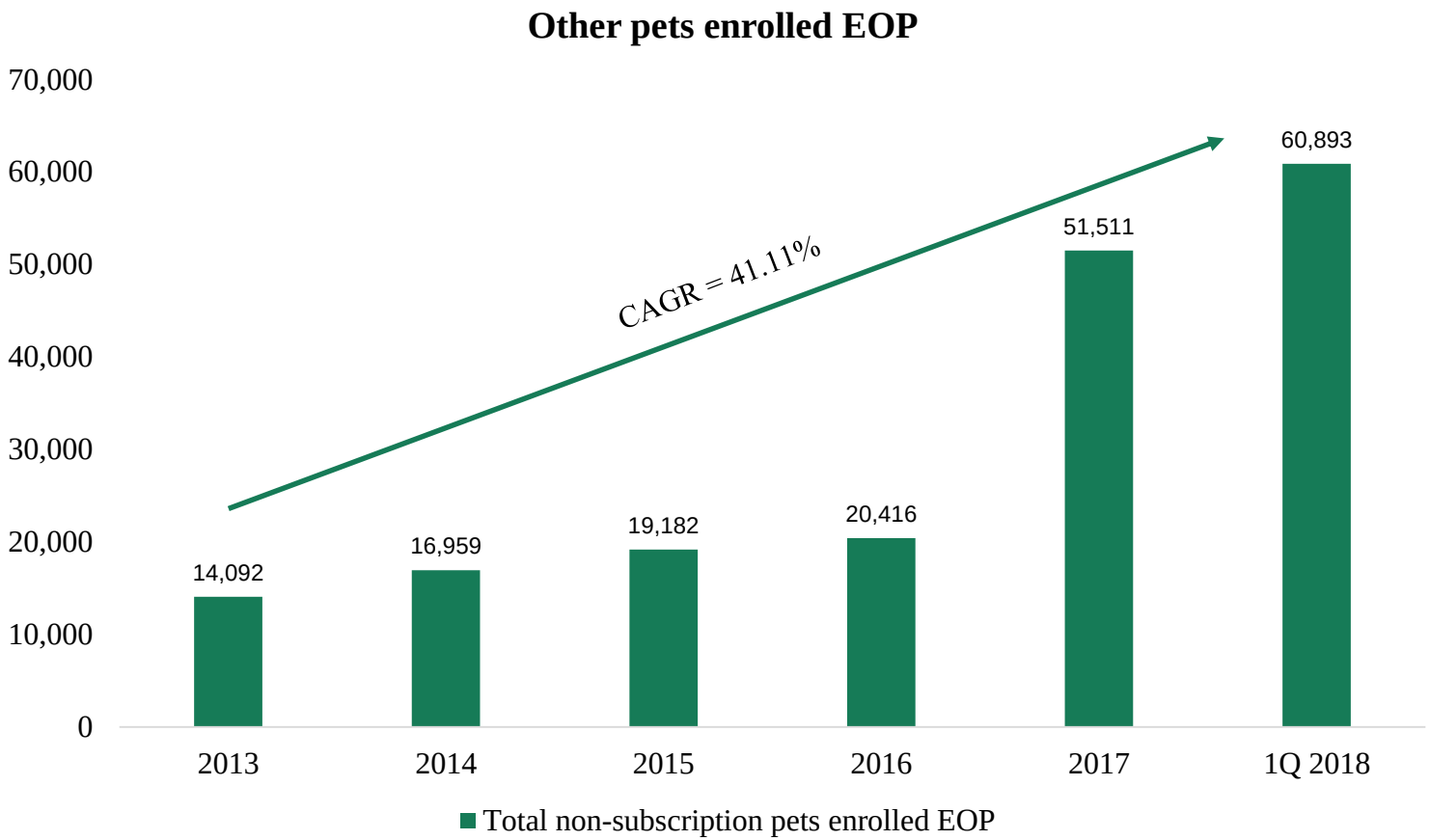
Trupanion Grew Total Pets Enrolled at ~23% CAGR Over the Past Four Years



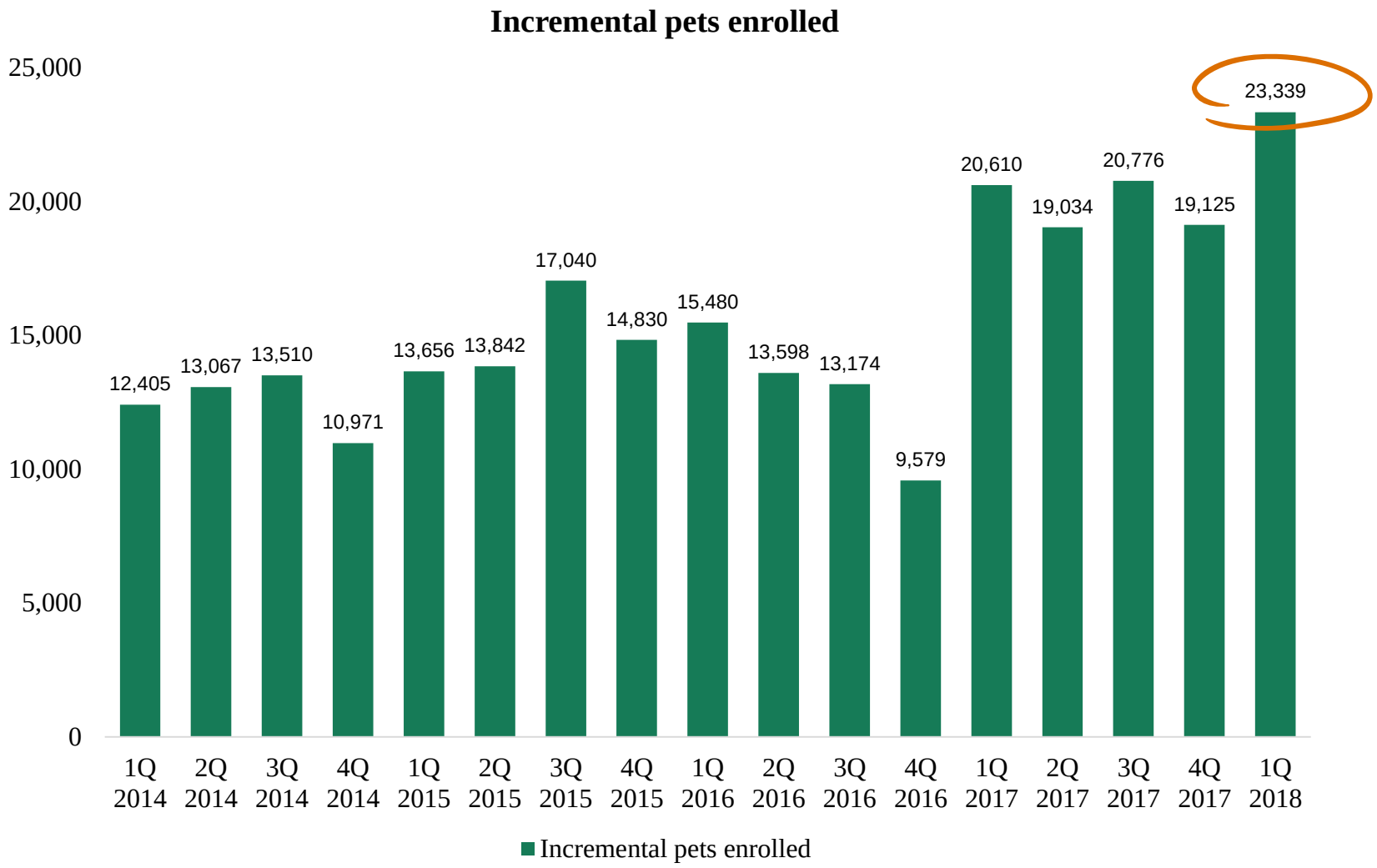
Trupanion Grew Subscription Pets Enrolled at ~21.5% CAGR Over the Past Four Years



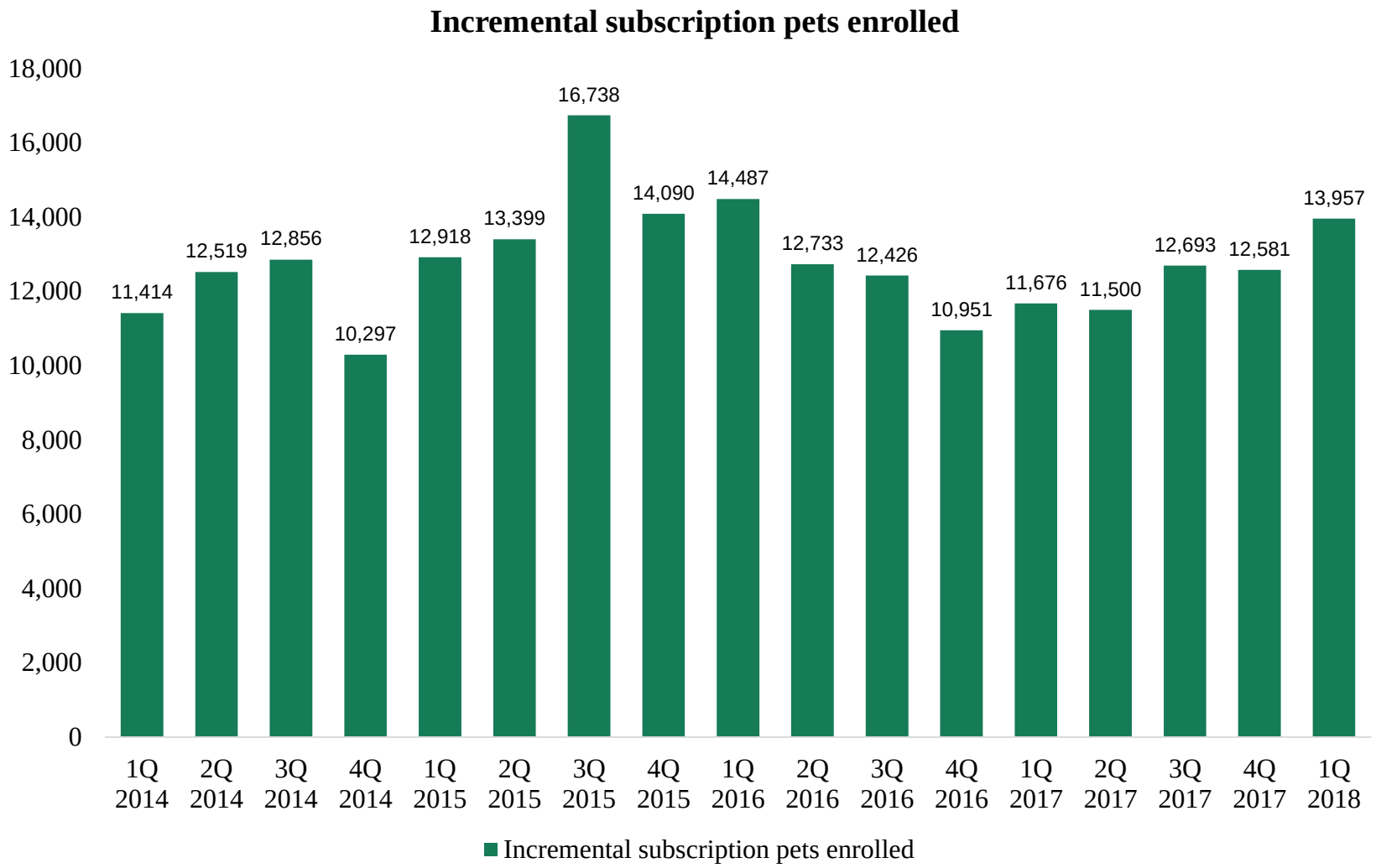
Trupanion Grew Other Pets Enrolled at ~41% CAGR Over the Past Four Years



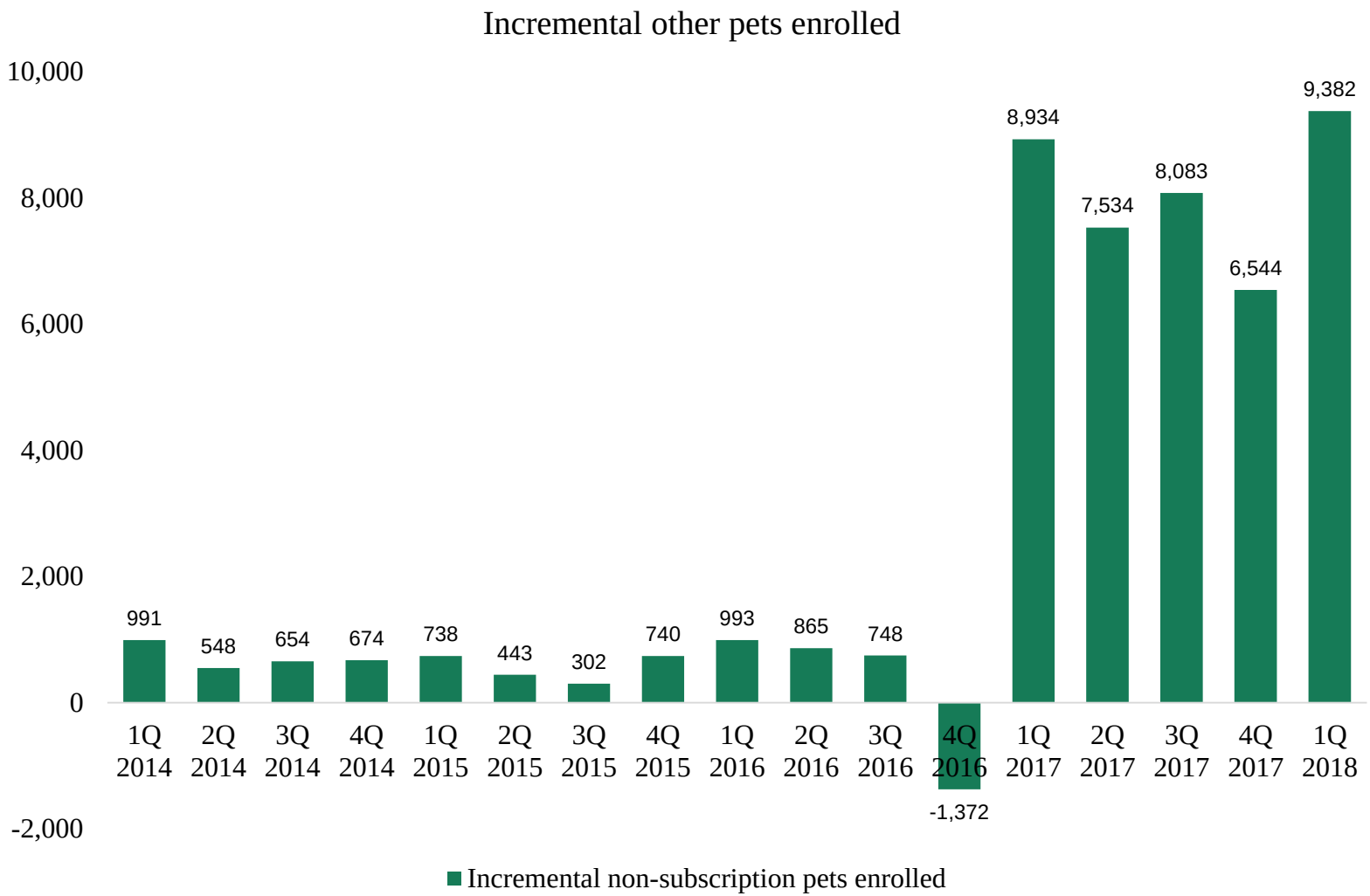
Incremental Pets Enrolled Reached Highest Level in 1Q 2018



Incremental Subscription Pets Enrolled Still Remain Below All-Time High Though It Is Moving in the Right Direction

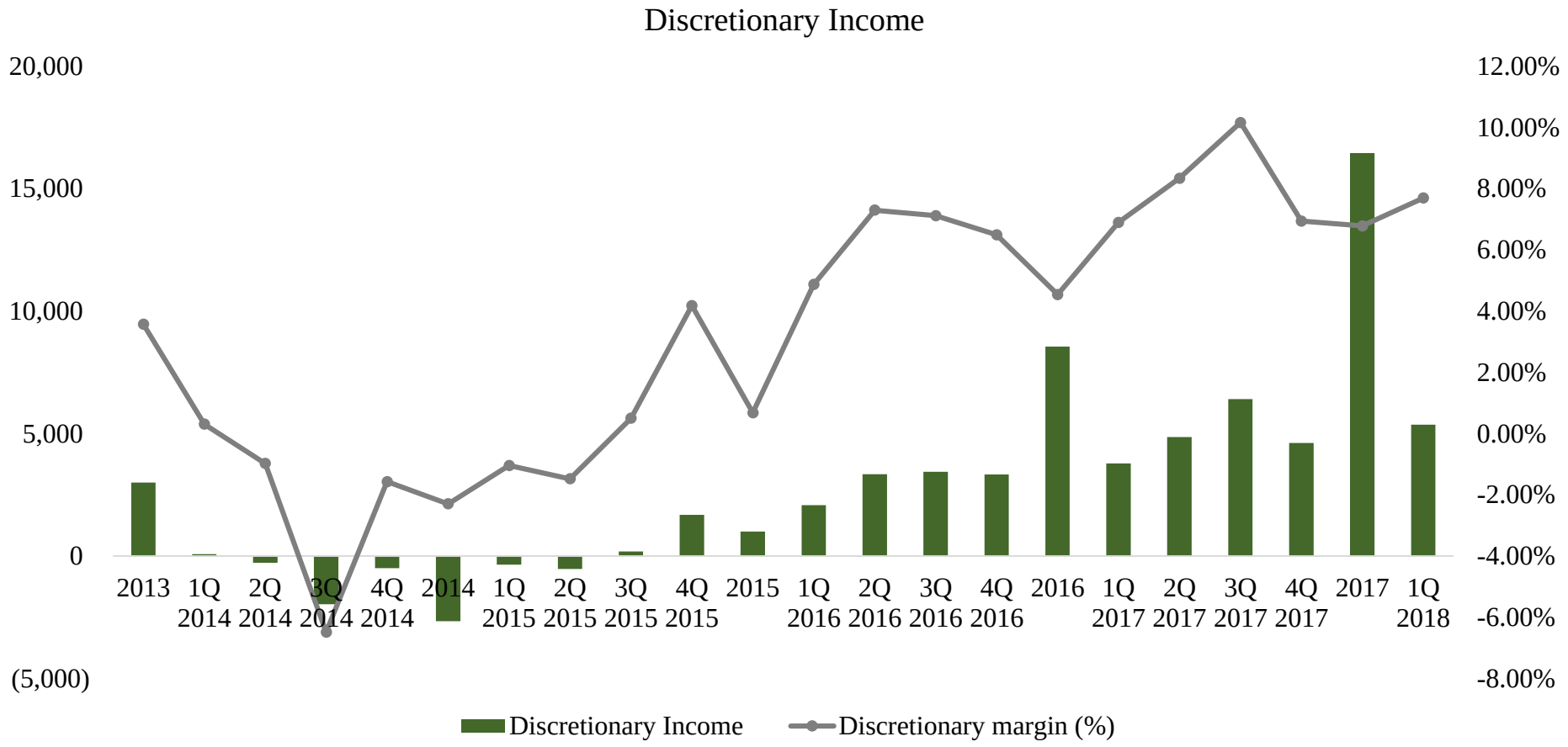


Incremental Other Pets Enrolled Went Up More Than 10X

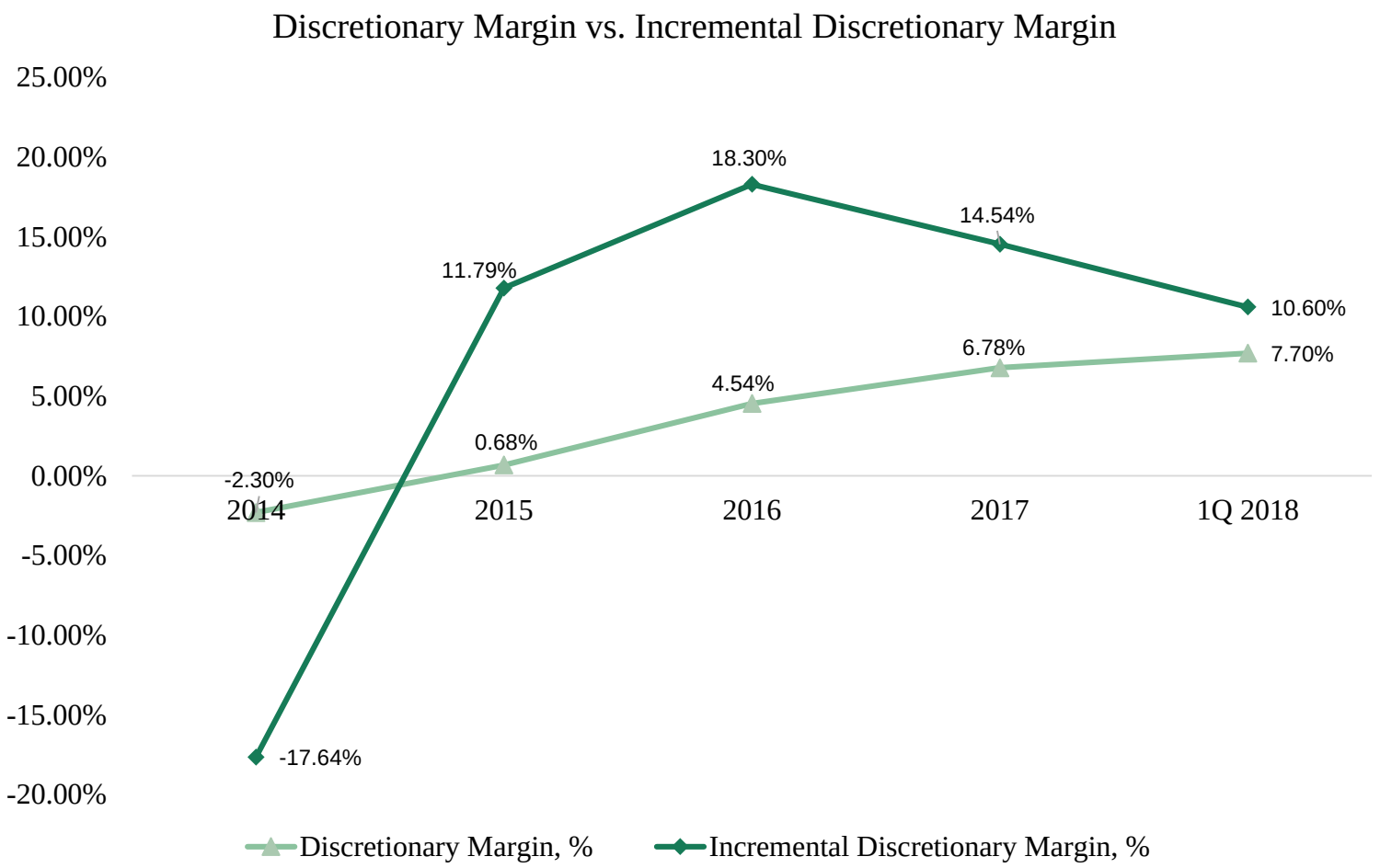


Discretionary Income: EBITDA Minus S&M

Our Approach Is More Coderivative Than Trupanion's



Discretionary Margin vs. Incremental Discretionary Margin



Trupanion Generated ~36% IRR on Its Marketing Spend in 2017

Year	0	1	2	3	4	5	6	Total
Months	6	12	12	12	12	12	7	73
Revenue	312	625	625	625	625	625	364	
AOM	$30	$60	$60	$60	$60	$60	$35	$365
Capital Charge	($3)	($5)	($5)	($5)	($5)	($5)	($3)	($31)
PAC	($151)							
FCP	($124)	$55	$55	$55	$55	$55	$32	$182
IRR	36.2%							

How Sensitive Is IRR to LVP to PAC and Discretionary Margin? Higher Operating Margin => Can Pay More to Acquire Pets

36.2%	3.00x	3.20x	3.40x	3.60x	3.80x	4.00x	4.20x	4.40x	4.60x	4.80x	5.00x
9.10%	9.5%	12.1%	14.7%	17.3%	19.8%	22.4%	24.9%	27.4%	30.0%	32.5%	35.1%
9.60%	11.8%	14.6%	17.3%	20.0%	22.7%	25.4%	28.1%	30.8%	33.5%	36.2%	38.9%
10.10%	14.2%	17.1%	20.0%	22.8%	25.7%	28.5%	31.3%	34.2%	37.1%	39.9%	42.8%
10.60%	16.5%	19.6%	22.6%	25.6%	28.6%	31.6%	34.6%	37.6%	40.6%	43.7%	46.8%
11.10%	18.9%	22.0%	25.2%	28.3%	31.5%	34.6%	37.8%	41.0%	44.2%	47.5%	50.7%
11.60%	21.2%	24.5%	27.8%	31.1%	34.4%	37.7%	41.1%	44.5%	47.9%	51.3%	54.8%
12.10%	23.5%	26.9%	30.4%	33.9%	37.3%	40.8%	44.4%	47.9%	51.5%	55.2%	58.9%
12.60%	25.8%	29.4%	33.0%	36.6%	40.3%	44.0%	47.7%	51.5%	55.3%	59.1%	63.1%
13.10%	28.1%	31.9%	35.6%	39.4%	43.3%	47.1%	51.1%	55.0%	59.1%	63.2%	67.3%
13.60%	30.4%	34.3%	38.3%	42.2%	46.3%	50.3%	54.4%	58.6%	62.9%	67.2%	71.7%
14.10%	32.7%	36.8%	40.9%	45.1%	49.3%	53.5%	57.9%	62.3%	66.8%	71.4%	76.1%
14.60%	35.0%	39.3%	43.6%	47.9%	52.3%	56.8%	61.4%	66.0%	70.8%	75.7%	80.7%
15.10%	37.3%	41.8%	46.2%	50.8%	55.4%	60.1%	64.9%	69.8%	74.9%	80.0%	85.3%

Lower LVP to PAC Will Open New Marketing and Pet Acquisition Channels

- While those channels may be cost prohibitive at the current (~9.8%) adjusted operating margin, those acquisition channels will still have a very compelling IRR.

- Let's keep in mind that the building acquisition will increase operating margins. It would likely mean that Trupanion will achieve scale at fewer than 650K – 750K enrolled pets.

Valuation at Scale

	units	#1	#2	#3
Pets enrolled	#	650,000	700,000	750,000
Years to get there	#	3	3	3
ARPP today	$	$53.6	$53.6	$53.6
ARPP annual inflation	%	5.5%	5.5%	5.5%
ARPP at Scale	$	$63.0	$63.0	$63.0
Annual revenue	mln $	$491.1	$528.9	$566.7
Adjusted operating margin	%	14.0%	14.5%	15.0%
Adjusted operating income	mln $	68.8	76.7	85.0
Multiple	#	20.0x	25.0x	30.0x
EV	mln $	$1,375	$1,917	$2,550
Excess cash today	mln $	$30	$30	$30
Cash build up	mln $	$3	$5	$7
Equity		**$1,408**	**$1,952**	**$2,587**
S/O	ths	31,187		
Dilutions from options	ths	3,171		
F/D S/O	ths	34,358		
Secondary	ths	1,818		
Over-allotment	ths	273		
F/D S/O after secondary	ths	36,449		
Annual dilution	%	2.20%		
F/D S/O at Scale	ths	38,908	38,908	38,908
Target price	$	$36.2	$50.2	$66.5
Spot price	$	$39.33	$39.33	$39.33
Upside	%	(8.0%)	27.6%	69.1%
IRR	%	(2.73%)	8.46%	19.13%

What if Trupanion Gets to Two Million Enrolled Pets …

	units	#4
Pets enrolled	#	2,000,000
Years to get there	#	10
ARPP today	$	$53.6
ARPP annual inflation	%	5.5%
ARPP at Scale	$	$91.6
Annual revenue	mln $	$2,198.2
Adjusted operating margin	%	15.0%
Adjusted operating income	mln $	329.7
Multiple	#	20.0x
EV	mln $	$6,595
Excess cash today	mln $	$30
Cash build up	mln $	$50
Equity	0	**$6,675**
S/O	ths	31,187
Dilutions from options	ths	3,171
F/D S/O	ths	34,358
Secondary	ths	1,818
Over-allotment	ths	273
F/D S/O after secondary	ths	36,449
Annual dilution	%	2.20%
F/D S/O at Scale	ths	45,310
Target price	$	$147.3
Spot price	$	$39.33
Upside	%	274.5%
IRR	%	14.12%

Can Trupanion Achieve Two Million Pets in 10 Years?

- Let's put things in perspective.
- There are ~185M – 190M pets in North America.
- At 3% penetration in 10 years there will be 5.7M insured pets.
- We view 3% penetration as *very low* and that number is likely to be higher.
- At 35% market share, Trupanion will have 2M enrolled pets.
- 35% market share is also conservative given that Trupanion already has ~15% - 20% market share and its *incremental* market share is ~40% (*i.e.*, number of new insured pets whose owners choose Trupanion).

Risks

- Execution, execution, execution.
  - ✓ Market is there.
  - ✓ Product is there.
  - ✓ Culture is there.
  - ✓ Now Trupanion needs to execute (which it has been doing for many years!).
- Capital allocation.
  - I would not have put it on the list two weeks ago.
  - However, secondary offering is alerting.
  - I still do not view capital allocation as a major risk given strong management and employee alignment with public shareholders but I will watching it more closely.

Questions and Further Inquiry

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