

Trupanion

4Q23 beat on earnings and revenues;
weaknesses in financial controls

Reiterate Rating: NEUTRAL | PO: 38.00 USD | Price: 35.28 USD

4Q23 loss of \$0.05 per share

This compared with our forecast of -\$0.13 and consensus of -\$0.16. The subscription medical loss ratio improved to 72.7% from 75.9% in 3Q23 and compared with our forecast of 74.0%. While 67k new Subscription pets (excl. Europe) was in line with our expectations, year-end Subscription pet count of 991k fell short of our 998k forecast, as persistency was modestly below our forecast. Many customers are seeing price increases in excess of 20% with monthly persistency among these customers at 98.3% as compared with 98.6% among the “high increase” cohort in 2022. Revenue growth of 16% was in line with our forecast as higher ARPU offset lower net pet growth. ARPU for the Subscription business was 6% overall and 7.5% for the flagship Trupanion product.

Material weaknesses in financial controls

The company indicated that, in preparing its 2023 Annual Report, it became aware of two material weaknesses in financial controls. One relates to “user access and program-change management over certain information technology systems,” and the second relates to financial reporting in the “Other Business” segment, which could delay the publication of its annual 10-K report. Given the high short interest in the stock (22 days to cover, according to Bloomberg), such material weakness could bolster the bear argument.

Guidance for 2024 was mostly within our expectations

Management forecasts total revenue of \$1.241bn-\$1.273bn (compared with our prior forecast of \$1.227bn and new forecast of \$1.257bn) with estimates for Subscription revenue of \$842mn-\$860mn (prior, \$847mn; new, \$853mn). The company is focused on restoring margins in the flagship business while the Other business has begun to shed net customers in accordance with the recalibration of the Pets Best relationship during 2023. Additionally, management expects to end 2024 with its target 15% operating margin in the Subscription business, which we are confident will be achieved with 26% price increases currently flowing through the book (against a 15% loss cost trend) and the potential for further rate filings. We believe the adj. operating income outlook of \$100-\$120mn errs conservatively given the margin improvement; we forecast \$133mn, down from \$140mn previously, persuaded some by management’s guidance. We adjust our 2024-2026 estimates.

Price objective remains \$38; maintain Neutral

Our PO is based on a sum of parts between the value of future and legacy pets' earnings at a normalized level of lifetime value of pet likely to be realized in 2025. Despite upside to our price objective, we await more clarity following completion of the 2023 audit given the two material weaknesses disclosed. Reiterate Neutral.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	(1.10)	(1.08)	(0.19)	0.58	0.74
EPS Change (YoY)	23.6%	-1.8%	-82.4%	-405.3%	27.6%
Consensus EPS (Bloomberg)			(0.02)	NA	NA
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	NM	NM	NM	60.8x	47.7x

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15 February 2024

Equity

Key Changes

(US\$)	Previous	Current
2024E EPS	-0.02	-0.19
2025E EPS	0.36	0.58
2026E EPS	0.55	0.74

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Stock Data

Price	35.28 USD
Price Objective	38.00 USD
Date Established	2-Nov-2023
Investment Opinion	C-2-9
52-Week Range	18.45 USD - 63.07 USD
Mrkt Val (mn) / Shares Out (mn)	1,466 USD / 41.5
Free Float	77.3%
Average Daily Value (mn)	20.69 USD
BofA Ticker / Exchange	TRUP / NAS
Bloomberg / Reuters	TRUP US / TRUP.OQ
ROE (2024E)	0%
Net Dbt to Eqty (Dec-2023A)	NA
ESGMeter™	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to “BofA ESGMeter Methodology”.

iQprofileSM Trupanion

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premiums	905	1,109	1,257	1,362	1,474
Net Investment Income	NA	NA	NA	NA	NA
Total Revenue	905	1,108	1,257	1,362	1,474
Total Cost of Benefits and Claims	(783)	(978)	(1,071)	(1,127)	(1,218)
S,G & A (Including Commissions)	(129)	(138)	(151)	(166)	(181)
Total Operating Expenses	(952)	(1,161)	(1,272)	(1,339)	(1,429)
Pre-Tax Operating Earnings	(47)	(53)	(16)	23	45
Income Tax Expense	0	0	(1)	(7)	(9)
Operating Earnings After Tax	(46)	(46)	(8)	25	32
Net Income (Reported)	(45)	(45)	(8)	25	45
Diluted Shares	42	43	42	43	44
Operating Earnings Per Share	(1.10)	(1.08)	(0.19)	0.58	0.74
Net Income (Reported) Per Share	(1.10)	(1.08)	(0.19)	0.58	0.74

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Fixed Income Securities	NA	NA	NA	NA	NA
Total Cash and Investments	222	277	370	417	471
Total Assets	672	783	775	800	832
Reserves	NA	NA	NA	NA	NA
LT Debt	69	129	0	0	0
Total Liabilities	366	479	479	479	479
Total Equity	305	304	296	321	353
Total Equity (Ex FAS 115)	305	304	296	321	353
Book Value per Share (Reported)	NA	NA	NA	NA	NA
Book Value per Share (Ex FAS 115)	NA	NA	NA	NA	NA

Ratios (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Expense Ratio	14.2%	12.4%	12.0%	12.2%	12.3%
Loss Ratio	0%	0%	0%	0%	0%
Combined Ratio	14.2%	12.4%	12.0%	12.2%	12.3%
Avg Assets / Avg Eq (Ex FAS 115) Ratio	1.9x	2.4x	2.6x	2.6x	2.4x

Growth Rates (YoY) (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premium	29.5%	22.5%	13.3%	8.4%	8.2%
Net Investment Income	NM	NM	NM	NM	NM
Total Revenue	29.5%	22.5%	13.4%	8.4%	8.2%
Operating Earnings per Share	23.6%	-1.8%	-82.4%	-405.3%	27.6%
Asset	19.4%	16.6%	-1.0%	3.2%	4.0%
Reported Book Value per Share	NM	NM	NM	NM	NM

Performance Metrics (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Operating ROE	NA	NA	NA	NA	NA
Operating ROE (Ex FAS 115)	NA	NA	NA	NA	NA
Operating Return on Average Assets	NM	NM	NM	3.2%	4.0%
Operating Margin	-5.1%	-4.2%	-0.6%	1.8%	2.2%
Long Term Debt to Cap Ratio (Ex FAS 115)	18.5%	29.8%	0%	0%	0%
Net Income % Operating Income	96.1%	96.4%	98.4%	99.5%	140.1%
Amtz of DAC % Pretax Profit bef Amtz of DAC	0%	0%	0%	0%	0%

Company Sector

Insurance - Non-Life

Company Description

Trupanion is a premier pet insurance provider based in Seattle, offering health insurance for cats and dogs in the United States, Canada, Puerto Rico, and Australia. The company operates in two business segments: 1) subscription business related to Trupanion-branded products and 2) "other" business comprised of writing policies on behalf of 3rd parties and various other offerings.

Investment Rationale

Trupanion continues to be viewed as an industry leader, offering a superior value proposition with multiple growth levers and an underpenetrated/growing total addressable market (TAM) within the pet insurance industry. We estimate new pet count growing at 20-25% CAGR vs. S&P 500 growing earnings at 10% CAGR. We believe the current valuation reflects an opportunity to invest in a robust and profitable growth outlook with multi-year high double-digit revenue growth expected.

Stock Data

Average Daily Volume 586,335

Quarterly Earnings Estimates

	2023	2024
Q1	-0.60A	-0.19E
Q2	-0.33A	-0.09E
Q3	-0.10A	0.01E
Q4	-0.05A	0.08E

Price objective basis & risk

Trupanion (TRUP)

Our \$38 price objective is based on summing the value of future and legacy pets' earnings. Legacy business is valued at 1x the runoff discounted cash flow (DCF) valuation of the current economics. Future value is based on putting a multiple on the long-term value added by next year's new pets and putting a multiple on that. We value the Trupanion businesses at a 8x 2024 P/E multiple. The Pets Best business, which will be in a form of run-off, we value at 3x. The non-subscription businesses (Pets best/other) make up less than \$100mn of the equity valuation. We believe the subscription business could trade at a premium-to-market multiple given its higher revenue growth rate, currently 20% in 2023-2024 in our model. However, inflationary pressures on the unit economics currently suggest that future earnings are less predictable, auguring for a discount.

Downside risks to our PO are 1) the company misses on execution of its five-year growth plan, 2) the revenue growth rate deteriorates to at-or-below that of the broader pet insurance market, 3) pet owners show higher price sensitivity to Trupanion's high-ticket product vs cheaper competitor products and 4) Trupanion fails to improve penetration rates in current markets. Upside risks recognize the very high retail short interest in the stock where a low bar where favorable news could have an outsized impact. Two current inquiries into weakness in controls can weigh on the stock.

Analyst Certification

I, Joshua Shanker, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Aflac	AFL	AFL US	Joshua Shanker
	Allstate Corp.	ALL	ALL US	Joshua Shanker
	American International Group	AIG	AIG US	Joshua Shanker
	Arch Capital	ACGL	ACGL US	Joshua Shanker
	Assurant	AIZ	AIZ US	Grace Carter, CFA
	Axis Capital	AXS	AXS US	Joshua Shanker
	BRP Group, Inc.	BRP	BRP US	Joshua Shanker
	Cincinnati Financial Corporation	CINF	CINF US	Grace Carter, CFA
	Corebridge Financial	CRBG	CRBG US	Joshua Shanker
	Everest Group Ltd	EG	EG US	Joshua Shanker
	Intact Financial	YIFC	IFC CN	Grace Carter, CFA
	Intact Financial	IFCZF	IFCZF US	Grace Carter, CFA
	MetLife	MET	MET US	Joshua Shanker
	Progressive	PGR	PGR US	Joshua Shanker
	RenaissanceRe	RNR	RNR US	Joshua Shanker
	The Hartford	HIG	HIG US	Joshua Shanker
	Voya	VOYA	VOYA US	Joshua Shanker
	W.R. Berkley	WRB	WRB US	Joshua Shanker
NEUTRAL				
	Aon	AON	AON US	Joshua Shanker
	Brown & Brown	BRO	BRO US	Grace Carter, CFA



US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Lincoln National	LNC	LNC US	Joshua Shanker
	Marsh McLennan	MMC	MMC US	Joshua Shanker
	Principal Financial Group	PFG	PFG US	Joshua Shanker
	Prudential Financial	PRU	PRU US	Joshua Shanker
	The Hanover	THG	THG US	Grace Carter, CFA
	Trupanion	TRUP	TRUP US	Joshua Shanker
	Unum	UNM	UNM US	Joshua Shanker

UNDERPERFORM

	Arthur J. Gallagher & Co.	AJG	AJG US	Joshua Shanker
	Chubb Ltd	CB	CB US	Joshua Shanker
	CNA Financial	CNA	CNA US	Joshua Shanker
	Goosehead Insurance Inc.	GSHD	GSHD US	Joshua Shanker
	Selective	SIGI	SIGI US	Grace Carter, CFA
	Travelers Cos	TRV	TRV US	Joshua Shanker
	Willis Towers Watson	WTW	WTW US	Joshua Shanker

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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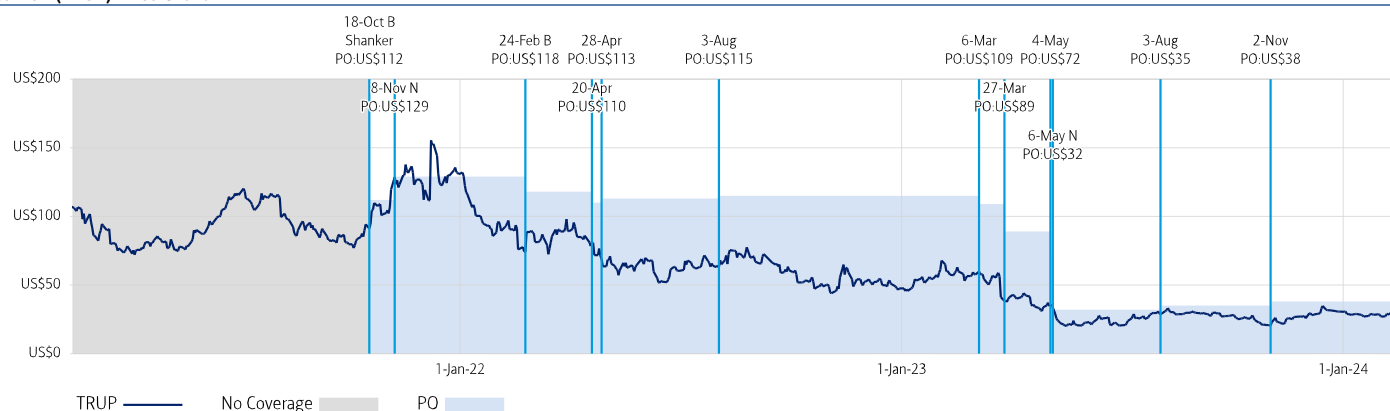
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Trupanion (TRUP) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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