

Q2 Holdings, Inc. NYSE:QTWO

FQ2 2025 Earnings Call Transcripts

Wednesday, July 30, 2025 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2025-			-FQ3 2025-	-FY 2025-	-FY 2026-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.53	0.52	▼ (1.89 %)	0.55	2.21	NA
Revenue (mm)	193.71	195.15	▲ 0.74	194.85	782.52	NA

Currency: USD
Consensus as of Jul-30-2025 10:23 PM GMT

Unable to generate Chart: Unable to get data to chart

- EPS NORMALIZED -			
	CONSENSUS	ACTUAL	SURPRISE
FQ3 2024	0.36	0.44	▲ 1 22.22 %
FQ4 2024	0.47	0.48	▲ 2 2.13 %
FQ1 2025	0.48	0.50	▲ 3 4.17 %
FQ2 2025	0.53	0.52	▼ 4 (1.89 %)

Table of Contents

Call Participants	3
Presentation	4
Question and Answer	8

Call Participants

EXECUTIVES

Jonathan A. Price
CFO and Executive VP of Strategy & Emerging Businesses

Josh Yankovich
Investor Contact

Kirk L. Coleman
President

Matthew P. Flake
CEO & Chairman of the Board

ANALYSTS

Alexander James Sklar
Raymond James & Associates, Inc., Research Division

Terrell Frederick Tillman
Truist Securities, Inc., Research Division

Cristopher David Kennedy
William Blair & Company L.L.C., Research Division

Unknown Analyst

Daniel Rock Perlin
RBC Capital Markets, Research Division

Eleanor Osgoode Smith
JPMorgan Chase & Co, Research Division

Jeffrey Parker Lane
Stifel, Nicolaus & Company, Incorporated, Research Division

Matthew David VanVliet
Cantor Fitzgerald & Co., Research Division

Michael Nicholas Infante
Morgan Stanley, Research Division

Presentation

Operator

Good afternoon. My name is Tina, and I will be your conference operator today. At this time, I would like to welcome everyone to the Q2 Holdings Second Quarter 2025 Financial Results Conference Call.

[Operator Instructions]

I would now like to turn the conference over to Josh Yankovich, Investor Relations. Sir, please go ahead.

Josh Yankovich *Investor Contact*

Thank you, operator. Good afternoon, everyone, and thank you for joining us for our second quarter 2025 conference call. With me on the call today are Matt Flake, our CEO; Jonathan Price, our CFO; and Kirk Coleman, our President, who will join us for the Q&A portion of the call.

This call contains forward-looking statements that are subject to significant risks and uncertainties, including, among other things, with respect to our expectations for the future operating and financial performance of Q2 Holdings and for the financial services industry. Actual results may differ materially from those contemplated by these forward-looking statements, and we can give no assurance that such expectations or any of our forward-looking statements will prove to be correct.

Important factors that could cause actual results to differ materially from those reflected in the forward-looking statements are included in our periodic reports filed with the SEC, copies of which may be found on the Investor Relations section of our website, including our quarterly report on Form 10-Q for the second quarter of 2025 and the press release distributed this afternoon and filed in our Form 8-K with the SEC regarding the financial results we will discuss today.

Forward-looking statements that we make on this call are based on assumptions only as of the date discussed. Investors should not assume that these statements will remain operative at a later time, and we undertake no obligation to update any such forward-looking statements discussed in this call. Also, unless otherwise stated, all financial measures discussed on this call other than revenue will be on a non-GAAP basis. A discussion of why we use non-GAAP financial measures and a reconciliation of the non-GAAP measures to the most comparable GAAP measures is included in our press release, which is available on the Investor Relations section of our website and in our Form 8-K filed today with the SEC. We have also published additional materials related to today's results on our Investor Relations website. Let me now turn the call over to Matt.

Matthew P. Flake *CEO & Chairman of the Board*

Thanks, Josh. Good afternoon, everyone, and thanks for joining us. I'll start today's call by sharing our second quarter results and highlights from across the business. Then I'll hand it off to Jonathan to share more detail on our financial performance and updated outlook before providing final thoughts.

We delivered strong financial results in the second quarter, building on the momentum we established in Q1 and continuing our execution against the priorities we outlined at the start of the year. We generated revenue of \$195 million and adjusted EBITDA of \$46 million, both coming in above the high end of our guidance. Revenue grew 13% year-over-year.

Our adjusted EBITDA margin reached 23.5%, and we generated free cash flow of \$42 million. These results are a reflection of our execution across the business and the demand for the mission-critical solutions we deliver to financial institutions of all sizes. Our bookings in the quarter were highlighted by 6 Tier 1 wins through a mix of net new and expansion deals, further expanding our footprint among some of the largest institutions in the market.

We complemented that with success in the Tier 2 and 3 segments as well, which represented a meaningful portion of our bookings performance. We also had notable M&A activity amongst our customers in the quarter. We had 2 scenarios where an existing customer acquired another financial institution, each resulting in incremental bookings that carried the equivalent of a Tier 1 size deal. In one case, the newly combined entity will be a top 100 U.S. bank and will expand the use of our digital banking platform and relationship pricing solutions across the bank.

In the other, a commercial institution opted to retain our relationship pricing solutions and expanded their use across the newly combined entity. Because our platform is already fully trained on the bank's policies and commercial customer base, the bank saw it as a way to provide consistent pricing across their merged teams and to help their new commercial relationship managers rapidly become productive. As we've said in the past, we have tended to be the beneficiary of M&A among our customer base, and these deals underscore that dynamic. We believe expansion through M&A is a compelling potential differentiator for us as customers in these scenarios have frequently continued to choose our technology to help them integrate smoothly, operate more efficiently and scale post-acquisition.

We also saw solid bookings results for our risk and fraud solutions, which continue to be our top cross-sold products and represented one of our Tier 1 expansion wins from the quarter. A sign of the growing strategic importance and scale of these fraud-related deals and as FraudTech has seen an explosion of point solutions in recent years, Innovation Studio is increasingly becoming a key differentiator in this space, not only by complementing our existing risk and fraud solutions, but also by allowing our customers to easily access, deploy and manage many other best-in-class solutions from the broader fraud tech vendor ecosystem.

In the second quarter, we also hosted our annual customer conference, Connect, and the energy among the attendees was strong. The big takeaway this year was that financial institutions remain deeply focused on strategic digital initiatives, and there are several key areas where we're seeing investment and engagement accelerate, many of which were front and center at Connect.

First, the level of focus on risk and fraud is very high. While the pace of change in the fraud landscape is increasing, and as I touched on a moment ago, new fraud technology vendors are emerging rapidly to solve many individual pain points across the bank, which is an increasingly complex challenge for our customers to manage from a technology and vendor management perspective. We believe Q2 has differentiated ability to help our customers manage the growing fraud challenge more holistically. The power of our platform is that we have visibility into account holder data across the entire customer life cycle in both retail and commercial context.

And because we manage the workflows, we also have the ability to intervene and stop fraud in real time, in many cases, something many point solution providers are not able to do holistically. We are also using the Innovation Studio ecosystem to give customers access to best-in-class fraud solutions across a range of complementary use cases and integrate them seamlessly into their digital banking platform. This gives our financial institutions a single pane of glass to manage their fraud tech capabilities and address the fraud vendor management challenge in a more holistic, integrated and cost-effective way.

Finally, we're continuing to drive AI innovation across our product portfolio, and we believe fraud is one of the areas with the greatest near-term potential for further enhancement. For example, at Connect, we shared a recent innovation called Enhanced Payee Match, which uses artificial intelligence to detect and prevent check fraud more accurately and efficiently. We continue to see check and ACH fraud grow as a percentage of fraud attacks in the financial industry, making it a major focus area for our customers and protecting their commercial banking relationship.

And based on feedback we received at Connect, I believe our customers are glad to see us driving innovation with AI to deliver even stronger fraud capabilities. Another theme from Connect was the continued demand for commercial innovation and not just with established commercial banks, but across our customer base. What's resonating with customers is our ability to deliver retail, small business and commercial functionality from a single platform, enabling them to scale their capabilities over time without complex conversions or migrations. We also continue to invest in solutions that help our customers compete upmarket for larger and more sophisticated corporate clients.

At Connect, we announced a new direct ERP integration product that allows institutions to embed Q2 digital banking functionality directly into their customers' ERP systems, placing Q2 at the center of commercial reconciliation workflows. This product is designed to improve automation, enhance security and reduce reconciliation errors while helping institutions compete for and retain large corporate customers. It's a natural evolution of our existing commercial offerings and has been very well received by early customers.

And finally, Innovation Studio was central to the conversations at Connect as it continues to be a cornerstone of our platform and a driver of measurable impact for our customers. During the conference, our customers shared a range of outcomes they are delivering through Innovation Studio across some of their most pressing and strategic initiatives. For example, one customer reduced account takeover fraud by 50% year-over-year by implementing an authentication partner.

Another customer is using a combination of several partners to grow deposits, citing a material increase in new deposits in just 1 month from a personalized CD campaign. And customers are using it to drive operational efficiencies with one financial institution deflecting 65% or more of support traffic using AI-powered chat and messaging.

Today, over 85% of our digital banking customers utilize Innovation Studio in some capacity, and we're continuing to see this adoption grow, both in volume and strategic importance. In an environment where efficiency, growth and differentiation matter more than ever, Innovation Studio continues to help our customers do more with what they have and do it faster than ever before.

As we look to the second half of the year, our pipeline remains solid and our outlook is positive. Even with our performance to date, we expect the majority of enterprise and Tier 1 activity for the year to land in the back half of 2025. We remain confident with the financial framework we shared at the beginning of the year, and Jonathan will speak to our updated full year guidance and increased outlook for 2025 in just a moment. With that, I'll turn it over to Jonathan to walk through our financials in more detail.

Josh Yankovich
Investor Contact

Thanks, Matt. Our second quarter results demonstrate continued strong execution across several key metrics, including revenue and adjusted EBITDA, both of which exceeded the high end of our previously issued guidance. These results underscore the continued progress with our profitable growth strategy, reinforced by another quarter of bookings execution and record free cash flow generation.

I will now discuss our financial results in more detail and conclude with our guidance for the third quarter and full year 2025. Total revenue for the second quarter was \$195.1 million, an increase of 13% year-over-year and up 3% sequentially. Our revenue growth was primarily driven by subscription-based revenues, which grew 16% year-over-year and 3% sequentially and ended the quarter at 81% of total revenue.

The year-over-year and sequential revenue growth was primarily driven by a combination of new customer go-lives and expansion with existing customers. Our services and other revenues increased 1% year-over-year, reflecting a modest improvement compared to the prior quarter's year-over-year trends. This growth is being driven by higher professional services revenues tied to core conversions, M&A activity and other implementation-related engagements. These increases helped offset ongoing declines in more discretionary professional service offerings, which remain under pressure.

Looking ahead, we expect total services and other revenue to be roughly flat year-over-year for full year 2025. In the first half, services revenues were down approximately 3% year-over-year, a trend we expect to continue into 2026. The second half will benefit from an easier comp as we lap the impact from First Republic Bank, which will increase year-over-year services revenue growth in the next quarter.

Total annualized recurring revenue or total ARR grew to \$861 million, up 10% year-over-year from \$783 million at the end of the second quarter of 2024, driven by strength in our subscription ARR, which grew to \$716 million, up 13% year-over-year from \$634 million in the prior year period.

Total ARR growth was fueled by subscription-based bookings from both new and existing customers, partially offset by declines in discretionary services-based revenue. Our subscription ARR growth was pressured by higher-than-typical churn concentrated within the second quarter. Even with that concentration, full year churn expectations remain in line with our original assumptions with lower churn levels anticipated in the back half of the year.

Our ending backlog of approximately \$2.4 billion increased by \$61 million sequentially or 3% and \$403 million year-over-year, representing 21% growth. The year-over-year and sequential increases were primarily driven by expansion with existing customers and was broad-based across market segments. We saw continued success in the Tier 2 and 3 segments, which represented a meaningful portion of our bookings performance for the quarter.

As we have mentioned previously, the sequential change in backlog may fluctuate quarter-to-quarter based on the number of renewal opportunities available within that quarter. Gross margin was 57.5% for the second quarter, up from 55.7% in the prior year period and slightly below the 57.9% we saw in the previous quarter.

The year-over-year increase in gross margin was driven by an increasing mix of higher-margin subscription-based revenues. The sequential decline in gross margin was driven by increased costs, including costs related to our cloud migration, which we continue to expect to be complete by early 2026. As the transition progresses through the rest of the year, we expect the gross margin to be roughly flat in 3Q with sequential expansion in the fourth quarter. And we now expect full year gross margin expansion of at least 200 basis points, up from our prior outlook of 150 basis points.

Total operating expenses for the second quarter were \$75 million or 38.2% of revenue compared to \$74 million or 42.7% of revenue in the prior year quarter and \$77 million or 40.7% of revenue in the first quarter. The year-over-year and sequential improvement in

operating expenses as a percent of revenue was driven by increased scaling across all operating expense categories, with G&A and sales and marketing showing the biggest year-over-year improvements.

As a percentage of revenue, G&A showed the largest sequential improvement in the quarter, benefiting from lower payroll taxes tied to annual vesting and bonus payouts concentrated in the first quarter, which positively impacted all expense categories.

Total adjusted EBITDA was a record \$45.8 million, up 53% from \$29.9 million in the prior year period and up 12% from \$40.7 million in the previous quarter. We ended the second quarter with cash, cash equivalents and investments of \$532 million, up from \$486 million at the end of the previous quarter. In the second quarter, free cash flow was once again strong, benefiting from timing-related collection activity, including a material cash payment that is now expected to land in the third quarter.

We generated \$49 million in cash flow from operations, driven by improved profitability and continued effective working capital management and delivered \$42 million in free cash flow. As a result of the timing shift, we expect third quarter free cash flow to moderate relative to the second quarter. That said, we continue to expect second half free cash flow to slightly exceed the first half with a more balanced distribution than in prior years.

As usual, we anticipate the fourth quarter will be our strongest free cash flow quarter, consistent with typical seasonality. And based on our performance to date and expected second half strength, we are raising our full year free cash flow conversion outlook from 85% to 90%. We are also lifting our full year free cash flow conversion expectations to 90% for 2026 as well.

Let me wrap up by sharing our third quarter and updated full year 2025 guidance. We forecast third quarter revenue in the range of \$196 million to \$200 million, and we are raising our full year revenue to the range of \$783 million to \$788 million, representing year-over-year growth of 12% to 13% for the full year. In addition, we anticipate full year 2025 subscription revenue growth of at least 16%, an increase from the 15.5% outlook we previously communicated. We forecast third quarter adjusted EBITDA of \$44 million to \$47 million and are raising our full year 2025 adjusted EBITDA guidance to \$177 million to \$181 million, representing 23% of revenue for the full year.

In summary, we delivered a strong financial performance, which exceeded the high end of our previously issued guidance. This performance, coupled with our outlook for the remainder of the year, has given us the confidence to raise our full year guidance on both revenue and adjusted EBITDA and increase our full year outlook for subscription revenue growth and free cash flow conversion.

We remain dedicated to delivering growth, profitability expansion and improved capital efficiency and believe that our results to date collectively illustrate our progress and potential as we continue to evolve the business and drive shareholder value. With that, I'll turn the call back over to Matt for his closing remarks.

Matthew P. Flake
CEO & Chairman of the Board

Thanks, Jonathan. Before we open it up for questions, I'll close with a few final thoughts. We delivered a solid first half of the year with strong financial results and key wins across the business. Connect, our client conference during the second quarter, underscored that our customers are more committed to digital transformation and investments than ever before. And they're entrusting Q2 to help drive the next wave of innovation across key areas like fraud, AI, commercial growth and profitability and platform extensibility through Innovation Studio.

As we look to the second half of 2025 and beyond, we remain focused on disciplined execution, capitalizing on the market demand and expansion opportunities, delivering operational excellence and helping our customers address their most important strategic initiatives. Thank you. And with that, I'll hand it over to the operator for questions.

Question and Answer

Operator

[Operator Instructions]

Your first question comes from the line of Alex Sklar with Raymond James.

Alexander James Sklar

Raymond James & Associates, Inc., Research Division

Matt or Kirk, in the prepared remarks kind of struck a more positive tone on the demand environment. We've seen bank earnings be a little bit stronger this quarter and the deregulatory agenda seems like it's progressing. Are you seeing any of that kind of show up in your own pipeline growth or new opportunities relative to the last couple of quarters?

Matthew P. Flake

CEO & Chairman of the Board

Yes, Alex, thanks for the question. The pipeline is strong, and I think it's -- the fact that those things are coming through, I think they anticipated it. So I haven't seen a big lift, but I'm happy with where the pipeline is. Hopefully, it brings decisions quicker and gives them more confidence in the future. And so that usually drives more deals for us. But I haven't seen a big lift in the pipeline, but the pipeline has been healthy for quite a while. So that's how I think about it.

Alexander James Sklar

Raymond James & Associates, Inc., Research Division

Okay. And then maybe just in terms of the enterprise activity you referenced, Matt, you kind of called out stronger second half expectations. What are you seeing from that segment of the market exactly? And just remind us how incremental would enterprise activity this year be versus what you saw in 2024?

Matthew P. Flake

CEO & Chairman of the Board

Well, as we talked about, you kind of -- those deals take a while to build them up in the pipeline, you work them, the decisions usually come slower. So we had a strong finish to the year last year in the pipe and the sales teams are out working those deals. So what's happening, they're evolving. We're going through all the processes you've got to go through.

It's a significantly more exhaustive diligence process. And so we see the engagement. And so we feel good about the number of opportunities. And we talked about that at the beginning of the year, it's going to mix more to larger deals in the back half. So now the team has got to go out and close them, and that's what we're focused on right now, but feel good about it incrementally, Adam.

Josh Yankovich

Investor Contact

Yes. I would just -- I would add, it's Jonathan, Alex. From a mix in '24, you saw a much heavier than I would say, typical mix historically of Tier 2 and 3 deals. And as we look at 2025, Matt said at the beginning of the year and would reiterate here in the second half that it's a much more normal mix where you have more of the Tier 1 enterprise level deals. And those within '25 were concentrated in the back half of the year, if that makes sense.

Operator

Your next question comes from the line of Adam Hotchkiss with Goldman Sachs.

Unknown Analyst

This is Grayson Skob on for Adam Hotchkiss at Goldman. You talked a little bit about the risk and fraud opportunity and that being the #1 cross-sold product within the base. I was wondering if you could sort of quantify the penetration there just on those specific products within the existing base?

Josh Yankovich

Investor Contact

I guess what I'd say there is we have -- when it comes to the Centrix portfolio, and that's a product we've owned since 2015 when we did that acquisition, we have hundreds of stand-alone clients for that portfolio. And then we have a meaningful component of our digital banking customer base that also has Centrix products, along with our other risk and fraud solutions that are native to the digital banking platform as well as our Innovation Studio partners.

So depending on how you slice it, penetration is tough to quantify. I think what we're saying is it is a pain point that is top of mind for all financial institutions right now, and we're helping them solve that pain point through products that are native to the digital banking platform when it comes to real-time fraud prevention, products that are part of the Centrix portfolio that we've been distributing and developing for many years since 2015 and now an Innovation Studio, ecosystem of fraud partners that we're also selling into them and helping them address those challenges. So really strong penetration in terms of individual FIs having one or more of those, but lots of opportunity to continue to sell additional fraud products into all of our customers.

Unknown Analyst

Got it. And then I just wanted to quickly touch on the slightly higher than normal churn in the second quarter. Anything to call out there on what drove that as well as what's baked into your expectations for that sort of normalizing in the second half?

Josh Yankovich
Investor Contact

Yes. No, I would just say when we look at the shape of '25 and the churn that we expected, the concentration was higher in the second quarter than the back half of the year, which is what we mentioned in the prepared remarks.

And then I would also say in a couple of instances, there was some M&A transactions where that was also known for a couple of quarters now where that manifested itself in the second quarter. So that was really just the pressure that was localized in the second quarter. But again, when we think about full year churn, when we think about second half churn, it's where we expected it and feel good about churn being lower in the second half than the first half.

Operator

Your next question comes from the line of Parker Lane with Stifel.

Jeffrey Parker Lane
Stifel, Nicolaus & Company, Incorporated, Research Division

Sticking on the risk and fraud side of the business, I know there's a lot of products under the hood there. Are you finding that in a lot of the cases you're winning here, this is incremental solutions for customers, something they've never really addressed before? Or is there a number of different vendors that you're having success displacing out there for that piece specifically?

Kirk L. Coleman
President

Parker, it's Kirk. I'll take that. So we're seeing a little bit of both. In some cases, what we're seeing is that, again, this is a pain that's so acute inside banks and credit unions that maybe products that they had that were a little bit behind from an innovation perspective, they're looking for better solutions. And so that's where we're seeing some replacements of existing product. And that's been very healthy growth for us.

Worth mentioning there that part of that also is like in our Centrix product family, that is also like positive pay products that they're turning around and selling to their customers. That's kind of an important part of that chain of value. The second part is that there's definitely new innovation, most notably in some of the releases we've done earlier in the year around Alloy and tools like that.

And what I would say about that is that back to Jonathan's point on Innovation Studio is there's like this portfolio of capabilities that we can put into the field that we feel like we're uniquely prepared to kind of orchestrate across all of them. And so that's net new functionality for our customers and giving them new capabilities to fight fraud.

Jeffrey Parker Lane
Stifel, Nicolaus & Company, Incorporated, Research Division

Understood. And then one for you, Jonathan. Just a clarification on the gross margin uptick in the outlook for this year. Is that a reflection of a faster-than-expected migration to the cloud and maybe some benchmarks being achieved there? Or is that just a mix shift of revenue?

Josh Yankovich
Investor Contact

A little bit of both, actually. I think what you saw in the second quarter with the slight sequential decline was a little bit of a pull forward of costs as we got further into the journey than planned. And so you had some higher costs in the second quarter. And so as we get into the back half, you see the reciprocal of that happen.

And so we see some lighter costs, especially in the fourth quarter when it comes to some of the remaining cloud migration activity. And then to your other point, as we continue to see what is typically seasonally strong fourth quarter subs growth, you see the mix shift occur, and that also aids the back half margin dynamic.

Operator

Your next question comes from the line of Matthew VanVliet with Cantor.

Matthew David VanVliet
Cantor Fitzgerald & Co., Research Division

I guess first on Innovation Studio, as you've now gotten that into a vast majority of your customers, has there been any evolution of the monetization strategy there? Should we expect that to be a more maybe meaningful contribution of revenue growth going forward?

Or are you still thinking about that more as just a demand engine and kind of qualifying customers and getting more entrenched? Maybe just what are you thinking of that? And any impact on the raised margin guidance going forward?

Josh Yankovich
Investor Contact

Yes. A few things I would add from my perspective. The impact, we do think the impact will continue to grow in terms of the financials, both from a revenue perspective. And as you know, the model is such where that's very high-margin dollars. So we feel really good about that.

From an evolution standpoint, I would just say it's less around the model and the fact that we're trying to monetize it. It's more around -- as adoption grows, we're seeing revenue grow alongside it. So we're seeing all the strategic halo effects of the impact it's having on our net new win rates, the impact it's having with existing customers and retention.

But as we're selling more and more and as we're driving more adoption, we're seeing more meaningful revenue. So yes, we feel good about it. It's a long journey to go when we say 85% plus adoption, that means an FI is using it in one of the programs of at least one product. And so as you think about the journey to go from one product to multiple products, as you think about the journey from launching one of those products and then getting broad-based adoption within the institution, there's a long arc there where we have to grow and drive adoption alongside the FI.

Matthew David VanVliet
Cantor Fitzgerald & Co., Research Division

Okay. Very helpful. And then on the Helix side of the with, I guess, a more open or at least more known approach to the digital assets and crypto overall from the current administration, are you seeing that as a potential opportunity to grow that business again? Or any of your current partners or customers looking to expand, whether it's on stablecoins or other digital assets? Any thinking of how that business might grow on a go-forward basis?

Kirk L. Coleman
President

Yes, it's Kirk. I'll take that. So from a stablecoin perspective, I'll just say more broadly across is that we're seeing a lot of cooperation across our customers and partners to make sure that they can all participate in stablecoin. And as they think about how they're going to -- banks are going to serve issuers or custodians or gateways or all 3, when you couple that with the need for that kind of regulatory clarity that you were mentioning and kind of infrastructure maturity, consumers and businesses kind of catching up to the use cases for what they're going to do. Some of that's pretty early, but we do see opportunity there for us and for our bank customers more than a threat.

From a Helix perspective, there's -- obviously, there's some crossover there, but I would say that the current regulatory environment has at least settled out kind of what those business models look like from a fintech perspective. All through this kind of cycle over

the last 2 years, we've really focused on kind of who the high-quality operators are. And we've had some nice wins along the way, some good expansion with existing customers. We're seeing some green shoots there, which is encouraging. So we're pleased with that performance.

Operator

Your next question comes from Ella Smith with JPMorgan.

Eleanor Osgoode Smith

JPMorgan Chase & Co, Research Division

So first, as you move upmarket and win additional Tier 1 and enterprise digital banking customers, what core offerings or competencies of Q2's help secure these deals?

Matthew P. Flake

CEO & Chairman of the Board

Yes. Thanks for the question. I think whether it's PrecisionLender or relationship pricing tool, which we have, I think, 9 of the 14 largest banks in North America, we're firmly entrenched there, and you can sell -- and the data set we have around deposits and loans is really the differentiator for them when they're trying to price the relationships.

On the digital banking side, the fact that we have best-in-class retail, small business and corporate banking, all on the same platform, that's where you're seeing the expansion. We had an opportunity. We had an expansion opportunity with about a \$40 billion bank where they took the commercial live and then they signed for the retail business with us in the quarter.

So the fact that the -- it's a single platform, so you get a better user experience, one login ID, one password for a customer whether they're the small business owner and they can see their retail accounts and their business accounts or it's a corporate customer that can see their small business accounts or whatever is the single platform drives a better user experience. It's more efficient to operate. You have one system, one back-office system to upgrade to manage your customers, one set of interfaces to all of the different back-office systems.

And we can get you technology faster since it's a single platform. We write one set of code that upgrades all the different features from across the board. So that, coupled with all of the data we get from all the customers is more informative to the customer. So that story, whether you're a \$400 billion bank or a \$400 million bank, it resonates with them. And that's why we have 40% of the top 100 banks and 40% of the top 100 credit unions do business with us today. So we continue to expand in that space, both on the net new side and with the existing customers.

Eleanor Osgoode Smith

JPMorgan Chase & Co, Research Division

That's very helpful. And for a quick follow-up, beyond retiring your 2025 and 2026 convertible debt, what are you seeing as the most attractive uses of capital?

Josh Yankovich

Investor Contact

Yes. Thanks, Ella. I mean, sort of traditional answer there in terms of we're always exploring the M&A environment. A lot of things have to line up. We have a very different financial profile now. So the criteria for M&A, obviously, value expectations and being disciplined on value. But then when it comes to the criteria in terms of our growth expectations, margin requirements are just tougher and the environment, when I look at the corp dev pipeline, you still don't see all of those things lining up where we see great assets that have the financial profile we're looking for at reasonable value.

So in the long run, I think we're a very strategic acquirer, and we can think about the right deals that make sense for this business. But a lot of those things have to line up, and we're not going to be undisciplined when it comes to M&A execution. The other obvious things we'll always look at is where we can reinvest back into the business.

And as we think and talk more as we enter 2026 around the opportunity for more EBITDA margin expansion, there is that question of how much more incrementally do we want to invest back into the business versus dropping it to EBITDA and free cash flow in '26 and beyond to ensure that elongated growth rate. And so that's a big part of capital allocation.

And then the last one would be opportunities around return of capital, which we haven't done historically, but we will always consider and be thoughtful around if that makes sense. So hopefully, that gives you a bit of a picture.

Operator

Your next question comes from the line of Terry Tillman with Truist Securities.

Terrell Frederick Tillman

Truist Securities, Inc., Research Division

I'm just curious -- and this is more of a bigger picture question. When you're talking to customers and prospects, is there any kind of tilting of the conversation from deposits gathering and retention of deposits versus lending and maybe more of a lending-friendly environment?

The reason why I'm asking this is you all had really good tailwinds on the deposit account -- on the deposit side. So with your digital banking and retail and commercial. Just trying to understand what kind of ongoing tailwinds you see there with a focus on deposits. And then I had a follow-up for Jonathan.

Matthew P. Flake

CEO & Chairman of the Board

Deposits are still fundamental to the bank and with rates where they are and currently today, they're staying where they are. There it's real competition to get deposits. So I think that historically, over the last 100 years, that's the way it's been. We had a little bit of a unique environment from 2012 to 2022. So I don't think this is a trend that's going to go away, and I think there's even more competition for deposits. So I think the deposit -- the drive to retain and grow deposits and the most profitable ones are commercial, as we've talked about, is still out there. On the lending side, I haven't seen a big pickup there. But hopefully, that will start to pick up back half of this year or early '26.

Kirk L. Coleman

President

Terry, I'd just add that, right, each of those deposit accounts represents a relationship where they can also generate fees. So it's really important to the bottom line of the bank, obviously. And when the rates are at a more favorable place, it also represents lending opportunities for those banks. So that deposit account being the anchor rather than if you go back years where the lending might have been the anchor to the relationship, I think, is an important shift.

Terrell Frederick Tillman

Truist Securities, Inc., Research Division

That's helpful. And I guess just, Jonathan, for you in terms of -- it looks like the subscription ARR, and I know that is kind of -- that can move around a little bit, but you have a tough comp for 3Q. But hearing Matt talk about kind of the lining up of a strong pipeline for second half, could you foresee subscription ARR picking up some from what we saw in the first half?

Jonathan A. Price

CFO and Executive VP of Strategy & Emerging Businesses

Yes. I mean it's a tricky one because you're right, we were facing -- we are starting to face more difficult comps versus the subs ARR growth metrics you saw essentially throughout all of '24 until the fourth quarter where the more difficult comp came into play against Q4 of '23.

So sort of where we are now in terms of the baseline of ARR and subs ARR in particular, it feels like we're sort of at a level that's sustainable and durable. You're right, there will be variability quarter-to-quarter depending on the bookings in totality as well as the mix. We had a quarter here in the second quarter where you had a little bit of suppression due to localized churn that I already talked about.

But when you think about the last several quarters and as we look ahead, it seems like sequentially, these quarters are typically shaking out in the 2% to 4% sequential growth a quarter. And in the absence of a mega quarter like Q4 of '23, that it feels like this range of, call it, 12% to 14% subs ARR growth is where we feel comfortable and where we feel there's sustainability and durability at that level.

Operator

Our next question comes from the line of Dan Perlin with RBC.

Daniel Rock Perlin
RBC Capital Markets, Research Division

So Matt, I wanted to come back to your comment around notable M&A kind of in the quarter. And I guess the question there, clearly, the narrative is that there's a lot of that going on. I feel like last quarter, I think you called out like you were involved in 21 transactions. I think you won out in 20 of those. So is it picking up relative to what we've seen? And then just maybe again, as a reminder, at least for us, just why you feel so confident that you typically are beneficiaries in that type of transaction?

Matthew P. Flake
CEO & Chairman of the Board

Yes, Dan, the M&A environment is -- it's still -- the actual transactions are slow. I think there's been 150 in the first half of the year. And so -- but the amount of conversations we're having with banks about M&A, there's a lot of talk about it happening. I think sellers and buyers have to get aligned and the more transactions that happens, the more established the valuation of these banks.

But my confidence comes from, I think, year-to-date, we had 52 M&A events within Q2 customers and 49 of those Q2 was the acquirer of the surviving entity in MOE, so 94%. Historically, we've been 90% to 95%, the successor in those. And that's really the nature of our clients are -- they're buying a new digital banking system. They're paying more than they were.

They're committed to the digital channel, and they believe it's how they're going to grow their bank in the future as opposed to some that are trying to sell the bank, and we typically don't sign those types of customers. So my confidence comes from the historical numbers. It doesn't mean that's just going to happen moving forward, but we certainly hope it does. But I do think you'll see M&A pick up in the back half -- later in this year and then in '26, I think you're going to see quite a bit more. But the numbers are not accelerating any more than they were last year.

Daniel Rock Perlin
RBC Capital Markets, Research Division

Okay. That's great. That's great color. I also wanted to circle back on the risk and fraud solutions. I know there's a few questions on this already. But the commentary around like a lot of new point vendors expanding broadly. I guess the question is, it's pretty clear like it sounds like the clients are gravitating towards your solutions. But as you have so many of these incremental new vendors, point solutions kind of coming into the market, are they creating like moments of pause because it has like this decision tree that your clients have to kind of go through just in vetting what they're offering relative to you? Or do you feel like because there's so much of that noise that's being created by them that it actually is benefiting kind of your holistic product today?

Matthew P. Flake
CEO & Chairman of the Board

Yes, Dan, to be clear, a lot of those vendors are coming to us to sell to the banks, and they're doing it through Innovation Studio because we have the integration to the customer for their core, their payment systems. And then we have where the transaction takes place in our system, so authenticating the customer, ensuring that they're paying who they intend to pay that somebody else isn't paying them.

They want to work with us, and we have so many commercial customers, which is what people are -- they're concerned about the retail fraud, but that's usually not the same scale as the commercial customers. So a lot of these vendors are partnering with us, and we are packaging them in our solution through Innovation Studio to offer a comprehensive fraud solution. Now we have our own products, but some of these other vendors are nice add-ons to us, and we partner and we put them in and we cross-sell them and they're upsells for us.

Daniel Rock Perlin
RBC Capital Markets, Research Division

Got it. I kind of thought you were thinking there was other kind of competitive dynamics out there.

Operator

And our final question comes from the line of Chris Kennedy with William Blair.

Cristopher David Kennedy

William Blair & Company L.L.C., Research Division

Can you just give us an update on your cross-selling initiatives? I think that's one of the bigger opportunities that you've had and you've had a lot of renewals recently. Just how the cross-selling is going?

Matthew P. Flake
CEO & Chairman of the Board

Yes. We've had obviously a solid year. One of the things that always drives more cross-sell is our client event, and it was in late May this year. And so typically, they leave the event. They've got the inventory list of all the products we have. They're excited about it.

And so I think you're going to see a strong back half of the year in not just the risk product, Innovation Studio, and it could be a commercial banking cross-sell, but there's a lot of energy behind it. The team has done an amazing job on the renewal side and renewing at a greater value, and they're focused on that in the back half of the year. So we should have a strong back half of the year on renewals as well.

Cristopher David Kennedy
William Blair & Company L.L.C., Research Division

Great. And then just as you think about the data center migration to the public cloud, can you just talk about the long-term benefits of that?

Jonathan A. Price
CFO and Executive VP of Strategy & Emerging Businesses

Yes. From a financial standpoint, I think there are many benefits. I think the most near-term one, we can get to long term in a minute because I think there's some strategic ones we can talk about. But when I think about it from a financial standpoint, the near-term benefit comes through as we enter 2026. The exiting of the data center just has a very quantifiable cost component that goes away for us that we've historically had. So sort of, if you will, the end of the double bubble or right near the end.

And so there's a clear benefit there, and you see that in the '26 gross margin expansion that we've talked about. Beyond that, as we think about the next leg of being in the cloud, there's a whole opportunity around DevOps and how do we think about optimizing for elasticity. And once we've been in the cloud for some period of time, understanding how to manage the cost structure more efficiently is a common exercise that we're already starting to think about how do we take that next leg up. I don't know, Kirk, you'd add anything from like a strategic perspective when you think about that.

Kirk L. Coleman
President

Yes. I would just add that it's an exciting time to be completing our cloud transition. And one of the reasons for that is kind of the transformational opportunities that lie ahead of us, whether that's cloud-native technology, which continues to -- AI is getting a lot of the headlines, but cloud technology continues to evolve rapidly, the tools available to us, kind of the industrial strength kind of development environments that are available to us that are in the in return to our customers. And then I think also in terms of the role that all the various kinds of AI is going to play in that cloud environment, I think, is really exciting. So we're bullish on the opportunities ahead of us.

Operator

And we had one final question, Michael Infante with Morgan Stanley.

Michael Nicholas Infante
Morgan Stanley, Research Division

Jonathan, I couldn't let the obligatory question on '26 pass us by. So 2-part question there. Was the net new subscription ARR that you added on a sequential basis in line with your expectations sort of when you strip out that atypical M&A-related churn you mentioned? And 2, how is the deal composition and just the mix between larger and smaller deals that you saw in the first half and expect in the back half factoring in there?

Jonathan A. Price
CFO and Executive VP of Strategy & Emerging Businesses

Yes. So yes, if you were to back out the sort of concentrated churn and even if you look at sort of 2Q trends from last year, you sort of directionally, the sequential subs ARR add is where we would have expected and certainly would have been in a good place relative to expectations, absent that concentration of churn. So I feel good there.

And then from a deal composition and mix standpoint, it was very much in line with what we said at the beginning of the year and then what we're reiterating now where while we did have the 6 Tier 1s that we talked about, the volume of Tier 2 and 3 deals was really high and the bigger Tier 1 opportunity set is more in the back half. And so while we had the Tier 1 deals, the biggest opportunities fall in the back half. And so that sort of explains a little bit of the mix shift that we saw in the first half and again, right in line with expectations.

Michael Nicholas Infante
Morgan Stanley, Research Division

Helpful. Matt, maybe just a higher level one for you. Obviously, has been a lot of commentary coming out of certain banks that have the intention to begin to charge third-party aggregators for API access to customer account data. Is there anything we should be aware of in terms of the percentage of your subscription business that relies at least in some form or fashion on data aggregators?

And if that proposed pricing structure or the concept of it becomes pervasive across the banking landscape, like how do you think about the impact both on your customers, on your margins as well as some opportunities you have on the margin side with the ERP integration initiative that you have underway?

Matthew P. Flake
CEO & Chairman of the Board

I'll have Jonathan cover some of that, but it's a very small amount of customers that where actual aggregation is taking place where I think you would have any issues.

Jonathan A. Price
CFO and Executive VP of Strategy & Emerging Businesses

Yes. It's early to quantify. I think as we think about it with the partners we work with when it comes to the universe of aggregators and then we think about what the potential economic implications are, we're working through it with them. I agree with Matt. I don't think from a materiality standpoint, we're worried about it. I think it's something we're watching and monitoring.

And I think as our partners begin to engage with us on it, I think they still think this is very early in terms of how this is going to play out and what it will mean for their business in terms of passing that cost along to the end user versus who would eat the incremental fees that are being proposed. So nothing there that we're worried about, but we're watching it. And again, I wouldn't say it's an issue from a materiality standpoint.

Operator

And with that, thank you for joining us today. This does conclude today's conference call. You may now disconnect.

Copyright © 2025 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

© 2025 S&P Global Market Intelligence.