

Presentation

Operator

Good afternoon. My name is Brent, and I will be your conference operator today. At this time, I would like to welcome everyone to the Q2 Holdings Second Quarter 2023 Financial Results Conference Call. [Operator Instructions]

I would now like to turn the call 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 2023 conference call. With me on the call today are Matt Flake, our CEO; David Mehok, our CFO; Jonathan Price, our Executive Vice President of Strategy and Emerging Businesses; and Kirk Coleman, our President, who will join us for the Q&A portion of our call.

This call contains forward-looking statements that are subject to significant risks and uncertainties, including 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 filed today and subsequent filings, and the press release distributed this afternoon 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 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 may be found on the Investor Relations section of our website and in our Form 8-K filed with the SEC this afternoon. We have also published additional materials related to today's results on our Investor Relations website.

And finally, before we begin, we'd like to remind everyone that our annual ESG report was released last month and is also accessible on our website.

Let me now turn the call over to Matt.

Matthew P. Flake *CEO & Director*

Thanks, Josh. I'll start today's call by sharing our second quarter results and highlights from across the business. I'll then hand it over to Jonathan to provide more insights into the emerging businesses organization he oversees. David will then discuss our financial results and guidance in more detail.

Since August of last year, we've been laser-focused on managing our business towards profitable growth, and our financial results demonstrate that we're executing on that strategy. In the second quarter, we generated non-GAAP revenue of \$154.6 million, up 10% year-over-year. We saw continued strength in subscription revenue, which was up 15% year-over-year and we had another quarter of strong profitability results as well, with adjusted EBITDA of \$17.6 million or 11% of revenue. We're especially pleased with our ability to prudently manage costs in recent quarters, which is reflected in our approximately 450 basis point expansion in adjusted EBITDA margin over the past year.

We had another solid bookings performance in the second quarter, resulting in the best first half of bookings in company history. Year-to-date, we've continued to see a few specific trends in our sales performance regarding the types of deals we're winning, their magnitude and their impact to the business.

First, our average sales price has seen a meaningful increase as our deals have become more comprehensive, and we continue to move up market. Our ASP has grown by approximately 30% over the past year. This expansion has been driven largely by our commercial solutions, which were front and center in the majority of our net new deals in the first half of the year. We also continue to see a broader adoption of products from across our portfolio. As a result of the expansion in ASP, many of our Tier 2 deals from the first

half had an initial bookings impact similar to our historical Tier 1 deals. For example, our largest deal from the second quarter was with a \$3 billion credit union.

The second trend I'd highlight is that we're competing extremely well, as demonstrated by a win rate of over 50% for the first half of the year. Our win rate span a broad mix of both the retail and commercial deals, reinforcing why we believe we're uniquely positioned in the digital banking landscape. Q2 Innovation Studio has become a significant differentiator in virtually every digital banking opportunity. It continues to be cited as a key driver in the majority of our digital banking wins from the first half and was included in every single digital banking win in the second quarter, whether retail or commercial.

On the commercial side, more specifically, we're winning and moving up market with a comprehensive feature set that's wrapped in a modern, mobile-enabled user experience. In the second quarter, this approach to commercial earned us recognition as the Best-in-Class Leader in the 2023 Cash Management Technology Providers Vendor Assessment by Aite-Novarica. We're proud to be recognized by such a prominent source in the industry and believe this recognition validates our leadership position in commercial digital banking and will continue to contribute to our momentum in the market.

When we started this company, our first line of code included business functionality. And over the last decade, we've made substantial investments in broadening our commercial solutions to support larger, more complex businesses. It's hard, time-intensive work building the unique integrations and conversion experience required to operate and win in the commercial space. And I'm proud to see it paying off for Q2. And more importantly, for our commercial customers, as they navigate the heightened pressure to acquire and retain deposits.

So despite some of the disruptions in our end market in the first half of the year, we're encouraged by the strength of the demand environment, the rate at which we're winning deals and the continued adoption of a broad set of our solutions. And even with our ongoing booking strength over the last several quarters, we believe our pipeline remains strong, a great signal for the demand environment and our opportunity in the second half of the year.

Focusing in on the second quarter specifically, we landed a solid mix of deals, including two Tier 1 digital banking wins, 1 net new relationship pricing deal with a Tier 1 institution and an expansion with a top 100 U.S. bank also using our relationship pricing solutions. The expansion is particularly noteworthy because it came from our existing relationship with the financial institution that was recently acquired by a large bank holding company. This deal extends our initial agreement and over time, can lead to additional opportunities to increase adoption across the holding company. Both the net new and expansion deals were competitive scenarios where our relationship pricing tools were selected as the solutions of choice by the customer. And the loan and relationship pricing activity from the quarter gives us momentum entering the back half of the year.

Another major highlight from the quarter was our annual client conference, CONNECT, which we hosted in person for the first time since the pandemic began. We saw record attendance at the event with more than 1,000 attendees from customers, prospects and partners. The overall customer sentiment at CONNECT was extremely positive, and there were a few key themes from our conversations I'd like to highlight. First, attracting, retaining and growing deposits was top of mind for customers this year given what's happened in the banking industry. It's clear they believe digital banking is critical to their deposit strategies and we have a broad set of solutions designed to help them succeed across the retail and commercial aspects of their business.

Second, there was a lot of buzz about AI at CONNECT, including large language models and machine learning. Coming out of the conference, we believe our customers share our excitement for the potential of these capabilities and that they view us as a trusted partner in this space. With almost 22 million end users, 5.1 billion annual logins and over \$1 trillion in loans supported by our solutions, we have one of the most comprehensive data sets in financial services. We've been using this data to power artificial intelligence and machine learning solutions for almost 15 years.

Today, we offer data-driven products that help our customers prevent fraud, target and cross-sell to their account holders and personalize the digital banking experience. Because of this, we have deep domain expertise in AI, and we've established a framework that's enabling our internal teams to utilize new AI tools. We're prepared for things to evolve quickly in this area, and we're excited to leverage our leadership position to expand our use of AI, both for our customers and to drive efficiencies within the business.

The final theme I'd highlight from CONNECT was the energy around Q2 Innovation Studio, which drove a lot of engagement at the event. Thanks to our partner ecosystem model, we had over 150 partner attendees at CONNECT. And many customers shared stories on stage about some of the outcomes they're driving with Q2 Innovation Studio, such as launching new solutions in just a few weeks, achieving more than \$1 million in combined fees and cost savings and reducing call volumes by over 70% with a virtual chatbot, just to name a few. Based on the buzz around Q2 Innovation Studio, it's easy to see why it's playing a key role in our high win rates the last several quarters, and we're excited to see more financial institution to fintech partnerships coming out of the event.

In conclusion, CONNECT '23 was our biggest and best conference yet and our customers' commitment to digital was on full display. They're highly engaged, excited about our roadmap and they want to do more in the digital channel. This energy has contributed to the momentum we believe we're bringing into the back half of the year across our business with the existing customers, key prospects and fintech partners.

With that, let me hand the call over to Jonathan to cover a few key highlights from our emerging businesses.

Jonathan A. Price

Executive Vice President of Emerging Business, Corporate & Business Development

Thanks, Matt. I'm pleased with the role Q2 Innovation Studio continues to play in the success of our business. Since last year, the number of fintech solutions deployed by our customers as well as the number of end users utilizing them has more than doubled. Through this flywheel effect, we're executing on our vision for Q2 Innovation Studio, and we're confident it will continue to differentiate us in the market. In fact, Q2 Innovation Studio was cited as a key reason for selecting Q2 in 100% of our net new digital banking deals from the second quarter. While we've previously reported that it has contributed to the majority of our deals in past quarters, this is the first time it's been a key driver in every single one.

Q2 Innovation Studio even played a role in one of our wins on the Helix side in the quarter, which I'll move over to now. Helix saw solid activity in the second quarter, highlighted by a significant win with a market-leading insurance provider and the addition of a Tier 1 institution, Five Star Bank, as a bank of record. Our initial relationship with Five Star began on the digital banking side. After their positive experience with Q2 and the Innovation Studio, the bank determined they could expand their deposit strategy through partnering with Helix. As a bank of record, Five Star will provide the depository infrastructure for brands and fintechs that use the Helix platform to offer checking and savings accounts to their customers, a key component of our Helix offering. As deposit growth and retention remain top priorities for our customers, bank of record partnerships like this are a unique way for financial institutions to generate additional deposits outside of their existing customer base.

During the quarter, we also landed a net new deal with one of the largest insurance providers in the nation. With this deal, Helix will help the company roll out a unique deposit account offering, which will embed our solution across multiple insurance products within the company, helping them drive deeper engagement across their products and greater value for their customers. In a highly competitive selection process, the company ultimately chose Helix because we offer a cloud-based, real-time core that gives them the personalization, flexibility and granular control to design and manage a unique product for each of their users' needs, and because of our proven ability to support major clients like this at scale. Thank you.

And with that, I'll hand the call over to David to discuss our financials.

David J. Mehok

CFO & Principal Accounting Officer

Thanks, Jonathan. Our second quarter results continue to demonstrate the demand environment remains favorable, and we're focused on executing on driving growth with enhanced profitability. For the quarter, non-GAAP revenue came in near the top end of our guidance range and adjusted EBITDA exceeded the high end of our guidance. As Matt mentioned, we've increased our adjusted EBITDA margins by approximately 450 basis points over the past 4 quarters, and we continue to see strength in bookings associated with our higher-margin subscription business, which is reflected in our ARR.

With that, I'll begin by reviewing our results and conclude with updated guidance for the third quarter and full year 2023. Total non-GAAP revenue for the second quarter was \$154.6 million, an increase of 10% year-over-year and 1% sequentially. The year-over-year increase was driven by growth in subscription-based revenue, which was up 15%. The year-over-year subscription revenue growth was driven by a mix of the deployment of net new digital banking and loan relationship pricing customers as well as cross-sold products. In addition, we've seen continued strong growth from our risk and fraud solutions. Our subscription revenue for the quarter was 75% of total revenue, aligned with the previous quarter, and up from 72% of total revenue in the prior year. The continued strength in subscription revenue reflects the start of some of the go-lives associated with the strong bookings from our core solutions we saw in the second half of last year.

Transactional revenue represented 11% of total revenue for the quarter, down from the prior year period of 13% and consistent with the previous quarter. The year-over-year decline in transactional revenue is a result of the trends we started to observe last year, including continued secular slowing of bill pay as well as reduced growth in Helix-based transactional revenue. During the quarter, we added more than 200,000 users to our digital banking platform, ending the quarter with approximately 21.7 million registered users, an increase of 8% year-over-year. The year-over-year and sequential increase was largely driven by organic user growth.

Annualized recurring revenue, or ARR, grew to \$681.2 million, up 11% year-over-year. Our subscription ARO growth for the quarter was 16% year-over-year, driven largely by net new deals within our digital banking business and continued expansion with existing customers. We expect subscription ARR growth will be at a premium to total ARR growth for the remainder of the year. We ended the quarter with total backlog of over \$1.5 billion. This represents year-over-year growth of 12% and is down marginally compared to last quarter by \$1 million. The year-over-year increase was attributable to strength in net new bookings, particularly within digital banking over the past 12 months.

As we've mentioned previously, the sequential change in backlog may fluctuate quarter-to-quarter based on the number of renewal opportunities available within a given quarter. However, we continue to believe we will show an increase in backlog for the full year. Gross margins were 54.2% for the quarter, up from 51.3% in the prior year period and 54% in the previous quarter. The year-over-year improvement in gross margin was driven primarily by a favorable mix in revenue towards our higher-margin subscription-based business, in addition to cost efficiencies we began driving in the second half of 2022. The slight sequential increase in gross margin benefited from a lower mix of pass-through revenue from our Helix business and reduced expenses associated with payroll taxes following our Q1 annual equity vesting and bonus payout.

Total operating expenses for the second quarter were \$72.9 million or 47.1% of revenue compared to \$67.4 million or 48% of revenue in the second quarter of 2022 and \$72.5 million or 47.4% of revenue in the first quarter of 2023. The year-over-year and sequential decrease in operating expenses as a percent of revenue were driven primarily from improved cost scaling to revenue within sales and marketing and research and development through the effective utilization of our global workforce and enhanced productivity which more than offsets the increase in G&A expenses, which were predominantly related to third-party fees. As a reminder, we mentioned that our annual client conference would incur additional costs in the second quarter and, therefore, expect to see improvement in sales and marketing cost scaling to revenue in the second half of the year.

Total adjusted EBITDA was \$17.6 million for the second quarter, a company record, and up from \$9.7 million in the prior year period and \$16.5 million in the previous quarter. The roughly 450 basis points of improvement in adjusted EBITDA margin from a year ago, benefited from the mix towards higher-margin subscription revenue, more effective utilization of our global workforce and broad-based efficiencies across the organization. The sequential change in adjusted EBITDA benefited from lower-than-anticipated bad debt as well as cost efficiencies associated with developing, delivering and supporting our solutions.

We ended the second quarter with cash, cash equivalents and investments of \$280 million, up from \$271.7 million at the end of the first quarter. We generated positive cash from operations of \$13.1 million as a result of our continued emphasis on profitability and strong working capital management. We also generated free cash flow of \$3.7 million in the quarter, resulting in positive free cash flow for the first half of the year. Typically, our first half is a more challenged period for our cash flow generation based on seasonal drivers. But for the first time in company history, we delivered positive free cash flow for the first 6 months of the year.

Let me wrap up by sharing our third quarter and updated full year guidance. We forecast third quarter non-GAAP revenue in the range of \$153.5 million to \$156.5 million and full year non-GAAP revenue in the range of \$620 million to \$628 million, representing year-over-year growth of 9% to 11%. We forecast third quarter adjusted EBITDA of \$17 million to \$19 million. And we're raising our full year 2023 adjusted EBITDA to a range of \$71 million to \$75 million, representing approximately 11% to 12% of non-GAAP revenue for the year.

In summary, for the second quarter, we delivered revenue results at the top end of our guide with adjusted EBITDA results above our expectations. We continue to see our total revenue and ARR growth driven by our higher-margin subscription-based business. This, combined with our continued focus on driving cost efficiencies, gives us confidence in raising our adjusted EBITDA outlook for the remainder of the year, as well as our ability to meet our Rule of 30 target at some point in the back half of 2024.

With that, I'll turn the call back over to Matt for his closing remarks.

Matthew P. Flake
CEO & Director

Thanks, David. In closing, I'm extremely pleased with our performance in the first half of the year and the direction of our business moving forward. Our broad mix of deals and consistently high win rates demonstrate both the continued demand for our solutions and our competitive positioning in the market. Looking ahead, we expect to focus on deposits to maintain a favorable demand environment for our solutions. And when you consider our sales execution in recent quarters, the continued recognition from industry analysts like Aite-Novarica and the tailwinds we anticipate from our annual client conference, we believe we enter the second half of the year with a lot of positive momentum. We remain laser-focused on converting our pipeline and executing against our profitable growth strategy to continue driving value for employees, customers and shareholders.

Thank you, and I'll hand it over to the operator for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Matthew VanVliet with BTIG.

Matthew David VanVliet
BTIG, LLC, Research Division

Wanted to dive in a little bit on not only the bookings strength, but the backlog commentary and just sort of how the progression of rollouts are going, the appetite for customers to go live as sort of quickly as possible and how various parts of the Innovation Studio are helping sort of speed that process along to get customers to revenue?

David J. Mehok
CFO & Principal Accounting Officer

Matt, as we've talked about, we've had great strength in bookings over the last few quarters. Now a lot of those deals were larger in nature. When you have larger deals and more complex deals, you tend to have elongated time to revenue. We're certainly expecting that. And in regard to Innovation Studio specifically, the team there has gotten very efficient. So that does not become an obstacle in terms of delivering on the implementation dates that we've agreed on with our customers. So if you think about Implementation Studio, it's obviously an incremental aspect of the digital banking solution, but it does not elongate it. What elongates the deals are the overarching complexity and size of the digital banking opportunity.

Matthew David VanVliet
BTIG, LLC, Research Division

Very helpful. And then Jonathan, on the Helix deal in the quarter and maybe looking at sort of all of the additional features you're adding, and you mentioned every deal in this quarter even on the digital banking side, included Innovation Studio. So obviously, kind of a broad question here, but what are you doing for the nontraditional institutions that are seeing an increasing rate of adoption? And then maybe just touch on how much of that has been sort of brought over from the digital banking side and enabling some of those capabilities?

Jonathan A. Price
Executive Vice President of Emerging Business, Corporate & Business Development

Yes. So I will start on the digital banking side with Innovation Studio. Yes, there, we're seeing a lot of adoption at scale. I think if we had this conversation 6 months ago, a year ago, we would have been talking about 1 or 2 apps on a small segment of FIs. And now we're starting to see multiple apps go live across numerous FIs.

And so what I would say is just as this continues to get further and further into the flywheel of adoption, we're just looking for more opportunities to get these products into the hands of their end users faster and really importantly, helping them market these solutions to their end users, because there's only so much value in putting more products in the hands of the FIs if they're not actually getting utilization and adoption by their customers. And so that's really where the focus is on. It's how do we help them extract the value they're getting from this incremental innovation that we're putting in their hands.

And then translating over to the Helix side, we are seeing a lot of cross-pollination between Innovation Studio and Helix when it comes to talking to banks that want to participate in the bank of record program, talking to larger fintechs who want to think about launching an embedded finance program.

When I think about the big win we had in the quarter and just some of the momentum and the pipeline going forward, the common theme is there is more focus around deposits, sort of similar to Matt's commentary around digital banking and the focus on deposits. That's true across financial services. And so that's really driving the strategy. It's certainly driving the strategy of the big win we talked about in the quarter. So lots of good things happening, but we're just trying to facilitate getting more of these deals in the door and getting these products and the adoption flywheel rolling as fast as we can.

Operator

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

Adam R. Hotchkiss

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Goldman Sachs Group, Inc., Research Division

Matt, could you just dig a little deeper on how the demand environment is evolving, particularly as it relates to the larger ASPs you talked about. When you think about how things are going now and what's driving customers to land broader with you guys, how sustainable do you think that is over a multiyear period? And how much of that is just sort of reminiscent of the current demand environment?

Matthew P. Flake
CEO & Director

Yes. I mean as we've talked about, right now, to go -- to have a strong fourth quarter as we did then the first and the second, it's unusual we get that many in a row. I think we had 3 Tier 1s, big Tier 1s in the first quarter and 2 on the digital banking side, and then a Tier 1 on the relationship pricing side of the business. With the deposit -- the thirst for deposits right now and then the pressure that they're feeling from the deposits that moved to other financial institutions -- the larger financial institutions around a digital banking experience that's commensurate with the big 4, we're in a really unique position with the breadth of our products, the experience in delivering them and supporting them and the integrations that we have.

And so as long as you have this demand around deposits that we have right now, and you have -- we're really uniquely positioned in the \$1 billion to \$250 billion bank credit union space, I think this is going to continue for the foreseeable future. I don't see any relief on the deposit side of the business. So I think this is something that is going to continue for a while. The pipeline demonstrates that. It's up still after the last 3 strong quarters we've had, and I anticipate closing those deals and having a strong finish to the year.

Adam R. Hotchkiss
Goldman Sachs Group, Inc., Research Division

Great. No, that's really helpful. And then just to double click on Q2 Innovation Studio. When you take a step back, how big of an opportunity do you think that can be for you guys? I can imagine a world where you look across the platform and there are dozens more partners and developers working with you guys on different pieces of functionality. When you look at both, what the depth of the product could look like and the breadth of the product from an offering perspective, how much do you think that adds from a penetration perspective on your -- on the sort of prospective pipeline in the FI space versus where you are today? Just would love a higher level commentary on where do you think that can go.

Matthew P. Flake
CEO & Director

Yes. Jonathan, why don't you take that? You built that business.

Jonathan A. Price
Executive Vice President of Emerging Business, Corporate & Business Development

Yes. Well, I'd start by just saying when we think about the universe of products that we're adding, these partners that are coming and building to our APIs and then embedding within digital banking, we very much see that as an extension of our own R&D paradigm, our own innovation that we are widening the aperture of what we can deliver to our customers and to their end users. And so when you think about R&D scaling, when you think about long-term from a P&L perspective, what that brings from a margin perspective, there's a lot of value there.

But when you sort of talk about what it could do from a penetration perspective to our customers, I mean, we've seen it quarter-over-quarter for the last several in terms of the way it's impacting our net new wins. As I talked about on this call, 100% of the net new digital banking wins cited Innovation Studio as a key reason for selecting us.

And then you think about how the overall economics will flow over time as we have more and more of these partners embedded within the banks. The banks are participating in economics via interchange, via rev share on subscription revenue. And as importantly, they're saving a tremendous amount of cost when it comes to onetime integration fees and ongoing partner fees that they would have minimums around if they were going direct in another model. And so all those lead to more engagement with our customers, better retention and stickiness with these customers over the long run and, ultimately, an economic model that can be attractive for everyone involved.

So we really think this is a very strategic piece of the business and the economic value that can come from revenue and the margin profile associated with that revenue because it's all net and it comes at high margins, we think is very intriguing over the long run on what it -- how it can help the business. So hopefully, that helps address the question.

Operator

Your next question comes from Terry Tillman with Truist Securities.

Terrell Frederick Tillman

Truist Securities, Inc., Research Division

Solid job on the results. First question for me is we're not hearing much about large increases in ASPs or deal sizes. So it's impressive about the 30% growth there. I'm curious, actually. Are some of this around the product and packaging that you all have been evolving over the last 1.5 years with Q2 Catalyst? How much of a catalyst, no pun intended, is that with some of this big ASP growth? And then I had a follow-up question.

Matthew P. Flake

CEO & Director

Yes. I mean clearly, the demand for pricing relationships, onboarding, fulfilling and then actually running the operating accounts is at the center of what's happening and our timing on it couldn't have been better. Kirk is in the room with me here. He was -- he spearheaded a lot of that. But I think a lot of it has to do with the Catalyst product, but if -- I think I said in the script, every deal had retail in it as well. So we're winning on retail. We're winning on small business. We're winning on commercial. PrecisionLender, the relationship pricing tool, is -- actually pulled a couple of deals in ahead of what I thought they were.

So it's stacking up very nicely, both on not just the Q2 Catalyst solution that we have, but all of the features and the products that we put so much time and energy in over the last 19 years, but in particular, the last 4 or 5 on the commercial banking side of things. And the Catalyst product are really differentiated in the marketplace, and that shows up in win rates and ASPs.

Terrell Frederick Tillman

Truist Securities, Inc., Research Division

Got it. And I guess in terms of some puts and takes that are going to continue as we move into '24, I'm just curious if there's anything you all can share kind of growth algorithm wise in terms of you've got this ongoing probably weak discretionary services, transactional revenue. And then at some point, maybe FRB dynamics, offset by the string of strong bookings. I mean anything at all you can share about as you look further out and how to think about some of those puts and takes?

David J. Mehok

CFO & Principal Accounting Officer

Terry, you covered a lot of those variables there and the question itself. And it's certainly -- it's too early to get into any specific outlook on '24, but based on what we know today, we would expect the pressures that we're seeing in transactional and services to continue to '24. And I would also make sure that, as you're thinking about '24, you're factoring in that impact of FRB migrating off of our platform at some point during the year.

On the subscription side, Matt asked the question around delivery times. And as I said in answering that question, we've had strong bookings for sure, but they're having large deals. And so we've got to make sure that we're factoring that in as we're looking at the go-lives of those deals over the course of the next 6 to 18 months.

And then very importantly, we have to understand how the back half of '23 bookings plays out, both in terms of the shape of them in terms of the mix of cross relative to net new as well as the overarching size. And as we talked about this consistently, and we're going to continue to talk about it, we're continuing to aggressively execute on all the efficiencies and the cost profile of the business, and we certainly expect that the path to the Rule of 30 at some point at the end of 2024 that we've mentioned is going to be vastly weighted towards EBITDA expansion.

Operator

Your next question is from the line of Joe Vruwink with Baird.

Joseph D. Vruwink

Robert W. Baird & Co. Incorporated, Research Division

Maybe just picking up on that last question. So I wanted to ask about pipeline and how you think about risk adjusting pipeline, just given, obviously, digital banking is in vogue and you're talking about big opportunities, but the big opportunities also come with timing and sales cycles that can be a bit trickier. And then related to the last question just on sales cycles, obviously, anything booked

now doesn't really impact this year, but how might that kind of risk adjusting of pipeline factor into kind of the back half of next year and that Rule of 30 framework you're discussing?

Matthew P. Flake
CEO & Director

Yes. So as far as risk adjustment in the pipeline, we obviously have been doing this a long time. And so we're able to look at the deals. We're engaged in the conversations, both at an executive level and at the rep level. And we do a pretty good job of factoring when the decisions are going to be done. At the end of the quarter, it always comes down to can you get it done by the end of the month. And we don't really live off of cutting deals at the end of the quarter because we don't book any revenue on it.

So with the close rates that -- with the win rates that we've had as well as the pipe as I look at it, it continues to grow, and I look at these deals, they are larger, both in ASP and then the size of the financial institution, I feel really good about where we are for the -- where the pipe is and our ability to execute on our plan for the back half of this year.

The relationship pricing, PrecisionLender, those deals tend to skew larger. So those take a little longer when you're dealing with top 100 institutions. But I'd also point out that those opportunities have a tremendous amount of expansion opportunity. You get in and you might be on one line of business and then you can expand on that line of -- into other lines of businesses as well as other geographies. We have seen that happen on the PrecisionLender product. And I think you're going to see that happen unfold for us in '24, '25.

And David can talk about how they're going to flow through. I think he talked a little bit about how they're going to have to -- we have to look at what the products are going to be delivered with the timing of the financial institutions because that matters as well. When can they apply the resources to deliver it. But I would tell you that it sets up the last 3 quarters and then the back half of this year sets up for a really nice back half of '24 for sure and a really strong '25 as we start getting into this. That's just the time it takes to deliver these products in this space. But the durability and the outlook for us, when we start to have strong quarters like this, it just -- it rippled through for a long time. David, anything you want to add?

David J. Mehok
CFO & Principal Accounting Officer

No, I think you hit it, Matt.

Joseph D. Vruwink
Robert W. Baird & Co. Incorporated, Research Division

Okay. And then I don't want to let David off the hook. So maybe one question for him. Just on the booking strength, do you think some of the trends in RPO, looking at maybe the next 24-month contribution or even longest-term segmentation of RPO, is that kind of the best place to look to foot to the booking strength? Because then I want to relate it to maybe the calculated billings in the quarter decelerating, and just getting your take on kind of the best set of numbers to look at.

David J. Mehok
CFO & Principal Accounting Officer

Yes, Joe, I would say a couple of things, one in regard to RPO. The one thing that -- we understand that it's leaning into care that you look at. And if you look at it over an elongated period of time, it's going to give you an idea of the type of revenue opportunities that we have on the horizon. If you look at it quarter-to-quarter, you can be head faked very easily by the amount of renewals that are in scope. So -- and I know we've been emphasizing that, but it's really important to do that because you saw in Q4 of last year, we did 43% of our renewals in Q4 of last year. So as a result, you saw a huge spike in our backlog at the end of Q4.

We expect that this year, it's going to be back-end loaded in terms of renewals as well. That's seasonally what we typically have. The one thing that I would tell you to look at more so is our ARR and what that's telling you terms of not only how it's building, which is really important, the subscription growth rate within that, which we disclosed is 16% year-over-year, so you're seeing strong growth on the subscription side.

And then one other data point that may help you in regard to your question specifically is there's 12% of that ARR that's not live yet, and that's the highest level we've seen in a couple of years. So that also gives you an idea of sort of what's out there on the horizon to be booked -- to be turned into revenue over the course of the next 12 to 24 months.

Operator

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

Matthew James Kikkert

Stifel, Nicolaus & Company, Incorporated, Research Division

This is Matthew Kikkert on for Parker. To start, I'm curious what your thoughts are on the health of regional banks and credit unions right now coming off of the Q1 banking crisis. And how is that impacting layers of your revenue guidance for the remainder of the year, particularly around discretionary services spend?

Matthew P. Flake

CEO & Director

Kirk, do you want to jump into the health of the banks and the credit unions? And then we can just take the guidance one.

Kirk L. Coleman

President

Yes, sure. So I mean the reasons for that people need banks and credit unions are sound and fine and the -- that little mini crisis we had at the end of the first quarter doesn't change that. And so in terms of the services that they're providing and -- we tend to -- I think people tend to paint banks and credit unions as just kind of one thing, and it's very often the last thing they read in the paper. But the truth is, is that there's a great wealth of diversity amongst the communities that they serve and the institutions themselves.

So we see a lot of strength in that. We see a lot of really strong strategic thinking and operational focus amongst our customer base and the prospects we're talking to. And although they're really focused on deposit pricing and retaining all the operating accounts of their customers and high on credit, they're also focused on their highest priorities because they got to see all the way through whatever rocky period we're in, and we think digital remains one of those top priorities.

Matthew P. Flake

CEO & Director

The other thing I would add is that I was talking with one of our customers at a probably \$10 billion financial institution, and he was telling me that he's beginning to hear some customers that move some -- just move deposits to some of the larger banks, and they're already frustrated with communication responsiveness, follow-up, follow-through, pricing. When you're running a business, small or big, you need a banking relationship and you have to be available and you have to understand the challenges, whether it's in the community or whether it's the industry they're in.

And that's one of the things that a lot of our customers, banks and credit unions, both bring, whether it's retail or commercial, it's just that understanding and that ability for them to access those people and solve problems with them. So I think that's probably going to be a trend that continues once the dust from March 10 settles down a little bit. David, you can fill in on the guidance, but I would probably just say that it's folded in, but...

David J. Mehok

CFO & Principal Accounting Officer

It is. That's the short answer, it's folded in. Matthew, in May when we took down our revenue guidance, it was predominantly related to the discretionary spending component that we've been talking about, and that was part of your question. We do have more certainty now than we did 3 months ago. That's probably not surprising. And as a result, we've tightened the range by \$2 million at the bottom, \$2 million at the top, at the same midpoint. So how we viewed that discretionary spending back in May is still relatively aligned with how we're viewing it today. It's just the high end and the low end have tightened a bit.

Matthew James Kikkert

Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. That's good to hear. And really interesting on the relationship side. And then secondly, you start to generate additional free cash flow as part of your margin expansion strategy. Could you talk a bit about your capital allocation plans over, let's say, the next 2 to 3 years?

David J. Mehok

CFO & Principal Accounting Officer

Sure. We're constantly looking at optimizing our capital allocation. There's obviously different levers and opportunities that we have. We pulled one of those levers in March in terms of buying back some of the convertible debt that was outstanding at a discount. That

generated a nice return for us. We're constantly perusing the landscape to understand if there's opportunities out there, and I'll let Jonathan sort of talk about the M&A environment at large. And then obviously, we're deploying our cash internally to the investments internally that we think are going to generate the best and biggest return.

And we're being much more focused over the course of the last 9 to 12 months. Matt had talked about some of the things that we began doing in August of last year, both in terms of our cost structure and in terms of our capital allocation and making sure that where our investments are going are to where we're going to generate the biggest return. And the areas that aren't, we're de-investing in. And we think that, that's going to provide the most value to our customers as well as to our shareholders. And Jonathan, do you want to talk about the M&A environment?

Jonathan A. Price

Executive Vice President of Emerging Business, Corporate & Business Development

Yes, I would just say, we're constantly evaluating the M&A landscape. We think over the long run, you mentioned 2 years, like as we get out 2-plus years out, we think there's going to be lots of opportunity for consolidation across the fintech landscape. But what I would say is sort of sitting here now and looking at the pipeline is between the converts that David mentioned and the overall financing environment we're in, there's a lot of scarcity value to our cash balance that we have.

And so we're going to be very disciplined and have a pretty prudent approach to thinking about allocating capital towards M&A and making sure that both value and quality of asset come in line. And in our view, what we've seen, especially in the private M&A markets, those 2 things haven't come in line yet, but we'd expect that to happen here over the coming 6 to 18 months. So always watching it, but cautiously waiting for that opportunity.

Operator

Your next question is from the line of Alex Sklar with Raymond James.

Alexander James Sklar

Raymond James & Associates, Inc., Research Division

Matt or David, I know third quarter isn't historically a big bookings quarter for you all seasonally. But given some of your earlier comments on pipeline and then the earlier deal closings that you referenced for PrecisionLender, what are you underwriting for the rest of the year in terms of kind of sales cycles and demand backdrop for subscription bookings relative to what you saw in the first half of the year?

David J. Mehok

CFO & Principal Accounting Officer

Yes. We don't -- as you know, Alex, we don't give very specific guidance on subscription relative to transactional and services. But what we will say is that we absolutely believe that subscription is going to be growing at a significant premium to both those other two revenue -- both those other revenue streams. We think that is going to continue Q3 and obviously into Q4 as well.

And in fact, if you look at Q3 specifically from a sequential standpoint, the guide contemplates what will likely be a reduction in the combination of transactional and services, offset by sequential growth in subscription. So that will help give you a jumping off point into Q4, where, again, we expect to see strong growth in subscription relative to continued subdued services and transaction.

Alexander James Sklar

Raymond James & Associates, Inc., Research Division

Okay. Great color on that. And then just as a follow-up, Matt or Kirk. I did want to ask about some of your more data-oriented solutions. So great PrecisionLender success this quarter. And Q2 SMART as well, I'll lump in that bucket. But can you just elaborate a little bit more on what's driving the uptick in demand for those year-to-date in the current backdrop?

Kirk L. Coleman

President

Yes, sure. Thanks for the question. It's -- I think -- particularly in both cases, really, but I think this particularly applies to the relationship pricing aspect for PrecisionLender. We have a business environment that a lot of bankers just don't have a lot of practice in, if you sort of think about the rank and files of commercial banks. And so the breadth of data that we have, and we're able to put the work for them, we're able to provide them with really kind of database coaching tools that they can use every day in terms of working with their customers. And that allows them to focus on the thing that makes them special, right, the relationship they have

with those individuals running those businesses. We think it is a really important part of why that's -- we're seeing some strength there and interest in that.

And even if rates go down at some point, that environment is not going to change. I think we're just in a different space here for quite a while in terms of what the competitive environment is. And so they'll continue to need to put the work, as much data as they can. But in the end, it really comes down to kind of that banker, that person at the base of the customer, putting that data to work every day, and that's where -- what a lot of our solutions are focused on.

Matthew P. Flake
CEO & Director

Yes. I would just add that all of those things and then addition to that, the analytics and the data that we use on our fraud analytics tools for payments and identifying who's who in the system and that they're actually doing what they're supposed to be doing is really paying off. We stopped a lot of fraud with the demand on these systems. It's through the roof. I think I said 5 billion log-ins in the last 12 months on the application. Not all of those are good people. So we are using that data to stop fraud and it's almost attached to every single deal, and existing customers that don't have it are in line to get it. So it's a big cross-sell item for us, and it's attached to most of the net new deals as well.

So as I said in the script, we are -- we have a team that's worked with data for a long time, and we have data that we -- we come in, we take very seriously and we want to make sure that we're using it in the best way possible for our customers, whether it's to understand our customers better, cross-sell products or stop fraud. So really excited about that opportunity for us.

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

Got it. That's great added color. I did see the new Security Insights announcements, and I know those are core to the Q2 Catalyst package.

Matthew P. Flake
CEO & Director

Absolutely. Thanks, Alex.

Operator

Your next question comes from the line of Bob Napoli with William Blair.

Adib Hasan Choudhury
William Blair & Company L.L.C., Research Division

This is Adib Choudhury on for Bob. So one question, bigger picture on Helix. Could you kind of frame the embedded finance opportunity more broadly for Helix and if you're seeing an acceleration just in terms of brands or fintechs and obviously, you guys have diversified with the insurance one, but just kind of that demand for financial products from nonfinancial institutions? And then maybe a bit on the competitive landscape there as well.

Jonathan A. Price
Executive Vice President of Emerging Business, Corporate & Business Development

Yes, sure. So yes, this is something that has evolved from, let's say, a year ago where the aperture of industries that was looking to get into embedded finance was very, very broad. Basically any vertical of the economy and any brand that had a large user base with a ton of loyalty to their brand was contemplating entering financial services. As the last year has played out with the economy and with folks across every industry really focusing on their core business, we've seen the universe of areas where this makes sense, where they're willing to act and enter embedded finance and launch an embedded finance strategy, narrow. And so that's why you've seen a lot of our wins recently come in verticals that I would call adjacent to traditional financial services. Areas like insurance and wealth, in particular, have been areas of focus for us and where we've had success.

And so we still see a lot of opportunity in embedded finance. We still think brands and fintechs over the long run will value and enter the space and launch programs. But the last year has certainly been a smaller universe of folks that are willing to go and undertake this strategy, if it's not really core to their primary business. So hopefully, that gives you a bit of color.

As far as the competitive landscape, we really haven't seen much shift. What I'll say is a lot of the providers that popped up as fintech was being well funded over the last 5, 6 years, are middleware providers as opposed to an actual core like we are. And there's differences, and that's popped up in terms the regulatory framework and where the OCC has been focused in terms of how you can -- how your controls and procedures work relative to a traditional bank. And the expectations being the same from the regulators, even though it's for a fintech and a middleware provider and a BaaS bank. And so whether it's the regulatory environment, whether it's actually being the source of truth in the core, we have some real competitive differentiation versus those folks.

And then there's been some of the larger players that are well known in this space, be it a Green Dot or a Galileo, that continue to play in the space and are adjusting and have done acquisitions and their businesses have changed over time. So it's an evolving space, and we think we're in a unique position in terms of our product, with what the Helix product is in terms of our go-to-market strategy. And we're just trying to focus on where we are well positioned, where we think we have the right to win, and we're executing at a high level on that. And so that's been the focus.

Operator

Your next question is from the line of Andrew Schmidt with Citi Global Markets.

Andrew Garth Schmidt
Citigroup Inc., Research Division

Congrats on the steady results here. I wanted to dig into the win rate a little bit, and apologize -- I hopped on late, apologies if this has been asked. But continues to be elevated, very positive. What do you feel like is driving it? Obviously, there's a self-driven function in terms of your product set, I think commercial capability is a part of it. But is there also a competitive or a market dynamic as well that's supporting the elevated win rate? Would love to just dive into the -- what's supporting that elevated win rate.

Matthew P. Flake
CEO & Director

Yes. Thanks, Andrew. I will tell you it's a couple of things. The work that the 2,300 people this company do every day to provide a great customer experience sells a lot of software for us. They wake up, they get up early in the middle of the night. When they're going to solve problems, they'll do that. And we have -- I don't know that I've had customers as happy as they were at this last conference that we had and pleased with our delivery, not just of our products but of the service associated around it.

Obviously, the next thing will be the products are highly differentiated in the marketplace. And I don't know why, but for some reason, other providers in the space are struggling with that. I don't want to use any names, but there's a collection of larger companies that are out there that are -- have a lot of different things going on and focus that may not be on digital banking applications and all the stuff I just talked about that matters earlier. And then when you get into an environment where you are right now, where there's just a feeling of a regulatory push coming down on financial institutions, smaller companies that aren't profitable, that aren't publicly traded and don't have all of the things that come with that, it's difficult for a customer -- for prospective customers to do business with those folks.

So you have kind of the churn and the thrash that's going on with the larger providers that are out there or the ones that have been around a little longer. And then you have the smaller customers, which it's really difficult to get to the regulatory gates, to get some of the deals done for these banks. So that's what I would say contribute to the win rate for us right now.

Andrew Garth Schmidt
Citigroup Inc., Research Division

Very nice. And then maybe just dig into your technology initiatives a little bit. I know you guys are always doing a lot, but we talked about this in the past. Maybe a little reminder. I know you guys have a number of things going on, whether it's moving workloads to the public cloud, streamlining code bases, things like that. Maybe just talk through what you're doing internally and then -- progress there and then the influence on gross margin over time?

Matthew P. Flake
CEO & Director

Why don't you talk about the products? And then David, if you can talk about the gross margin improvement stuff that you're seeing through.

Kirk L. Coleman
President

Yes, sure. So thanks, Andrew, for the question. I mean, you pointed out a few of them. The truth of the matter is that if you go back over the '19 history of the company, right, it's never standing still, right? We never kind of get into this kind of legacy mindset where we're just kind of milking the asset. And so it's -- we're always pushing it forward, whether that's the product and the code itself or the underlying infrastructure, how we even think about going to market and supporting our customers.

And so I would say that inside the company, we're just really focused every day on -- look, there are some very big initiatives, whether it's a cloud migration, things like that, but there's also lots of smaller things that it's kind of like the compound interest of just doing the right things, from being good operators every single day, that add up. And that could be making sure that we chase out complexity of processes. That kind of naturally happens as you get better and making it simpler to do business with us. It could be the way that we prioritize work and having clear line of sight into the choices that we're making. I think we've gotten really good at that.

And that helps a lot that really pays dividends throughout the company as you add all those things up. We're excited about some of the opportunities that lie ahead of us also in areas like artificial intelligence and things like that in terms of just helping us be better operators, but also in terms of what that might mean for our products. It's a little early to really say exactly how that's going to play out, but we see some opportunity there. So it's a lot of things stacked one on top of the other that -- and that also makes it for a sustainable way of operating, right? It's not just kind of like one big swing of the axe, right, but it's something that we could do repeatedly.

David J. Mehok

CFO & Principal Accounting Officer

Yes. And Andrew, on the gross margin initiatives, you touched on one of them, and that's one that is not going to have an immediate impact to the P&L. You've got to look out 3 to 4 years before that starts to have material impact positively on gross margin, and that's migrating workloads out to the cloud. We're doing that in concert with our customers with their feedback and making sure there's absolutely zero disruption. And so it's happening in a very gradual fashion. We migrated about 25% of the workloads over last year. And this year, we're going to do about another 25%. And you can assume that the next 2 years following we'll get the remainder of it.

But shorter term, you've obviously seen that we've shown some pretty significant increase in gross margin. I think it's about 320 basis points year-over-year. Most of that is driven by things like migrating some of our tasks to our global workforce, and you can't do that without doing it with process improvement. So we've been able to drive process improvement across the organization, make things much more repeatable and predictable, and as a result, able to effectively utilize our global workforce much more so than we were able to even 12 months ago. We're doing the same thing with support.

And then we're also doing a lot with pricing and packaging, and that's not only on new deals but also through renewals. We're using tools that we have internally and obviously, different levers to make sure that as we're going through the renewal process, we're extracting the value that we're providing to our customers through that process and doing so in a much more thoughtful way. So all of those are adding up, you start stacking those on top of each other, and that's what drives the type of gross margin accretion that you've seen from us over the last 3 to 4 quarters.

Operator

There are no further questions at this time. Ladies and gentlemen, thank you for participating. This concludes today's call. You may now disconnect.

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