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Q2 Holdings, Inc. (QTWO)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Sarah and I will be your conference operator today. At this time, I would like to welcome everyone to the Q2 Holdings Fourth Quarter and Full Year 2023 Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

I would now like to turn the call over to Josh Yankovich, Investor Relations. Sir, you may begin.

Josh Yankovich

Director-Investor Relations, Q2 Holdings, Inc.

Thank you, operator. Good afternoon, everyone, and thank you for joining us for our fourth quarter and full year 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 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 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 Annual Report on Form 10-K for the full year 2023 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 the 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 on 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 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

Chief Executive Officer & Director, Q2 Holdings, Inc.

Thanks, Josh. I'll start today's call by sharing our fourth quarter and full year results and highlights from across the business. I'll then hand the call over to Jonathan to discuss our strategy and provide updates on our emerging businesses. David will then discuss our financial results, share guidance for the first quarter and full year, and provide updated financial targets for the next three years.

In the fourth quarter, we continued to execute at the high end of our financial expectations, generating non-GAAP revenue of \$162.2 million, up 11% year-over-year and 5% sequentially. We also generated adjusted EBITDA of

\$23.2 million, representing 14.3% of non-GAAP revenue, an improvement of more than 850 basis points of adjusted EBITDA margin over the prior year quarter.

We closed out 2023 with outstanding sales execution in the fourth quarter, demonstrated by a record total bookings performance that was over 75% higher than our previous all-time high for a single quarter. Sequentially, we added a record \$269 million in total backlog and approximately \$47 million in subscription annualized recurring revenue or subscription ARR, and we signed our two largest deals in company history.

The largest deal was a digital banking platform win with a top 10 credit union. This was a retail opportunity and to win a deal of this magnitude in the credit union space highlights the strength and differentiation of our retail solutions.

The second largest deal in company history was a net new relationship pricing win with a top four US bank. With the addition of this customer, 7 of the top 15 North American banks now utilize our relationship pricing solutions. In addition to these record deals, our sales success from the quarter was broad, covering a strong mix of net new and expansion deals with financial institutions of all sizes across our target segments.

The fourth quarter sales performance concluded the most impressive sales year in company history, and I'd like to take a few minutes to recap the full year. And looking back at 2023, the macroeconomic environment ultimately created a tailwind for our sales efforts.

Financial institutions rapidly shifted their focus to attracting and growing deposits, which we believe contributed to one of the strongest demand environments we've seen in 20 years. And the strength of our product portfolio puts us in an advantageous position to capitalize on these market dynamics. We believe we're the only digital banking provider with best-in-class retail, small business and commercial solutions on a single platform that's proven to help financial institutions grow deposits.

Our sales teams executed on the strong demand and product market fit, making 2023 our biggest bookings year ever, not only in terms of net new deals, but also in cross-sales and renewal. We signed 17 total Tier 1 and enterprise deals in the year, with 4 of them among our top 10 deals of all time in terms of contracted ARR. We had a number of marquee relationship pricing wins, particularly with Tier 1 and enterprise institutions. And in addition to our success upmarket, we won retail, small business and commercial digital banking deals across Tier 2 and 3 segments as well, which have long been the bread and butter of our digital banking business.

On the product innovation front, one of the biggest themes in our industry and in our customer conversations in 2023 was the discussion around new AI advancements and how they might impact financial services. We've been using machine learning in our products for almost 15 years, helping our customers drive better fraud prevention, marketing and operational efficiency. Going forward, we intend to keep AI as a core tenant of our innovation strategy, whether by developing and partnering around new AI-powered products or using AI to enhance our existing product portfolio.

In addition, we already have internal use cases for our employees leveraging AI, which has the potential to further enhance our operational efficiency. We believe that financial institutions are going to expect their vendors to have a comprehensive and compliant approach to AI. And that with our deep domain expertise, we're positioned to lead the way in delivering innovative solutions that anticipate the evolving demands of the industry and help our customers to be more efficient and effective.

Last but not least, 2023 was a year in which we made considerable progress on improved profitability, by increasing our focus on higher margin subscription revenue opportunities and continuing to execute on cost efficiencies across the business. We drove nearly 600 basis points of adjusted EBITDA improvement for the full year while delivering an exceptional customer experience, continued product innovation and maintaining an award-winning culture. This record sales performance, our broad and differentiated product portfolio, as well as the rapid progress on our profitable growth initiatives, all demonstrate the strength of our business model and give me confidence in our trajectory looking ahead to 2024 and beyond.

With that, I'll hand it over to Jonathan to discuss our strategy and updates on our emerging businesses.

Jonathan A. Price

Executive Vice President-Strategy & Emerging Businesses, Q2 Holdings, Inc.

Thanks, Matt. I'll start with Q2 Innovation Studio, which had a breakout year in 2023 in terms of driving sales success for the company. It was cited as a key reason for choosing Q2 in more than 90% of net new digital banking deals in the year. And today, approximately 80% of our digital banking platform customers are participating in the Innovation Studio ecosystem.

Now that Q2 Innovation Studio has such a strong roster of partners and customer utilization, it's beginning to drive an increasing financial impact for our customers. In fact, a number of our customers have told us they have been able to offset the annual cost of their digital banking contract by more than 50% through the revenue and cost savings they drove with our Innovation Studio solutions in 2023. We're only in the early innings of seeing this flywheel effect, and we're excited about Q2 Innovation Studio's ability to continue differentiating us in the competitive landscape and drive even more strategic and economic value for our customers and Q2 over the long term.

On the Helix front, we had a number of key wins and developments in 2023. In spite of a more challenging fintech backdrop than in prior years, we added new customers, extended some of our biggest existing customers, and launched new programs and products, and ended the year strong with a couple of wins in the fourth quarter.

We also began to expand our go-to-market focus to deliver Helix to financial institutions in late 2023. Helix is a cost-effective, cloud-based core for deposit accounts. Given the macroeconomic backdrop, we've seen an increase in demand for this technology from financial institutions and believe there are several exciting use cases for financial institutions to use Helix to bolster their deposit-gathering strategies, such as launching a direct bank with Q2 Fabric, which we announced last quarter.

We believe taking Helix to market with financial institutions is a natural evolution of our strategy, and we're excited to bring it closer to our digital banking customer base in the quarters ahead. And whether it's by helping financial institutions drive more efficient and profitable deposit growth via Helix or the tangible economic and strategic value we're delivering through Q2 Innovation Studio, we believe we'll look back on 2023 as a year in which our emerging businesses began to transform the relationship we have with our customers, creating a true ecosystem in which they're able to use our products for a wider range of their business needs, as well as improving their ROI by generating revenue and cost savings.

With that, I'll hand the call over to David to discuss our financial results.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Thanks, Jonathan. The fourth quarter concluded the year that delivered record financial performance across many key metrics, with significantly improved margins, cash flow and a stronger balance sheet. For the full year of 2023, adjusted EBITDA more than doubled from the prior year and full year free cash flow improved by over \$30 million, resulting in an end-of-year cash balance of over \$324 million.

In the fourth quarter, we delivered strong financial results with adjusted EBITDA at the high end of our guidance, as well as our best ever bookings performance, which drove record growth of subscription ARR and backlog.

I will now discuss our financial results in more detail and conclude with our guidance for 2024, as well as updated three-year financial targets. Non-GAAP revenue for the fourth quarter was \$162.2 million, an increase of 11% year-over-year and up 5% sequentially. Total non-GAAP revenue for the full year was \$625 million, up 10% from the prior year. The year-over-year and sequential increases for the quarter were primarily driven by an increase in subscription revenue associated with [ph] cross-sell (00:11:36) solutions and digital banking go-lives, which occurred during the quarter.

The year-over-year growth also benefited from the effect of the previously disclosed mutual termination of an [ph] all-buy (00:11:48) customer contract in the fourth quarter of 2022, which negatively impacted our 2022 results and contributed 230 and 320 basis points, respectively, to our Q4 2023 total revenue and subscription revenue growth rates.

Our subscription revenue growth for the full year was 16% and was a record high 78% of our total revenue. Based on the strength in subscription-based bookings we observed during the year, we continue to expect our subscription revenue will make up an increasing mix of our overall revenue in 2024.

As expected, our services and transactional revenue categories both declined year-over-year in the fourth quarter, driven by continued pressure associated with some of our professional services engagements, which are more discretionary in nature, as well as lower pass-through revenue from our Helix business, both of which have been impacted by macroeconomic factors.

In aggregate, our non-subscription-based revenues for the fourth quarter declined by 6% year-over-year and represented 22% of total company revenue, down from 26% in the prior year period. As we discussed previously, as part of our profitable growth strategy, we're directing investments towards our most profitable subscription revenue streams and given the industry and macroeconomic drivers we discussed, we expect the trajectory that we've experienced in our lower margin transactional and services revenue streams to continue.

Total annualized recurring revenue or total ARR grew to \$734.8 million, up 12% year-over-year, from \$655.2 million at the end of 2022. Our subscription ARR grew to \$593.9 million, up 19% year-over-year, from \$500.9 million at the end of 2022. Our ARR growth for the year was driven primarily by our strong bookings performance, with total ARR growth being partially impacted by a decline in transactional as well as services and other revenue.

Our ending backlog of approximately \$1.8 billion had record increases of \$269 million sequentially, or 17% and \$343 million year-over-year or 23%. The year-over-year and sequential increases were driven by the strength of net new, cross-sale and renewal bookings during the quarter. While we typically expect an increase in our fourth quarter backlog based on the seasonality of renewals, the magnitude of both the sequential and year-over-year increase clearly exhibit the exceptionally strong bookings performance.

Our trailing 12-month total net revenue retention rate for 2023 was 108%, down from 110% in 2022. The annual decline reflected the continued strength observed in subscription-based revenue derived from our existing

customers, offset by the expected decline in discretionary services-based revenue with some of our existing customers.

Our revenue churn for 2023 was 6.1%, improving from 6.3% in 2022. We believe we will see a continued reduction in our churn rates in 2024, with digital banking churn well below 5%, based on the renewal strength in 2023, coupled with continued high customer satisfaction. Gross margins were 56% for the fourth quarter, up from 51.5% in the prior year period and 53.9% in the previous quarter. Both the year-over-year and sequential increases were driven largely by a favorable increase in higher margin revenue mix and cost efficiencies, which resulted in cost of sales being roughly flat in terms of total spend.

The year-over-year increase in gross margin also benefited by approximately 150 basis points related to the impact of the previously discussed contract termination in the fourth quarter of 2022. Gross margins were 54.5% for the full year, up from 51.6% in the prior year. This expansion of almost 300 basis points was due to a higher mix of incremental subscription revenue, as well as efficiencies gained through more effective utilization of our global workforce.

Total operating expenses for the fourth quarter were \$74.8 million or 46.1% of revenue, compared to \$72.7 million or 49.5% of revenue in the fourth quarter of 2022, and \$71 million or 45.8% of revenue in the third quarter of 2023. The fourth quarter year-over-year improvement in operating expenses as a percent of revenue was driven primarily by improved scaling of expenses within sales and marketing as we continue to drive improvement in our cost of acquiring new customers and overall sales efficiency.

We ended the year with 2,315 total employees, up from 2,249 at the end of 2022, with the majority of additional resources on-boarded primarily within our cost of sales and R&D functions. Total adjusted EBITDA was \$23.2 million for the fourth quarter and \$76.9 million for the full year. The full year adjusted EBITDA was more than 2 times the adjusted EBITDA we delivered in 2022, with adjusted EBITDA margins up by approximately 580 basis points, as we continue to mix the higher margin revenue streams and drive efficiencies throughout the business.

We ended the year with cash, cash equivalents and investments of \$324 million, up from \$290.8 million at the end of the third quarter. We generated cash flow from operations in the fourth quarter of \$36.6 million. The strength in operating cash flow was primarily attributable to strong working capital management and favorable seasonality. We also generated free cash flow of \$29.8 million during the quarter.

For the full year, we generated cash flow from operations of \$70.3 million and free cash flow of \$39.6 million. Our free cash flow was negatively impacted by over \$7 million from a few larger customers delaying invoices into 2024. As a reminder, our first quarter is a seasonally low quarter for cash flow based on our annual bonus payout, combined with the end of year commission payouts.

Looking forward, we expect consistent progress on working capital management and scaling of our cash CapEx to revenue, resulting in free cash flow conversion to adjusted EBITDA of over 60% in 2024 and expanding thereafter.

Let me wrap up by sharing our first quarter and full year 2024 guidance. We forecast first quarter, non-GAAP revenue in the range of \$161.7 million to \$164.7 million and full year non-GAAP revenue in the range of \$683 million to \$689 million, representing year-over-year growth of 9% to 10%.

Please note, we do not anticipate any impact to revenue from deferred revenue associated with purchase accounting in 2024 and beyond. So our non-GAAP revenue guidance is the same as GAAP revenue for the

equivalent period. We forecast first quarter adjusted EBITDA of \$22 million to \$24 million and full year 2024 adjusted EBITDA of \$107 million to \$111 million, representing approximately 16% of revenue for the year. We continue to believe, we're well positioned to achieve our Rule of 30 target on a total revenue growth basis in the back half of the year.

In addition to our outlook for the current year, we're also unveiling our new financial targets. This set of long-term targets for the next three years is reflective of our expectations for the continued execution of our profitable growth strategy. Based on the strong bookings performance we had in 2023, in addition to the pipeline that we have entering the year, we're targeting an average subscription revenue growth rate of approximately 14% for the next three years.

It's important to remember that while some of the larger deals we've signed in the most recent quarter carry longer implementation timelines and have minimal benefit to revenue in 2024, these deals provide us with early visibility into 2025 and beyond.

In addition, we believe that with our continued progress on profitability improvements, we will achieve an annual average of 300 to 400 basis points in adjusted EBITDA margin expansion over the next three years. As we mentioned previously, this focus on increased profitability also extends to cash flow generation. We expect free cash flow conversion of adjusted EBITDA to increase to over 70% in 2026. And we currently expect to retire our existing convertible debt over the next few years, while maintaining ample cash on our balance sheet to run the business.

Looking back on 2023, it was a pivotal year in our financial journey, and we're pleased with the progress we made on our key objectives. We remain confident in our ability to continue to drive meaningful improvements in our results going forward. As we continue to execute on our profitable growth strategy, we will invest in areas of the business which we believe will generate the best returns for our customers and our shareholders while we continue to drive efficiencies and deliver outcomes aligned with our financial targets.

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

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

As we kick off 2024, my confidence in the future of the business is stronger than ever. In 2023, we saw record bookings performance across net new, cross and renewals, resulting in record backlog growth. We also built on our legacy of product innovation and excellent customer experience, further deepening our competitive differentiation.

I want to take a moment to thank our customers and employees. Our progress throughout 2023 was a direct result of their commitment and tireless execution. Coming off the last few years of highly complex operating conditions and a rapidly changing macro environment, we're especially pleased with the positive bookings performance and the impact it is having on our business.

We expect this will help drive acceleration and subscription revenue growth in 2025, as we implement some of the larger deals we signed in the second half of 2023. And, if I look at the state of our pipeline and the activity in the marketplace, we expect the strong demand environment to continue, as we believe the focus on deposits is here to stay for the foreseeable future.

Overall, our sales success and associated backlog growth, coupled with our improved profitability in 2023, gives me confidence in our ability to execute on the three-year financial targets that David just shared. And I'm excited about what is to come in 2024 and beyond.

Thank you. And with that, I'll hand it back to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Pete Heckmann with D.A. Davidson. Your line is open.

Pete J. Heckmann

Analyst, D. A. Davidson & Co.

Q

Hey, good afternoon, everybody. Thanks for taking the question and good to see the record bookings.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Yeah, thanks. We're really happy with it, Pete.

Pete J. Heckmann

Analyst, D. A. Davidson & Co.

Q

Can you talk a little bit about, has there been any change in terms of competitive displacements, who you might be displacing on some of these larger deals? Usual suspects, or in some cases are these maybe in-house systems that might take a little bit longer to replace?

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Yeah. It's the usual suspects. I mean, between the legacy providers and then – which are mostly upmarket. And then we competed very well. Win rates, we're at the levels they are, that they've always been at and then upmarket they were probably a little above average, but it's the usual players, Pete.

Pete J. Heckmann

Analyst, D. A. Davidson & Co.

Q

Okay. And then, on relationship pricing, could you remind us, if I remember correctly, in many cases that there is no incumbent solution, but how do those ramp in terms of revenue and how much relation is it to underlying volumes?

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Hey, Pete. It's David. Yeah. The way that those typically ramp is, it depends upon the complexity and the size of the customer. So the larger customers, they can take 9 up to 12 months for implementation. Then the typical customers that we have on those relationship pricing solutions, we can get up and live about six or seven months. Obviously, the one that Matt referenced on the call is a larger one. So that will take longer to implement.

Pete J. Heckmann

Analyst, D. A. Davidson & Co.

All right. That's helpful. I'll get back in the queue.

Q

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Thanks, Pete.

A

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Thanks, Pete.

A

Operator: Your next question comes from the line of Terry Tillman with Truist Securities. Your line is open.

Terry Tillman

Analyst, Truist Securities, Inc.

Yeah. Hey, good afternoon, gentlemen and congratulations from me as well on the bookings and improved cash flow. I guess, just a question for you, Matt, in terms of – it seems like right place, right time here in terms of your focus on deposits, commercial and treasury management. Maybe this is a multi-year product cycle or a placement cycle, I should say. I mean, I don't want to put words in your mouth, but what's the visibility in terms of the goodness continuing here with the opportunities on commercial deposits and treasury? I don't have any sense on how many more unit opportunities there are, but maybe you could shed some more light on the longevity of this potential replacement cycle? And then, I have a follow up.

Q

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Yeah, Terry. I mean, like I said, I haven't seen a demand environment like this in a long time. And I've been doing this since pretty much the beginning of Internet banking. The relationship pricing is also very popular. I think it shows the power of our products to acquire and retain deposits. And I think deposits are at the center of what our customers and prospects are looking for.

A

So the commercial opportunity is obviously tremendous. We still have a lot of greenfield out there to go get new opportunities, plus cross-sell into existing. The larger deal we signed in the quarter was a retail deal, though. I don't want to lose sight of the power of our retail platform. We certainly hope that we execute on that delivery, that there'll be a commercial opportunity down the road for them as well. But it's not just digital banking, it's not relationship pricing. We were really successful with our fraud products. We had good expansion in relationship pricing. Innovation Studio is continuing to differentiate for us. All of the Tier 1s that we signed on the digital banking side had Innovation Studio included in them.

So the momentum is there and you would think after the record performance, we had to close out the year, that the pipeline would kind of be drained a little bit, but the pipeline is healthier than it was last year at this time. You kind of build momentum throughout the year, through the seasonality of it, but we feel really good about the opportunity and where the products are right now. We just got to go execute on it and I have full faith and confidence in the sales organization and relationship management teams to go do that.

Terry Tillman

Analyst, Truist Securities, Inc.

Q

That's wonderful to hear, Matt. I guess, David, maybe just a question for you. I was pleasantly surprised to get three years' worth of financial target information. I guess, you all have been busy here getting into the – ahead of this earnings call. But one thing I'm curious about is if my math's right. If we're looking at a 22% to 24% EBITDA margin, as we look out [ph] four years (00:29:05). What I'm curious about is how much of that is gross margin expansion as opposed to any of the three OpEx items being outsized in terms of where the leverage comes from? Thank you.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah. Thanks, Terry. It is going to be a mix of both. And I would say for your modeling purposes, it would be skewed slightly towards OpEx scaling. So OpEx scaling, driving about 60% of that EBITDA improvement over the course of the three years. And gross margin expansion driving about 40%. And so, I think you could think about that as you model out each of the next three years.

Terry Tillman

Analyst, Truist Securities, Inc.

Q

Great. Thank you.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

You bet.

Operator: Your next question comes from the line of Alex Sklar with Raymond James. Your line is open.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you. Matt, I just want to follow up on Terry's first question. Just in terms of following up on the great bookings and your commentary on this macro being a little bit longer lasting. Can you just provide some more color on what you're seeing in terms of like pipeline growth or RFP activity? I know you commented on the past in terms of growth the start of last year. What are you seeing kind of in growth this year in terms of giving you that level of confidence?

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Well, it's a combination of the pipe is larger than it was a year ago in the first quarter. And as I said, it builds but I don't have the number on the RFP activity, but we're seeing good activity there, which is always an indicator. Plus, the deals that are in-flight right now. You have some carryover from the end of the year. It just gets busy and holidays get in the way. So when I combine all of those things and the engagement we're getting from executives at our prospects, it gives me a lot of confidence in the pipe for the foreseeable future. And it should continue to build based on this environment we have around deposits and it's the lifeblood of banks and credit unions right now.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Q

Okay, great and great to hear that the record bookings didn't exhaust the late-stage either. So that's a good start for this year here. And David, just on the renewal activity you saw in the fourth quarter. I know this has kind of been a bigger focus area for the company the last few quarters. Can you just talk about what you saw in Q4 from expansion on renewal or any other metric that you're tracking your investments there? Thanks.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah. Sure, Alex. And we talked about this previously, but we typically see a lot of renewals take place in Q4. If you go back a year ago to 2022, we saw about 43% of our renewals happen in Q4. This year, it's about 38%. So relatively aligned.

And to your question specifically, we're getting better economics out of the renewals. What we're seeing is opportunities to expand our product set. We're seeing opportunities to maintain and raise pricing depending upon how the deals were priced years ago. And all of that is resulting in more of an uplift as we go through this renewal process. And obviously, that compounds over time. So the more the teams continue to execute on this, like they have the last few quarters, the more that starts to build on our subscription revenue going forward for the next few years.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Q

All right. Great color. Thank you both.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Thanks, Alex.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Thanks, Alex.

Operator: Your next question comes from the line of Adam Hotchkiss with Goldman Sachs. Your line is open.

Adam Hotchkiss

Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Thanks for taking the questions. I guess, Matt, I'd be curious if you're seeing an evolution in change management philosophy with the momentum you saw in Q4. Are you seeing a higher proportion of companies that would typically stick with existing solutions, push through the anxiety around change friction and go forward with replacement? Or is this more just a function of a much wider top of funnel and that similar levels of conversion? Any color there would be helpful?

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

I just think the sense of urgency around these – our customers because of what went on in March, deposits went to the Big Four. A lot of those commercial customers got to see the technology that the Big Four use and they came back to people that were using legacy tech and saying, hey, I want to bank with you, but you've got to upgrade your tech. And that's where the demand is coming from, coupled with the breadth and depth of our platform that we can go replace a retail product, a small business product or a corporate product, as well as all the fraud solutions.

And it drives efficiency, it drives better user experience, makes the bank more efficient. And then, you couple that with all the data we get off of the single platform, it's a very compelling story. So I think that, a lot of the – whether it's a Tier 1, Tier 2 or Tier 3, I hate to say it, but fear sells a lot of software. And the environment that they ran into in March really got them focused on making these changes. And that's why the execution and the record year we had, it was just, like I said, something I haven't seen in a long time. And that momentum carries into 2024. So I think this is a decision that banks and credit unions are making that digital is where they have to go to drive user experiences to acquire and retain deposits. In this environment, they have to have the best platform out there.

So I think they're making the decision to do it and they're overlooking kind of run the bank technology like core and card and payments things to get the customer experience up to where it needs to be so they can acquire and retain those deposits.

Adam Hotchkiss

Analyst, Goldman Sachs & Co. LLC

Okay. Thanks, Matt. That's really helpful. And then, David, when you talk about the medium term EBITDA margin expansion guidance for 300 to 400 basis points, can you give us a better sense for what's embedded there from a revenue mix perspective? I guess, said another way, if you were to see a bit better performance in the lower margin segments like transactional and services, would you still expect to be able to achieve that or are you both more focused on EBITDA dollar generation?

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Yeah, Adam, and first, just to sort of reiterate the lay of the land around that revenue mix. Obviously, you have the subscription numbers out there in the 14% average that we're expecting over the next three years. We are expecting over that period of time and just based on what we know today, the continued pressure on the other forms of revenue, both transactional and services, just think of it as what we've seen over the last few quarters, which is low-single-digit declines year-over-year.

So if we do start to see a pickup in any of those revenue streams, you see some pressure on our gross margins. Now, we feel like we've done a very good job of addressing our spend in other areas of the business to maintain the types of margins that we're committing to. And that would certainly be the case here. So if we see some pressure on gross margin based upon incremental revenue, with some of these line items that are lower margin, we'll adjust our spending to make sure that we hit the targets that we've [ph] given today (00:35:58).

Adam Hotchkiss

Analyst, Goldman Sachs & Co. LLC

Okay. Really helpful. Thanks, David.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

You bet.

Operator: Your question comes from the line of James Faucette with Morgan Stanley. Your line is open.

James E. Faucette

Analyst, Morgan Stanley & Co. LLC

Great. Thank you so much. I want to just follow on the margin question. Clearly, a key objective for you is, as you said, you're going to adjust expenses, et cetera, accordingly. How should we be thinking about or at least how are you thinking about where the ultimate margin level for the business should be and what you think should be achievable, even if we're looking kind of beyond your three-year horizon?

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Yeah. James, I'm assuming you're talking about EBITDA margin and, right now, we...

James E. Faucette

Analyst, Morgan Stanley & Co. LLC

Yeah, yeah, yeah, yeah, yeah.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Yeah. And look, this is – I've said this term once before and I think, we all agree this is the case now. We're pleased with the targets that we have out to 2026, but doesn't mean we're done. I mean, we certainly feel there's opportunities to continue spend going forward from 2026. We're not going to provide an exact number on that. But it's not like, we get to this 300 to 400 basis points over the next three years and we're stopping.

We certainly feel like there's continued opportunities to continue to expand. We're just not going to give specifics on that, nor are we going to give an exact number. But the efficiencies that we're driving across the organization are sustainable. We can build on those over time. And as a company that's approaching at some point down the road, \$1 billion, we certainly get scale out of a lot of the things that we're doing as a company. And we have certain aspects of our cost structure that's fixed. And as we continue to grow the business, the margins naturally expand from there.

James E. Faucette

Analyst, Morgan Stanley & Co. LLC

Yeah, yeah, yeah. Okay. That's super helpful. And then, capital allocation, you mentioned in the release that one of the primary uses of your free cash flow would be to service debt. And I'd imagine that there should be some enterprise value shift to equity from that. But can you rank order for us how you're thinking about capital allocation, generally? And how should we think about how that may change as free cash flow conversion improves? And you bring down kind of debt levels. Does it make more sense to do buybacks or acquisitions to further expand the capability that you can deliver to customers? Just trying to think how you're thinking about rank order prioritization right now.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Yeah. James, I'll start off and I'll hand over to Jonathan, he can talk a little bit about the M&A landscape because obviously, that's one avenue to deploy our capital. I mean, but as we sit here today, given the backdrop that we have from a macro standpoint and the debt that we have coming due in 2025 and 2026, we're maniacally focused on continuing to generate cash. And that cash, as we sit here today, will be used to retire the debt.

But as environments typically do, they may change but Jonathan can give you the lay of the land on how he sees things today, and then how we might be able to pivot going forward.

Jonathan A. Price

Executive Vice President-Strategy & Emerging Businesses, Q2 Holdings, Inc.

A

Yeah. Hey, James. We feel pretty confident that the timing of as we work through the converts and we scale our free cash flow profile, that, that'll time out pretty well with when we expect to see opportunities come to the table with more realistic value expectations and higher quality assets. Even here in early 2024, the M&A pipeline tends to still be skewed with folks that haven't yet adjusted to public market valuations that have taken place over the last several months.

And also, not the higher quality assets that are willing to come to market. So as we get into the back of 2024 and into 2025, I think you're going to see more volume in the M&A markets broadly. And I think, we'll be in a stronger position, will be more credible from a balance sheet perspective to be competitive in those deals. And so, I think it's a longer-term opportunity when we think about capital allocation via M&A.

James E. Faucette

Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much for the color there.

Jonathan A. Price

Executive Vice President-Strategy & Emerging Businesses, Q2 Holdings, Inc.

A

Thanks, James.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Thanks, James.

Operator: Your next question comes from the line of Joseph Vafi with Canaccord Genuity. Your line is open.

Joseph Vafi

Analyst, Canaccord Genuity LLC

Q

Hey, guys. Good afternoon. My congratulations as well. Maybe just we start with – it sounds like you're doing well competitively in the marketplace. And obviously, it's still a dog eat dog competitive landscape. But just wondering if you have any pricing power in the business now versus a couple of years ago and generally, how the pricing environment is? And then, I have a follow-up.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Yeah, Joe, I mean, if you look at our ASPs, they're up. The pipeline's ASPs are up. So, we're able to drive the price we want. We don't really get into the price game too much. Our customers, our prospects, I guess, are ones

that are looking to use this technology as a weapon and not as a shield. And so, we continue to – with that group of people going cheap is usually not, it's actually probably the product that we're running on. It's probably a little less expensive. So they understand that it's expensive to build this. It's expensive to support it. It's expensive to deliver it. And so, we believe they're receiving a fair value for it. But also, you know, they want us to be around. They want us to be profitable. Many of our customers are excited about our progress on profitable growth.

So, we continue to be able to kind of command the price we need in these strategic deals, because we're able to sell the value of the platform that they get for, whether it's customer experience or operating efficiency or using the data down the road for them. So all that has really differentiated us in the market and that shows up in ASPs as they continue to go up.

Joseph Vafi

Analyst, Canaccord Genuity LLC

Q

Great. And then, just kind of understanding that the converts are coming and you're really focused on the debt paydown. But if that were not the case, how do you feel about the overall product suite right now? Are there areas to continue to expand? I mean, we're seeing a lot of traction, for example, in a lot of these next-generation lending algos and the like. Just, I mean, without giving up the strategic secret sauce, how do you look at the product roadmap? I know there are some nice areas to add on to the overall portfolio at this point. Thanks a lot.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Yeah, Joe, I would just say that we invested a lot in the product in 2020 and 2021 and 2022 across the board. That means user experience, commercial, fraud, relationship pricing, Helix, some of the things we've talked about there, our other products that are coming out, we're investing in AI. So, we're committed to investing in all of those products. We're going to continue to do it. We still run at 19% on R&D and somewhere in that area.

And so, we're – I tell people that whenever the customer prospects tell me I'm good, I don't need to build anything, then we'll slow down. But right now, there's – we're trying to digitize every experience you do in person or over the phone with a bank and try to do that on a mobile phone, a tablet or desktop. And there's a lot of features and functionalities we've got to build both for the end user, as well as for the bank, to make them more efficient and provide better experiences. So all of those areas are places we're investing in, and we're going to continue to do that because that's what differentiates us and it's what gives us durability in this company to be able to achieve our targets over the next 5 to 10 years.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

And hey, Joe, just to build on Matt's point, the aspect of us servicing and retiring our debt in no way, shape or form, prevents us from investing in the product. That is critically important for us, always has been, still is. We're continuing to prioritize the key investments in the product that our customers want and need most. That does not change because of the debt coming due.

Joseph Vafi

Analyst, Canaccord Genuity LLC

Q

Got it. Thanks for that color, guys. Great quarter.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Thanks, Joe

David J. Mehok
Chief Financial Officer, Q2 Holdings, Inc.

Thanks, Joe.

Operator: Your next question comes from the line of Adib Chowdhury with William Blair. Your line is open.

Adib Choudhury
Analyst, William Blair & Co. LLC

Hey. Good afternoon, guys. Thanks for taking our questions. I guess, on Fabric, I realized it's early days there, but could you kind of comment on some of the initial uptake you've been seeing over the last couple of months? And if you've kind of been getting a lot of interest from your existing customer base since that product was launched.

Jonathan A. Price
Executive Vice President-Strategy & Emerging Businesses, Q2 Holdings, Inc.

Yeah. Thanks, Adib. That is where the early focus has been, is on the existing customers. And yeah, we're having lots of conversations. I think it ties back to Matt's point around their orientation around deposits, and when they think about Fabric, it's an opportunity for them to leverage an existing solution they already have with the digital banking product, tied into our lightweight core. And so, those conversations are going well. Pipeline looks great. It's early. So, it just – it's too early to sort of call how much excitement we expect to see in terms of bookings velocity here in the early part of 2024. But we're seeing the right signs of interest from our customer base, and just tons of strategic conversations, and they're all around deposit gathering strategies, retention and growth for these institutions. And it's across banks and credit unions, it's all asset sizes across the spectrum. So, we're pretty excited and seeing good evidence that the strategy is making sense. But we just got to execute and see how these conversations come to fruition over the next few months to give you more color.

Adib Choudhury
Analyst, William Blair & Co. LLC

Okay. Good to hear. And I know you guys kind of commented already on M&A opportunities, potentially in the future. But thinking some of your – about some of your recent – or your acquisitions over the last couple of years, ClickSWITCH, PrecisionLender, Sensibill, as you kind of reflect on these deals, could you kind of generally comment on maybe how they've performed relative to your expectations? Thanks.

Jonathan A. Price
Executive Vice President-Strategy & Emerging Businesses, Q2 Holdings, Inc.

Yeah. I mean, I think in – we think about the most recent deals, I mean, we're seeing them being, in some cases, heavily cross-sold alongside platform deals on the digital banking side, and I think about a deal like Sensibill, where the use cases now across our AI initiatives internally are very prevalent and they're driving it, they're using their technology in unique ways to drive cost efficiencies out of our business. So when we think about the most recent deals, we're certainly excited about it. As we go back in time, obviously, different valuation paradigms. So, there's that element of thinking through those deals, but very strategic, even as we think about relationship pricing today, the biggest acquisition we've ever done in the deposit environment we're in today. That product is very topical for our banks, especially the upmarket enterprise space. And so, feel really good about that.

And just one thing I'll add to the sort of M&A discussion here is when we think about the future of what we're seeing also on the Innovation Studio side, we get a ton of visibility into the adjacent areas that our banks and credit unions really care about, what their customers want to see their banks and credit unions adopt technology-wise. And so, that's very informative for us as we think about the longer-term arc of where we need to go as a company, be it organically or inorganically. But we get to see those products in action, we get to see how their clients use it. And so, I think that's an important point to think about how we get informed around whether it's areas like small business applications, payments, like where are the adjacent areas, to one of the earlier questions, that we don't play in today, that maybe we need to in the longer term. That's pretty exciting from a longer-term perspective. So, I just want to throw that in there as well.

Adib Choudhury

Analyst, William Blair & Co. LLC

No, yeah. That makes a ton of sense. Thanks, guys. Appreciate it.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Thanks, Adib.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Thanks.

Jonathan A. Price

Executive Vice President-Strategy & Emerging Businesses, Q2 Holdings, Inc.

Thank you.

Operator: Your next question comes from the line of Parker Lane with Stifel. Your line is open.

Matthew Kikkert

Analyst, Stifel, Nicolaus & Co., Inc.

This is Matthew Kikkert on for Parker. Thanks for taking my questions and congrats on the record bookings and large Tier 1s you signed in Q4. First, given the increase in that backlog, have you given any thought to allocating more resources there to flow that through to revenue quicker?

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Yeah. Look, we are very focused on delivering these in an effective manner. We've been doing this now for 20 years and certainly understand how to slot these and the resources that are needed to do so. So we are certainly dedicating capital towards getting the right resources in place, and quite frankly, making the implementation processes as seamless as it possibly can be, so driving efficiencies through that process. But yes, we're very focused on that.

Matthew Kikkert

Analyst, Stifel, Nicolaus & Co., Inc.

Okay. Got it. And then, as you continue to roll out your Andi AI solution in 2024, what has been the feedback and demand been like since we last spoke? Is there any additional functionality you'd be looking to add to that feature?

Kirk Coleman

President, Q2 Holdings, Inc.

A

Yeah, hey, it's Kirk. I'll take that question. It's – we've had really good early feedback. So, we're in pilot with that right now. So, we're getting kind of live feedback not just from like project teams, but from commercial bankers who are really actually using that every day. So, it's still really early in that product development lifecycle, but we're really happy with the engagement we're getting from our customers and their willingness to work with us on that. And that's kind of spread into the other areas as well, as we sort of look for other opportunities to use AI across our business, both internally and in the products that we deliver straight to our customers.

Matthew Kikkert

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Terrific. Thank you.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Thanks, Matt.

Kirk Coleman

President, Q2 Holdings, Inc.

A

Thanks, Matt.

Operator: Your next question comes from the line of Matthew VanVliet of BTIG. Your line is open.

Matthew David van Vliet

Analyst, BTIG LLC

Q

Yeah. Good afternoon. Thanks for taking the question. So, you mentioned in the prepared remarks that Innovation Studio is continuing to be one of the biggest factors in driving new customer growth, and then you also mentioned that has great visibility into the M&A pipeline. But curious on sort of how much contribution to the Q2 P&L you're seeing from that and when, if at all, do we realize that as kind of a big top and bottom line driver or is this always just viewed as a great extension of the platform, gives more value to what you're delivering and the monetization of it directly maybe isn't as much of the story in the near term?

Jonathan A. Price

Executive Vice President-Strategy & Emerging Businesses, Q2 Holdings, Inc.

A

Yeah. Hey, Matt. I would say, I mean, I think, look, we saw outsized growth from a revenue perspective, let's say, well, north of 50%, but we're still just talking from a small base. And so, we haven't disclosed explicitly what that is for the Innovation Studio line item. Longer term, we very much still have conviction that this is both a strategic element of our business that has an impact on retention and winning new deals, but also a financial one, both on the top line in terms of the revenue impact and the margin profile, because it tends to be and is entirely net revenue that we're recognizing in this model. So, it is a longer cycle to where this is going to be material enough to disclose separately. But we still very much have conviction that it's both. And we were very happy with the – we

put forward from a from a financial perspective on our side in 2023. It's just relatively small numbers compared to the disclosures we have out there on the other lines of business.

Matthew David van Vliet

Analyst, BTIG LLC

Q

Okay. Very helpful. And then, you continue to have great success on the cross-selling side of it. But curious, looking at the opposite angle of where do you feel like you're at in terms of wallet share, whether it's with maybe Tier 1 customers or even across the entire customer base? But how much more can we expect you to have in terms of growth with the current product set at your existing customers compared to going out and finding new logos to maintain growth?

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Yeah, Matt. It's a hard number to quantify, but if you think about the customers that we have, we have 115 customers that are more than \$10 billion in assets. You have relationship pricing, you have the ability to sell either commercial or retail into a significant number of those, plus our fraud products, you have Innovation Studio. The opportunities, it's really early for us in these opportunities. One of the Tier 1s we did in the quarter was a commercial cross-sell to a retail customer that was one of the Tier 1s. So, there's a lot of those opportunities. And when you look at the renewals that we did, they were up 75% or whatever year-over-year in the fourth quarter. That's a customer that's sticking with you for another five years. And so, that typically means you're going to be able to cross-sell more of the products. So that ties to the R&D, the innovation, the roadmap that we have. And we're constantly building new things, whether it's our AI product or Andi copilot or any of those products. So, there's a tremendous amount of greenfield for us to go and cross-sell into this customer base, which provides us a lot of comfort as we think about the coming years on revenue and profitability.

Matthew David van Vliet

Analyst, BTIG LLC

Q

All right. Very helpful. Thank you.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Thanks, Matt.

Operator: Your next question comes from the line of Andrew Schmidt with Citi Global Markets. Your line is open.

Andrew G. Schmidt

Analyst, Citigroup Global Markets, Inc.

Q

Hey, guys. Thanks for taking my questions. Just wanted to dig in on the 14% subscription growth that's embedded in the longer-term outlook, and certainly appreciate the longer-term outlook here, can you talk about just the drivers at a high level? We think about net new clearly as a good visibility, probably through at some point in 2025, but the other growth drivers may be cross-sell or existing user growth, perhaps you could talk to those a little bit in terms of what gets you to 14% and what could kind of bias that one way or another? Thanks a lot, guys.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah, sure, Andrew. And you're right. I mean, we do have a lot better visibility into 2025 based upon the large opportunities that we want at the tail end of 2023. And that's factored into the numbers we provided, the 14% in this instance. As you look forward and try to bifurcate, if you will, between cross and net new, you're typically going to see, and this is what we've seen historically, we don't think it's going to change dramatically anywhere from 60% to 70% coming from net new, the remainder coming from cross. But we do see over the – over a course of time, those start to converge. I don't think they're going to converge too dramatically when we get out to 2026. But as you go model beyond that, I think you start to see a little bit more coming from cross, a little bit less from net new. But for the next three years, we continue to think that we have a lot of opportunity with net new. A lot of them are coming online obviously in 2025 from the bookings that I've said, and then in 2026, that's going to be driven predominantly by the bookings that we do this year in the first half of 2024 – excuse me, 2025.

Andrew G. Schmidt

Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thank you for that, David. And then, if I could just I ask on sales cycle, so topical and the election is coming up, and if I remember back to 2016, there was a little bit of malaise in the sales cycle as a result of uncertainty. Obviously, I think we're in a different time period from a technology adoption perspective with banks and credit unions, but maybe talk through kind of – if there's – I know you've talked about this previously on the call, but if there's anything you're hearing from bank executives about sort of their view heading into the rest of this year? Thanks a lot.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Yeah, Andrew, I don't have a lot of commentary on the election. 2016 was a unique year because you had two unknown commodities and there was a lot of uncertainty. 2020, it was more COVID-focused. And then, this year, who knows how it's going to play out. But right now, there's two known commodities. I haven't heard any slowdown. I don't want to predict it. I don't have a crystal ball. I don't know what's going to happen. But it'll definitely be interesting in the November call because it will be right around the election to see where things land.

But I don't think you have the barring something unforeseen. People know what you're going to get with the two candidates that they're looking at. But I haven't heard much out of our customers or prospects around the election yet. As it gets closer, I'm sure we will. But as long as you have a solid pipeline, you may get some decisions delayed, you may not. But after – there's nothing – after it's done, it's done and you'll get those decisions done. So I'm not seeing it yet, but we'll report back. Probably, we'd have more information in August of how that's looking. But right now, there's no – as I said, the pipe is solid. We feel like we're going to have a solid first half to the year and continue to build the pipe. And we can control what we can control, and the other stuff, we just got to manage through.

Andrew G. Schmidt

Analyst, Citigroup Global Markets, Inc.

Q

Absolutely. Thanks a lot, Matt. Appreciate the comments.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Thanks, Andrew.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

See you next week.

Operator: And your final question comes from the line of Dan Perlin with RBC. Your line is open.

Daniel R. Perlin

Analyst, RBC Capital Markets LLC

Q

Thanks. I just had a question kind of about the, I guess, the optionality of like this pull forward in demand. Like are you concerned that, like, all of these things are kind of hitting at the right time? You're clearly capturing it. There is this massive deposit gathering mentality in the market these days. And I'm just trying to make sure, as we sit here and think about calibrating this, and I know you gave three-year targets, so I mean, you obviously have a lot of conviction and visibility, but do you think there was like a pull forward that's happening right now and does it continue kind of into the early part of next year and then it kind of tapers off? I'm just trying to get a sense of how you're thinking about that.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Yeah. I mean, I think if you think about rates, which is what's driving this demand for deposits, and then the shrinking money supply, deposits are going to be critical for the foreseeable future. And so, I don't see rates going down as fast as they went – yeah, going down as fast as they went up. And so, I think you're going to have, for the foreseeable future, as far as I can see, deposits being at the center of the universe for these – for our customers and prospects. So hard to say what's going to happen out in 2025, but I'm going to make hay while the sun's shining and that's what we're doing. So as long as there's opportunities out there, we're going to continue to go hard at them and try to win them and deliver them and keep them happy and grow them like we've done and try to have 20 or 30-year relationships with these customers.

Daniel R. Perlin

Analyst, RBC Capital Markets LLC

Q

Yes. No, I totally agree. Just another – it's kind of a follow-up to an earlier question, but you've got this massive backlog. You're starting to see this subscription ARR really start to take off. But the growth rate for the year in aggregate is pretty similar to 2023's numbers in terms of the guide. So, you're not seeing a total revenue number that's accelerating materially despite the fact you get this big bolus in demand. So you talked a little bit about, I guess, trying to prioritize implementation cycles, but like is there an opportunity that we could actually see, like material reacceleration coming out of 2024 and into 2025, or is this just a really good visibility as you sit here today and we should just be comfortable with that?

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah, Dan, in Matt's prepared remarks, he did mention that based upon the bookings momentum we saw in Q4, we do expect to see a subscription acceleration in 2025. So, that's sort of embedded in that average 14% number. Where you see a little bit of pressure is continued headwinds on this transactional and services. But the reality of that is over time, that number becomes a smaller and smaller part of the mix. So you've got to fit that into the calculus of how you model the business going forward, which is why we've been focusing on subscription. It's going to breach the 80% mark at some point soon, and it's obviously – it has an increasing importance to our profitability as well.

Daniel R. Perlin
Analyst, RBC Capital Markets LLC

Q

Yes. No, that's great. Great quarter, guys. Thank you.

David J. Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

Thanks, Dan.

Matthew P. Flake
Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Thanks, Dan. Appreciate it.

Operator: And that will conclude today's conference call. We thank you for joining. You may now disconnect your lines.

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