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Q2 Holdings, Inc. (QTWO)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Pam, and I will be your conference operator today. At this time, I would like to welcome everyone to the Q2 Holdings First Quarter 2024 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] Thank you.

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

Josh Yankovich

Director-Investor Relations, Q2 Holdings, Inc.

Thank you, operator. Good afternoon, everyone, and thank you for joining us for our first quarter 2024 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 & 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 in which 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 quarterly report on Form 10-Q for the first quarter of 2024 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 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 first quarter results and highlights from across the business. I'll then hand it over to Jonathan to discuss our strategy and emerging businesses. David will then discuss our financial results and guidance in more detail.

Our financial results in the quarter outperformed our expectations, getting us off to a strong start towards the long-term financial targets we shared in February. In the first quarter, we generated a total non-GAAP revenue of \$165.5 million, above the high end of our guidance. We also continued to deliver on our commitment to improve profitability in the quarter with adjusted EBITDA of \$25.2 million, also above the high end of our guide. And for the first time, we generated positive free cash flow for the first quarter of the year, a total of \$6 million, demonstrating continued improvement in our financial profile. In addition to our solid financial results, we continue to see strong demand in the first quarter with notable activity across net new expansion and renewals. We signed a broad mix of deals across asset tiers highlighted by a greater number of total Tier 2 and 3 deals compared to any quarter last year, as well as four Tier 1 digital banking deals in the quarter, two net new and two that were meaningful expansions.

Our single-platform value proposition was a common theme across all four of these Tier 1 digital banking wins. On the net new side, we won an opportunity with a \$20 billion bank that will consolidate from multiple, disparate, incumbent digital banking solutions and use Q2 for retail, small business and commercial. The second Tier 1 win was a retail digital banking deal with a \$10 billion bank, demonstrating that our platform remains highly differentiated even in significant retail-only opportunities like this. And because of our single-platform value proposition, we expect to compete for the commercial business over time.

On the expansion side, we had significant wins with two existing Tier 1 customers that started with one component of the platform, either retail or commercial, and purchased the other during the quarter. These deals represent just how valuable our expansion opportunities can be, with one of them more than doubling the expected revenue contribution from that customer. I want to take this opportunity to talk about the unique position Q2 is in for continued expansion with our customers and why wins like the two I just mentioned are playing an increasingly important role in our bookings performance.

Starting with our first line of code, 20 years ago, we built a true single platform for retail, small business and commercial. Today, this approach remains tremendously valuable to our customers for a few reasons. First, it

makes our customers more competitive by upgrading them to a best-of-breed solution while unifying the user experience across the customer segments and devices. And because they can add features from across the platform, it lets them grow with their accountholders. So if a retail end user now requires business functionality, they can provide it without having to move them to a different system with a different log in and experience. It also helps our customers with vendor consolidation, allowing them to operate more efficient and moving to a single platform, they can consolidate through multiple systems and vendors down to one and use one set of code to roll out new capabilities. And finally, it helps innovation occur faster, centralizing our customers' data and integrations, making it easier to maintain, to take upgrades, and to add new products and services. Key elements of our product portfolio, such as Q2 Innovation Studio and our artificial intelligence capabilities are enhanced because we have this unified platform. And for Q2, we believe our single platform drives competitive advantage by improving our ability to land and expand.

Due to the various legacy systems that financial institutions often rely on, our customers frequently start with one major product set from us. But once they've converted to Q2, it becomes easier to add product sets through the expansion of our platform. One of our Tier 1 expansions from the quarter is a particular good example of this. An \$8 billion five-bank holding company that originally adopted our commercial digital banking solutions will now add a retail solution to their platform in addition to the improved user experience associated with the single platform. The customer will also drive operational efficiencies by consolidating from five separate bank instances to serve their retail users into a single instance for both lines of business. And when you pair our platform with the breadth and strength of our customer base, we believe our expansion opportunity only becomes greater.

We have approximately 1,400 total customers. And to put expansion potential into perspective, I'll illustrate the opportunity we have within our Tier 1 customer base alone. We have 90 Tier 1 customers that are using the digital banking platform, and less than half of them are using both retail and commercial solutions. On top of that, we have another 130 Tier 1 customers who are not using our digital banking platform, a portion of our customer base that we believe presents great expansion opportunity as well. So while our net new sales performance has been strong and we're optimistic about our pipeline through the remainder of the year, we anticipate this expansion dynamic to continue playing a key role in our overall bookings performance going forward.

Outside of digital banking, our Centrix risk and fraud and relationship pricing teams continue to drive notable sales activity for the business. We had two significant Tier 1 relationship pricing renewals in the quarter. And on the Centrix side, no matter what's happening in the economic environment, fraud remains top of mind for our customers. Our Centrix products, which help them manage risk and compliance, particularly in the commercial banking space, are regularly among our top cross-sell products. And in Q1, we saw over 50% growth in Centrix expansion bookings year-over-year.

So in summarizing the quarter, I'd reiterate the strength of our financial performance which outpaced our guidance in terms of revenue and profitability. Our continued momentum on the net new side with the demand environment that we believe remains strong as we look at the rest of 2024 and a single platform with a broad, diverse customer base that puts us in a unique position to expand our existing relationships as a complement to our net new sales execution.

With that, I'll hand the call over to Jonathan to cover some updates from across our emerging businesses where Q2 Innovation Studio and Helix are also playing a crucial role in deepening our customer relationships.

Jonathan A. Price

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

Thanks, Matt. I'll start with Q2 Innovation Studio. As Matt mentioned, the fintech partner ecosystem we've built through Innovation Studio has become a critical part of our story whether in winning net new deals where it was a key driver in every net new win in the quarter or in terms of expansion where it's helping our customers unlock new business outcomes and, in turn, strengthening our existing partnerships in ways that go far deeper than a typical incremental product expansion.

I'll share a quick customer story to demonstrate this dynamic. We have a Tier-1 bank that's been a Q2 customer for over 10 years. And like many financial institutions today, they're laser-focused on acquiring a new generation of customers. The bank believes embedding best-in-class fintech partners will be a key part of that strategy, and they are using Q2 Innovation Studio to rapidly deploy partner solutions, integrate it into their Q2 digital banking platform that will help them create a better user experience, reduce friction and meet the next generation of customers where they are.

One partner of the bank has deployed provides a digital customer support platform, providing AI-powered self-service and virtual chat capabilities, along with the ability to offer real-time, dedicated banking guidance, much like a traditional banker would in the branch, right inside the digital banking experience. The rollout of this partner has had a significant impact for the bank. Customer adoption has been incredible with minimal marketing on the bank's part. More than 20,000 of their customers are using the new solution. Those customers are now resolving a majority of their typical customer support issues using the virtual chat, which has had a direct correlation with the reduction in call center volumes. These gains have enabled the bank to rethink how they allocate their customer support functions, reducing time spent in their traditional call center and increasingly focusing on digital support and more strategic areas of their business.

And this is just one of many fintech partners the bank has launched to sharpen their value proposition and deepen digital engagement with their customers, both on the retail and commercial side. For example, they've used multiple partners to provide commercial payment capabilities and have achieved more than a 40% growth in payments volume processed by these solutions when comparing first quarter of 2024 with the prior year period. They've used another fintech partner to drive approximately 130% growth in international FX payments over the last 12 months, which is a critical offering in recruiting new commercial customers that also drives revenue for the bank. And beyond the customer experience, the overall impact to their business is impressive too. Through revenue share and cost efficiencies, they offset approximately 50% of their total digital banking cost in 2023.

When you consider stories like this, it's easy to see how Innovation Studio helps drive renewal and expansion activity. It allows our customers to rapidly deploy best-in-class fintech solutions from a marketplace of more than 160 partners. It helps them drive deeper engagements across a broader product suite, and it has the potential to offset the cost of their technology investment with us over time.

Shifting gears to Helix, we have some quality wins in the quarter including a net new fintech win and a meaningful program launch that I'll expand on briefly. In our February call, we mentioned a fintech win that was a competitive takeaway. And in the first quarter, just a few months later, we successfully converted and launched that customer's users on the Helix platform. We are very pleased with the speed of this launch. Not only does it demonstrate the flexibility and strength of the Helix technology, but also our team's ability to successfully launch programs and more specifically conversions off another platform.

Our successful launch with this customer is a particularly useful proof point for us in the market as the current backdrop continues to put pressure on the broader banking-as-a-service landscape. Additionally, this customer is the first to launch with a bank of record partner that we announced in the third quarter of last year which means we were able to stand up the Helix platform, successfully launched its first program and start bringing revenue to

the bank in roughly six months, about half the time it took us historically. As we continue to increase our focus on taking Helix to financial institutions, we believe that our ability to configure and deploy the Helix platform quickly and seamlessly alongside a bank's existing technology stack will be an important differentiator for us.

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

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Thanks, Jonathan. We started 2024 with a strong quarter. Bookings drove meaningful subscription ARR and backlog growth. We delivered revenue and adjusted EBITDA results above the high end of our guidance. And for the first time in company history, we generated positive free cash flow in the first quarter of the year despite normal seasonal cash flow headwinds.

I will now discuss our financial results in more detail and conclude with our updated guidance for our second quarter and full year of 2024. Revenue for the first quarter was \$165.5 million, an increase of 8% year-over-year and up 2% sequentially. Our total revenue growth was primarily from subscription-based revenues which grew 13% year-over-year and 4% sequentially. The year-over-year and sequential growth was driven by new customer go lives, strong expansion sales with existing customers, as well as improved renewal economics. Typically, these expansion sales have a quicker time to revenue and are accretive to gross margin. The stronger renewal performance we are seeing is a continuation of the renewal strength we saw in the second half of last year as we more effectively capture the value we deliver to our customers and extend the contract duration. As expected, our services and other revenue declined both sequentially and year-over-year, driven by continued pressure on the size and scope of our professional service engagements which are more discretionary in nature. We do expect the magnitude of the year-over-year decline in services to improve throughout the year. But as mentioned previously, we continue to expect to see contraction going forward in this lower margin revenue stream due to the macroeconomic factors and financial pressures our customers are facing. Transactional revenue increased by 5% year-over-year and 7% sequentially, largely driven by Helix-based revenues associated with higher seasonal usage.

Total annualized recurring revenue or total ARR grew to \$761 million, up 13% year-over-year from \$672.7 million at the end of the first quarter of 2023. Our subscription ARR grew to \$615.1 million, up 18% year-over-year from \$521.3 million in the prior year period. Our year-over-year subscription ARR growth was positively impacted by net new, renewal and expansion-based bookings with total ARR growth partially offset by a decline in professional services revenue. Our ending backlog of approximately \$1.9 billion increased \$83 million sequentially or 5% and \$387 million year-over-year, or 25%, which is the largest year-over-year dollar increase in company history and the highest year-over-year growth rate we've seen in over three years. The year-over-year and sequential increases were partially driven by renewals as well as expansion bookings as our customers added new solutions and extended contract durations. In addition, our year-over-year growth was positively impacted by consistently strong net new bookings performance over the last 12 months. As we mentioned previously, the sequential change in backlog may fluctuate quarter to quarter based on the number of renewal opportunities available within a given quarter.

Gross margins were 54.9% for the first quarter, up from 54% in the prior year period and down from 56% in the previous quarter. The year-over-year increase in gross margin was driven by an increasing mix of higher-margin, subscription-based revenues and increased efficiencies within our delivery and support functions. The sequential change in our gross margin reflects the incremental implementation expenses recognized in the first quarter associated with the delivery of a high number of go lives which were more than in any single quarter in 2023. Sequential margins were also impacted by a seasonal increase in payroll taxes and 401(k) matching expenses

due to the timing of annual bonus payments and the reset of taxes and 401(k) matching eligibility. Looking ahead, we anticipate continued year-over-year improvements in gross margin for each subsequent quarter and the full year.

Total operating expenses for the first quarter were \$72.8 million or 44% of revenue compared to \$72.5 million or 47.4% of revenue in the first quarter of 2023 and \$74.8 million or 46.1% of revenue in the fourth quarter of 2023. The year-over-year and sequential reduction in operating expenses as a percent of revenue was driven primarily by better scaling of sales and marketing expenses relative to revenue as we continue to drive improvement in our cost of acquiring new revenue which is partially attributable to lower costs associated with expansion bookings. The sequential decline was impacted by approximately \$1 million based on the seasonality of customer events, which are more pronounced in the fourth quarter. As a reminder, in the second quarter, we will be hosting our customers and prospects at Q2 CONNECT, our annual conference, which will have an approximate \$1.5 million impact sequentially on sales and marketing expense.

Total adjusted EBITDA was a record \$25.2 million, up from \$16.5 million in the prior year period and \$23.2 million in the previous quarter. We ended the year with cash, cash equivalents and investments of \$338.5 million, up from \$324 million at the end of the previous quarter. We generated cash flow from operations in the first quarter of \$13.4 million driven by improved profitability and continued effective working capital management. For the quarter, we also generated free cash flow of \$6 million, marking a breakthrough from the historical pattern of negative free cash flow during our first calendar quarter, which carries seasonally higher cash costs associated with our annual bonus and end of year commission payouts. As we mentioned previously, we continue to expect free cash flow as a percentage of adjusted EBITDA to be over 60% in 2024 with a target of continued expansion thereafter.

Let me wrap up by sharing our second quarter and full year 2024 guidance. We forecast second quarter non-GAAP revenue in the range of \$169 million to \$172 million and full year non-GAAP revenue in the range of \$686 million to \$692 million, representing year-over-year growth of 10% to 11% for the full year. We also anticipate subscription revenue growth for the full year to be at least 14%, above the initial outlook we had six months ago, driven by better than expected expansion and renewals bookings, as well as the organic growth we've seen to start the year. We forecast second quarter adjusted EBITDA of \$26 million to \$28 million and full year 2024 adjusted EBITDA of \$110 million to \$114 million, representing approximately 16% to 17% of non-GAAP revenue for the year.

In summary, we had a great start to the year building on the momentum coming out of 2023, with continued strong growth in subscription ARR and revenue as well as adjusted EBITDA results above the high end of our guidance. Our first quarter performance and projections for the remainder of the year give us the confidence to lift our full year outlook and reiterate our expectation of hitting our Rule of 30 target on a total revenue growth basis in the back half of the year. And looking beyond this year with the continued progress on our profitable growth strategy, the quality of our pipeline and substantial opportunity afforded to us to continue to expand with our existing customers, we believe we're well-positioned to continue executing towards the long-term targets we communicated last quarter.

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.

Thanks, David. I'll conclude by reiterating a few key takeaways from the quarter. First, we continued our sales momentum with a broad mix of net new and expansion wins. The two Tier 1 digital banking expansion wins from

the quarter demonstrate the unique opportunity we have to deepen our existing relationships because of our single platform and large, diverse customer base. And given the strength of the demand environment, the state of our pipeline and our recent win rates, we're optimistic about the remainder of the year. Our emerging businesses continue to execute well, and we saw key sales and renewal contributions from our Centrix risk management and relationship pricing solutions as well. And finally, we delivered financial results that outperformed our expectations while also achieving positive free cash flow for the first time in a first quarter. These results represent a promising start towards achieving the three-year financial targets we shared in February and underscore my confidence in the opportunities ahead of us.

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

QUESTION AND ANSWER SECTION

Operator: We will begin the question-and-answer session. [Operator Instructions] . And your first question comes from the line of Alex Sklar. Please go ahead.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Great. Thank you. Matt, just start with you. I appreciate all the expansion opportunity commentary and the excitement around that. I know a lot of your customers and prospects are probably on multiyear contracts for some of the solutions you're trying to expand with them on. Has anything changed in terms of their willingness to look at Q2 solutions earlier in their contracts cycles and not worry about timing just given renewed impetus around deposits and efficiencies that they can gain around the single platform? Thanks.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Yeah. Thanks, Alex. Well, the contract is for the SKU that they're running. And so what happens, particularly in the larger deals, is they buy the retail solution. It takes a year to deliver. We deliver. We have a good experience. And then they kind of get the team together on the commercial side or on PrecisionLender or one of the larger SKUs and say, let's go look at this to take advantage of all the stuff I talked about there about the single platform. But the advantage to us is you have a master services (sic) [service] agreement with them. You had a good experience on the conversion. They begin to know how you work and they want to do the expansion with us. And so that's really why we highlighted that in the call which is, as we talked about, we have 220 customers that are greater than \$5 billion in assets and 40% of them are only running one of our large SKUs. So they can go buy any of these products at any time. It's more about capacity that they have to project manage and be organization-ready to go do it. So it's a tremendous opportunity and I appreciate you asking the question because we wanted to make sure that we articulated it to the shareholders.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Okay. Great. And, David, just maybe a two-part question for you. Last quarter, you kind of called out the largest delta between booked and implemented ARR that you've had in some time. Just with another quarter past, can you update us on the visibility of getting that ARR live? And then second part here, just given the comments of some of these expansion bookings and faster time to revenue, is there any change that we should think about in terms of percentage of your bookings on average that can impact revenue kind of [indiscernible] (27:41)? Thanks.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

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Yeah. Sure, Alex. And I'll take the first one and then move on to the second. On the ARR, not live, so last quarter, if you remember, one of the things that we conveyed and we sort of gave this within the context of the overall ARR, our commentary was that 18% of that wasn't live. That number is now down to 15%. But two things to keep in mind. The first one is Q4 was a record bookings quarter and we talked a lot about the momentum that continues into Q1. But Q4 is seasonally large and that's part of the reason why you saw so much of that not live. The second part of that is that 15% number is still the second highest we've seen in years. So we're still at a really high percentage of our overall ARR base that is not in the ground yet. So that's great news for us in terms of visibility. It's great news for us in terms of what we've already told you in terms of those long-term projections.

The second question I think was around what percentage of our bookings do we see current year? The easiest way to think about that is with net new – sort of bifurcating net new and cross or expansion. On the net new side, anything that we do going forward for the rest of the year, you're going to see very little revenue. As you know, the implementation cycle, depending on the size of the deal, can be anywhere from 9 to 15 months. Conversely, on the cross or expansion side of things, we're seeing a lot of strength and the time to revenue for that is quicker. But you still do see, let's say, four to nine months, depending upon the types of expansion solution that we have. So we'll see some of that revenue. But the majority of it is going to come in the second half of the year. The one that we do see immediate time to revenue is some of the expansion opportunity we have with specific licenses for our solutions. So there is an immediate recognition for some of that. And we did see strength, quite frankly, in Q1. And that's part of the revenue upside that you saw in what we delivered.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

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Okay. That's great color. Thank you both. Congrats on the quarter.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

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Thanks, Alex.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

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Thanks.

Operator: Your next question comes from Terry Tillman. Please go ahead.

Terry Tillman

Analyst, Truist Securities, Inc.

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Yeah. Hey. Congrats from me as well. I'll keep it to two questions. The first question is, I like all the color in terms of the \$3 billion ARR opportunity and the 90 Tier 1s and 130 Tier 1s. I don't know if this is for you, Matt, or whoever else, but I wanted to probe on the 90 Tier 1s. I think they're only using one of your two digital banking sides of the house and then 130 Tier 1s that actually don't use any digital banking. As you look out at your pipeline and how you've got your go-to-market kind of targeting, which of those two that seems the most kind of actionable near term, again, the 90 or 130? Kind of curious any kind of commentary you could share on that and then I had a follow-up for Jonathan.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

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Yeah. Terry, I would say the 90 probably because they're using either retail or commercial banking with us, and so they're using the platform. And what we're really seeing right now as I talked about in the script is that these banks are trying to find efficiencies and they're trying to find a better digital experience. And when you're running our retail product and you want to add commercial, you don't have to implement a whole new system. You don't have to learn a new back office. You don't have to do new hooks into the core, check imaging, statement imaging, ACH and wires. The systems there is about on-demand and turning on those features and then converting the customers over. So there's a tremendous amount of efficiency that the bank or credit union gets from turning on those. And so those are the ones where we're seeing a tremendous amount of demand.

If you look at the two of the Tier 1s that we signed that were cross-sells, one added retail and one added commercial. So all of those are, what I would say, the opportunities are but that doesn't mean that we're not calling on the 130 to cross-sell into retail, small business, corporate, PrecisionLender, fraud products. There's just a lot of opportunity there. And we have a customer base. I don't know if you saw it or not, but the top 100 Forbes Banks were announced a couple – a week or so ago. 58 of those are Q2 customers. So we have a really solid customer base. I think we have the premier customer base in North America for financial institutions. And 58 of the top 100 Forbes customers use our technology. So there's a tremendous opportunity there. We have a really strong customer base to go cross-sell into. So we're obviously excited about the opportunities.

Terry Tillman

Analyst, Truist Securities, Inc.

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That's great, Matt. Thanks for that. And I guess maybe, Jonathan, on the Innovation Studio. You anecdote about the one customer kind of getting over 50% of the contracted platform, kind of almost making it up through the fees and just what they can do for their business. I'm curious, though, you have 160-plus partners, it seems like – and you're continuing to expand it, how are you getting monetization? Because it seems like you're providing value for both your end customer but then also the partners. So anything you can quantify on Innovation Studio monetization or how to think about it over the next couple of years? Thanks again.

Jonathan A. Price

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

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Yeah. Thanks, Terry. Yes, the way I think about it is whether it's in the accelerator program or the marketplace, we strike a revenue share with each of the partners for any deal they do. In the marketplace, we share in that revenue with the financial institution. And so if you think about it from the partners' lens, they're accessing our channel of 450-plus financial institutions that are live on digital banking today, 23 million end users on that platform that log in 5 billion times a year. So they're getting access to a pretty compelling channel with one integration to go deliver their solution. And for them, the alternative of going 1 to 1 across the FI landscape in the US is a pretty daunting task. And so they really do value the channel. And we have partners where we represent a meaningful component of their revenue as they scale across us and other channel partners. So it's certainly a valuable economic opportunity for the partner and for the FIs. Obviously, that story we told upfront on the call, certainly, talks to what we're starting to see in terms of the economic and strategic value to them. And then, obviously, our revenue share, I mentioned already. So, yeah, we're excited about it. It's continuing to grow in strategic impact and an economic value for all three of those constituents.

Terry Tillman

Analyst, Truist Securities, Inc.

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Great. Thank you.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Thanks, Terry.

A

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Thanks, Terry.

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Operator: [Operator Instructions] And the next question comes from the line of Adam Hotchkiss. Please go ahead.

Adam Hotchkiss

Analyst, Goldman Sachs & Co. LLC

Great. Thanks for taking my questions. Matt, I'd be curious how you think about the breadth of the platform as it stands today. There's clearly an expansion opportunity within the existing base that you mentioned and Q2 Innovation Studio, obviously, adds to that. But now that you're generating much more meaningful cash flow, are there any obvious areas customers are asking for that you'd look to invest in more deeply either organically or inorganically?

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Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Hey, Adam. I mean – I would say we're still early in the idea that this digital transformation which is basically taking any human experience that you – any human interaction you have with a financial institution and digitizing it. And then data, AI, how are we going to approach that? All these things are things we're diving into. But for us, user experience is critical and then you move to the commercial functionality, dynamic personalization. We have talked about multiple times fraud has gone through the roof. It was a large regional bank, I won't say the name, CEO mentioned that he's accounting for \$30 million of check fraud a quarter for the foreseeable future for the next couple of quarters. Check brought us back. And so that product was, I think, one of our top cross-sells in the year for fraud solutions.

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I'm going to have Kirk talk a little bit about what we're doing with AI. But also the other thing to think about and Terry talked about a second ago is Innovation Studio. We have 160 partners that we can go and cross-sell to solve problems. So I don't have to go into this. I don't have to go invest in all of these different smaller solutions. I can partner with people and get a piece of the revenue, solve a customer's problem and provide them with the best solution. So it really has scaled – I think 100% of the deals in the quarter had Innovation Studio attached to them. We saw tremendous growth in the Innovation Studio bookings in the first quarter. So we're going to continue to that user experience, commercial banking, fraud, data.

But maybe for a second, Kirk, you can talk about AI and how we're thinking about that because it's such a big initiative for us at the company.

Kirk Coleman

President, Q2 Holdings, Inc.

Yeah, I'll do it quickly. I mean, we're really excited about the future and what that's going to bring to us and our customers. We really think about it in three big buckets. There's internal use of it. How do we become more efficient for our own good, right, how do we embed it in our existing products, and then obviously what are some

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of the new products that we might be developing? There's an important fourth bucket, though, in that, and Jonathan alluded to it a second ago, which is Innovation Studio where we have all these fintech partners that are also going to be building AI solutions into their offerings. And already we see that in four categories in digital customer support, in fraud and marketing and targeting and also in insights and financial wellness. And so that's already not just in the pipeline but in the solutions that we offer through Innovation Studio.

And you just step back a little bit and think about in addition to the gigantic amount of digital banking data that we have and the millions of customers and users that log on every single day over 5 billion a year, we also have in our relationship pricing the largest – what we think is the largest commercial loan book in the world, data set in the world, and the largest commercial deposit data set in the world. And that is highly structured data already because of the way that it's used by our customers every day. So we think that all leads to a lot of crossover in terms of some of the solutions that we already have in market and what we could do there but also in terms of some of the products that we'll deliver in the future.

Adam Hotchkiss

Analyst, Goldman Sachs & Co. LLC

Q

Okay. Great. That's really useful. Thanks for that. And then, David, appreciate the commentary on RPO and some of the lumpiness that can happen there quarter to quarter. Could you just remind us what the rest of 2024 looks like from a renewal cadence perspective may be versus the same period last year? Just trying to get a better sense for how we should think about the RPO comps as we head through the year based on your visibility into renewals. Appreciate it.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah. Sure, Adam. This year's not going to be different than most years past where we're going to see most of our renewals come into scope in Q4. So that's going to give us the biggest opportunity for renewals. We did see good renewal strength in Q1. And as we sort of look through the year, the one quarter that is relatively pressured from a renewal standpoint is Q3. So we have good renewals and scope for the remainder of the year with Q3 being the most pressured, Q4 being that quarter with the most opportunity.

Adam Hotchkiss

Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks for taking the questions.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Thanks, Adam.

Operator: Your next question comes from the line of Matt VanVliet. Please go ahead.

Matthew David VanVliet

Analyst, BTIG LLC

Q

[audio gap] (39:16-39:21) but on the 90 banks that are using either commercial or retail but not the other, do you have much of a sense or what the mix is that are using something – somewhat modern that's not just kind of off the shelf from the core that might be a little bit more of a difficult, competitive displacement or thought otherwise, maybe what's the opportunity of something that's not modern and should be an easier win?

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Matt, I don't have that off the top of my head. I will tell you what they certainly don't have is a single platform that I talked about earlier which is they're running a separate system that requires separate upgrades, separate back office administration, separate set of interfaces, separate user experience. And so when they moved to us, they unify that experience both for the customer, they unify it for the bank employee and they unify it for the provider which is us in this case. And we can upgrade the software faster, give them – and the data is all unified as well which is what Kirk was talking about, the importance of having that clean data. So the quality of the system, obviously, with our win rates and the deals we're doing, I would argue we have the premier solution in the marketplace. So whatever we're competing against is not going to have that. It's more about the inertia to get them to be able to go through the conversion process and can we prioritize that. And as we've talked about with the focus right now, it's about acquiring, retaining and growing deposits and driving efficiencies to the business. Our systems are clearly coming up as a priority for these financial institutions to convert to and that's why you're seeing the demand environment that we've seen over the last couple of quarters and in the first quarter.

Matthew David VanVliet

Analyst, BTIG LLC

Q

All right. Very helpful. And then, David, when you look at kind of what the growth outlook is in the pipeline over the next couple of years, it seems pretty robust. And you're talking about pretty big backlog of ARR not yet live. Where do you stand out in terms of head count investments whether it's around the implementation teams or the go-to-market team? Where are we at in terms of the team that's on the field now ready to capture all the opportunity versus needing to add head count? And then sort of wrapped in that, any change in philosophy around using outside partners for some of the blocking and tackling-type situations on the implementations?

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Hey, Matt. Yeah. First and foremost, I think we still feel strongly about our ability to scale our costs relative to our revenue growth, so full stop on that. Having said that, on implementation, that's certainly one that we are going to continue to invest in head count there while investing in efficiencies. We're doing things more efficiently with our customers. We're utilizing our global resources more effectively to lower the overall cost of an average implementation. But we still have to add resources given all the momentum we've seen on the bookings side of things.

Sales and marketing, we've gotten a lot more efficient there as well. And I talked in the prepared remarks about our ability from a CAC standpoint to continue to get much more efficient, and we think we have more opportunities for efficiency. That doesn't mean we don't have to add some resources as we continue to grow the number of accounts that we're supporting. Matt talked a lot about the expansion opportunity in the call earlier. We need to have resources that are able to reach out and work with those customers to identify those opportunities and ultimately book them.

On utilizing partners more effectively, we're constantly looking at ways to get more efficient, partner utilization could be one of those. It's not something that we're committed to as of yet, but that's certainly one of the efficiency drivers that we're exploring going forward to improve the cost structure relative to the revenue that we're driving from a delivery standpoint.

Matthew David VanVliet

Analyst, BTIG LLC

Q

Great. Thank you.

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Thanks, Matt.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Thanks, Matt.

Operator: Your next question comes from the line of Andrew Schmidt. Please go ahead.

Andrew G. Schmidt

Analyst, Citigroup

Hey, guys. Thanks for taking my questions. Good results here. Apologies. I jumped on a little bit late. Sorry if this has been asked, but could you just talk a little bit more about what's driving the Tier 2 resurgence? It's really good to see – obviously, there's probably, platform development, environmental things going on. But if you could talk about what's going on with that size of FI, that'd be helpful. Thanks a lot.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Yeah, Andrew. I think to some extent, we had solid Tier 2, Tier 3 performance last year. It was maybe a little overshadowed by some of the larger Tier 1s we got. We had a solid quarter-over-quarter with the Tier 2s and Tier 3s last year. But the performance I would say is a lot of these financial institutions, it's just a time where they are on the pipe and coming up. But we have been building in the momentum that we've – the momentum we have with them has been building. And so they have the same challenges that the larger banks do. It's just a matter of our solution for them. It's a little bit bigger of a decision. As I was talking about earlier, the larger wants to do retail or commercial or small business. These guys usually take the entire platform, so the conversion for them is converting retail customers, small business customers and commercial customers. So it's a little bit – it takes a little more time for them to get organized, make that decision.

But we signed more Tier 2s and Tier 3s this quarter than we signed in any quarter last year. And there's – what they're beginning to realize is not only do they have the advantages of being local, their rates are going to be just as competitive as the big four. But they're able to walk out there and use our technology as a way to compete with Bank of America, Wells, Chase and Citi and their products. And we're hearing stories about wins taking large accounts from them whether it's municipalities, healthcare systems, larger companies, and they're going out and picking up this business because they have those advantages, being local, being there to solve the problem flow, and also being competitive on rates.

So I think it's just a matter of they have to become more efficient and technology is going to be how they're going to compete. And they go look at the systems and we're the only single platform out there. We have more customers running on our commercial solutions which work on mobile phones and tablets and desktops, and that's what you have to do to win the business. And so that's what's driving the demand environment. It's about acquiring, retaining and growing deposits. And we've shifted from a lending environment to get the deposits. And we've been in this business for – it'll be 20 years in August and have a great reputation of taking care of our customers and building great products and being there for them. And so that's ultimately what's driving the demand.

Andrew G. Schmidt

Analyst, Citigroup

Q

Got it. Yeah. Well-said. Thank you, Matt. I think, yeah, the commercial platform is certainly a differentiator. If you just touch on the pipeline for a second. I think a quarter ago, it seemed like the pipeline was a little bit more balanced from a size perspective versus last year. To some extent, I think we see that coming through here. But maybe you talk about the composition, is that still the case? And if it is the case from an evenly balanced perspective, does that imply more visibility in terms of timing of deal close and bookings and things like that versus maybe the larger wins that can be longer and have more certainty? Thanks a lot, guys.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Yeah. I would say it was probably out of balance last year with the size of the deals we did in the back half of the year, Andrew. I mean, it was steady Eddie in that Tier 2, 3. And then this quarter like [indiscernible] (46:40) we signed four Tier 1s in the quarter. So it was still a great quarter. But, yeah, the Tier 2, Tier 3 make up and you got to remember, a \$4 billion bank is not that different than a \$8 billion bank from an economic perspective. So, yeah, I mean I think David can comment on whether we're going to see some of this go live faster. But like I said earlier, a bank could do on a retail, small business and corporate conversion, that's a \$4 billion, \$4.5 billion bank could end up being a 9 to 12-month go live. But I think that you'll see with the expansion, some of the stuff come into revenue. We're seeing things come to revenue a little quicker, been happy with the results so far. I don't want to get ahead of us in a guide. David looks at me funny when I do that, but I think we have a lot of opportunity to – in the pipe as well as in that Tier 2 space and Tier 3 to win deals and get them live a little faster than the largest deal in the history of the company that we signed last quarter, the big four banks for PrecisionLender that we signed last year. So it should [ph] cover (47:41) the revenue faster.

But, David, do you want to comment on that at all?

David J. Mehok

Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah. Look, there's maybe one or two months for some of these deals that we'll see at the end of this year in terms of revenue recognition. But for the most part, the majority of this revenue is going to start coming through starting next year. And as I said, and I don't know if you were on yet, Andrew, I know you said you joined a little bit late, but we did talk a little bit earlier about sort of the shape of the bookings and how we see some of that manifest to revenue particularly on the cross side. So some of the cross-bookings or expansion bookings that we have, we'll see some revenue later in the year for those. And again, we were expecting some of that coming into the year. And then we have some immediate time to revenue like license expansion where we saw a lot of strength during the course of the quarter. Matt mentioned the growth in Centrix specifically, but that's one of those areas where we get fairly immediate revenue recognition on that. So feel good about the mix of expansion as well as net new in most of that net new you're going to see coming online in 2025.

Andrew G. Schmidt

Analyst, Citigroup

Q

Got it. Thank you very much. Appreciate the comments.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

A

Thanks, Andrew.

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

A

Thanks, Andrew.

Operator: Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.

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