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Q2 Holdings, Inc. (QTWO)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone. My name is Lisa, and I will be your conference operator today. At this time, I would like to welcome everyone to the Q2 Holdings First Quarter 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. Please go ahead, sir.

Josh Yankovich

Director-Investor Relations, Q2 Holdings, Inc.

Thank you, operator. Good afternoon, everyone, and thank you for joining us for our first quarter 2023 conference call. With me on the call today are Matt Flake, our CEO; David Mehok, our CFO; Jonathan Price, our Executive Vice President of Emerging Businesses, Corporate and Business Development; and newly appointed President, Kirk Coleman, 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 with respect to our expectations for the future operating and financial performance of Q2 Holdings and for the financial services industry. Actual results may differ materially from those contemplated by these forward-looking statements and we can give no assurance that such expectations or any of our forward-looking statements will prove to be correct.

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

Forward-looking statements that we make on this call are based on assumptions only as of the date discussed. Investors should not assume that these statements will remain operative at a later time, and we undertake no obligation to update any such forward-looking statements discussed in this call.

Also, unless otherwise stated, all financial measures discussed on this call will be on a non-GAAP basis. A discussion of why we use non-GAAP financial measures and a reconciliation of the non-GAAP measures to the most comparable GAAP measures is included in our press release, which may be found on the Investor Relations section of our website and on our Form 8-K filed with the SEC this afternoon. We've also published additional materials related to today's results on our Investor Relations website.

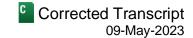
Let me now turn the call over to Matt.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Thanks, Josh. On today's call, I will share our results and highlights from the first quarter. I'll then hand it over to Jonathan to provide more insights into our emerging businesses activity before David discusses our financial results and guidance in more detail.

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However, before I dive into the quarter, I wanted to spend a few moments sharing our high-level perspective on the regional and community banking space. Over the past two months, we have spent a lot of time with our customers. We partner with a diverse mix of banks and credit unions that represent many different geographies and sizes. And in general, the vast majority of them report that they believe their businesses to be healthy and that they have not been meaningfully impacted by the recent challenges affecting a select number of banks, which aligns with the survey results and research findings that others in our sector have cited in recent calls.

Moreover, we believe that banking is going to continue to be done digitally and the financial institutions will continue to invest in upgrading their technology to compete in their markets and serve their customers more efficiently. In this environment, where retaining customers and deposits are at a premium, technology is especially critical. And we believe we have built a best-in-class digital banking platform, which is designed to help financial institutions win, retain and grow deposits across both retail and commercial lines of business, all from a single system. And we're seeing strong demand and sales execution to support these beliefs.

We've had two record sales quarters in a row. We had our best-ever win rates in the first quarter. We accelerated subscription revenue growth and our pipeline remains healthy. With that said, we're seeing some of our larger financial institution customers further tighten spend on discretionary services in addition to what we noted in the February call as they move to a more conservative financial position following recent events. As a result, we have updated our guidance to reflect some incremental pressure on our services revenue as well as the potential impact to our results associated with First Republic Bank, which, as we disclosed last week, represented 2.5% of our revenue in 2022, the majority of which was professional services driven.

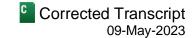
Now, let me jump into the results from the first quarter. We delivered strong growth in subscription revenue, which was up 19% year-over-year. As a reminder, subscription revenue, which is driven by our long-term contracts, is highly predictable and our largest and highest margin revenue category. Therefore, we believe it is an important barometer of the health and outlook of our business. In total, we generated non-GAAP revenue of \$153.1 million, up 14% year-over-year and 4% sequentially. And on top of accelerated subscription revenue growth, we delivered increased profitability results with adjusted EBITDA of \$16.5 million or 11% of revenue. In recent months, we've talked about managing the business with an increased focus on profitability and our adjusted EBITDA results from the quarter underscore our ability to continue executing on that strategy.

On the sales side, we drove strong bookings growth for the second straight quarter and had our best digital banking bookings quarter ever. We delivered record win rates across a broad mix of deals, large and small, bank and credit union, retail, small business and commercial. Competition for these deals are highly competitive and range from point solution startups to the core companies and payment processors. I'm proud that almost 20 years into this business we're still winning on innovation, user experience and our single platform approach.

We continued to win up-market, signing three new Tier 1 digital banking customers, including two top-100 US banks and a top-100 US credit union. One of these deals highlights the value of our single platform approach. The bank came to us for small business banking, but upon seeing the rest of our portfolio, purchased the whole suite from retail to small business to commercial and more, making this a top-five all-time deal in terms of ARR. In my view, the current focus on deposit growth is partially to thank for such a strong sales quarter. It's driving increased demand as prospects look to upgrade from legacy technology in order to win new customers and retain deposits. And our platform gives them a single, efficient, best-in-class solution with which to do that.

The current focus on deposits is also generating interest in our relationship pricing solutions, where we believe we have a strong second half pipeline. This is because in addition to pricing new loans, financial institutions use these solutions to get the most out of their existing portfolios and more effectively price services on the deposit

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side of their commercial relationships. In total, our sales execution and strong financial results from the quarter underscore why we remain confident about the fundamentals of our business. Demand is strong. We're competing better than we ever have. We're accelerating subscription revenue growth, and we are demonstrating our ability to drive improved profitability.

And finally, before I turn the call over to Jonathan, I wanted to pause and congratulate Kirk Coleman, who we recently promoted to President. Kirk spent his early career at Accenture, where he specialized in banking and digital transformation. He began his journey with Q2 as an executive at one of our large regional bank customers. In December 2021, he joined our team as Chief Banking Officer, where he's overseen our product, marketing and strategy functions. In that time, he's brought a deep empathy and understanding of our customers' businesses and the financial services industry in general to Q2, and has played an instrumental role in interfacing with customers and guiding our teams.

In his role as President, he will become responsible for scaling the operations of this business from sales and customer relationship management to product development, delivery and support, while I remain focused on areas like culture, strategic direction, and discussions with key customers, prospects and investors. I'm excited about his skill set, his passion, and his deep management experience. I look forward to partnering with him to capitalize on the opportunity in front of us.

I'd now like to turn the call over to Jonathan to provide updates and highlights from the first quarter for our emerging businesses.

Jonathan Price

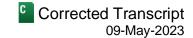
Executive Vice President-Emerging Businesses, Corporate & Business Development, Q2 Holdings, Inc.

Thanks, Matt. I'll start with Q2 Innovation Studio, which has continued to see strong adoption from both partners and customers. When we launched, our vision was to create a best-in-class partner ecosystem that would allow third-party technology to easily integrate into our digital banking platform and in turn give our customers the ability to seamlessly add those partners into their digital channel in a fraction of the time of traditional delivery. In doing this, Q2 Innovation Studio will provide financial institutions the ability to save costs associated with traditional technology partnerships, add solutions that drive non-interest fee income and, ultimately, drive deeper, broader engagement with our account holders.

Today, we are several steps towards achieving this vision. We have driven customer adoption with more than 300 of our digital banking customers representing approximately 16 million users now leveraging Q2 Innovation Studio. And we have scaled to partner ecosystem with more than 120 available technology partners. The last piece of the model is end user adoption. And in the past 12 months, we've more than doubled the number of users actively using our partner solutions, driving high margin revenue to Q2. That said, we believe we are still in the early innings of end user adoption. We are pleased with the progress to date and are seeing Q2 Innovation Studio drive real, meaningful outcomes for our customers.

Take the story of a roughly \$500 million bank in Tennessee. To differentiate themselves in their market, they set an aggressive innovation roadmap, but couldn't deliver against it quickly enough through conventional delivery channels, and like many regional communities, financial institutions, lacked the technology resources to take on the work themselves. In the last 12 months, the bank has added six new solutions using Q2 Innovation Studio's partner ecosystem from credit scoring to a residential mortgage offering to an AI chat box. And they have told us they expect to drive over \$1 million in combined revenue and cost savings from these solutions in 2023 alone, further strengthening their relationship with their customers and with Q2.

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In this environment, where financial institutions are looking for ways to deliver innovation more efficiently, retain and grow customers and deposits, and uncover new revenue opportunities, Q2 Innovation Studio provides an especially compelling value proposition. Because of this, we believe it's a key reason we're seeing record win rates in digital banking. As has been the case for several quarters, Q2 Innovation Studio was cited as a key reason we won in a majority of our digital banking deals. This quarter, it was cited in roughly 75% of our wins.

Moving to Helix, we had another strong quarter of renewal activity, signing two of our largest customers to multiyear deals. With these renewals, 9 of our 10 largest customers have signed multiyear extensions with us in the past 18 months. Multiyear renewals such as these demonstrate the confidence our customers place in us and provide an important base as we seek to grow and drive improved profitability of Helix in the years ahead. And the current backdrop is creating opportunities to deepen and grow our relationships, the flexibility of our technology and our deep, direct partnerships with our sponsor banks help us move quickly to support our customers as their goals and operating environments change.

For example, during the quarter, we worked closely with one customer who, after March 9, needed to quickly connect certain capabilities to an alternative bank. We helped them find a solution and leveraged Helix technology to solve their problems inside of 24 hours. And we added roughly 300,000 new users in the process. As far as the demand environment, we believe we have a solid pipeline for the remainder of the year and that companies in our target markets remain committed to pursuing embedded finance strategies. With the current prioritization of customer retention and deposits across the financial services landscape, embedded finance is a powerful way for customers and partner banks to grow deposits. And Helix has a proven, differentiated offering that's already supporting more than 14 million end users across our customer base.

Thank you. And with that, I'll pass the call to David to discuss our financial results and guidance in detail.

David Mehok

Chief Financial Officer, Q2 Holdings, Inc.

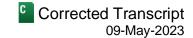
Thanks, Jonathan. At the start of the year, we communicated our focus on delivering accelerated growth in subscription revenue, coupled with a meaningful improvement in adjusted EBITDA and cash flow. We're extremely pleased with the progress we made on these priorities in the first quarter as we increased the growth rate of our subscription revenue and built on our bookings momentum with a record performance in digital banking.

We delivered better-than-expected revenue and adjusted EBITDA in addition to generating better-than-expected cash flow from operations for the first quarter of the year. We also took proactive action to reduce our total debt balance through the repurchase of \$171 million of long-term convertible debt at a meaningful discount to face value, reducing our total face value of debt by approximately 26%.

With that, I'll begin by reviewing our results and conclude with updated guidance for the second quarter and full year of 2023. Total non-GAAP revenue for the first quarter was \$153.1 million, an increase of 14% year-over-year and up 4% sequentially. The year-over-year and sequential increases for the quarter were primarily driven by growth in subscription-based revenue, which was up 19% year-over-year and 7% sequentially. The year-over-year acceleration in subscription revenue growth was primarily attributable to the deployment of new digital banking customers. In addition, the year-over-year and sequential acceleration in subscription revenue growth was driven from incremental revenue associated with cross-sell solutions and organic growth.

Our subscription revenue for the quarter was 75% of our total revenue, up from 72% of total revenue in the prior year period and 74% of total revenue in the previous quarter. Due to the strength we've observed in our

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subscription-based bookings, we continue to expect our full year 2023 subscription revenue will accelerate from the growth we observed in 2022. The strength in subscription revenue was partially offset by continued weakness in services and transactional revenue. Services revenue was up 5% year-over-year, while transactional revenue was down 5% year-over-year.

As Matt mentioned, we believe developments over the past couple of months will result in lower professional services revenue than anticipated for the remainder of the year. As a result, we're modifying our expectations for professional services engagements associated with projects that are more discretionary in nature, which I'll further discuss with our updated guidance. Transactional revenue represented 11% of total revenue for the quarter, down from the prior year period of 13% and consistent with the previous quarter. Both the year-over-year and sequential decline in transactional revenue are in line with the trends we started to observe in the back half of 2022.

During the quarter, we added approximately 400,000 users to our digital banking platform, ending the quarter with approximately 21.5 million registered users, an increase of 9% year-over-year. Year-over-year and sequential increase was largely driven by organic user growth. Annualized recurring revenue or ARR grew to \$672.7 million, up 13% year-over-year. Our subscription ARR growth for the quarter was up 17% year-over-year, driven largely by net new deals within our digital banking business and indicating continued strength in this important part of our business. Within ARR, the growth in subscription revenue was partially offset by a decline in transactional revenue and a moderation of growth in services, driven by lower professional and consulting services.

Our ending backlog of over \$1.5 billion increased by \$38 million sequentially or 3% and equated to a 10% increase year-over-year. The year-over-year increase was attributable to strength in net new bookings, including our largest-ever digital banking's booking quarter. The sequential increase was also driven from strong renewal performance. As we mentioned previously, while sequential change in backlog may fluctuate quarter to quarter, based on the number of renewal opportunities available within a given quarter, we continue to believe we will show an increase in backlog for the full year.

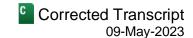
Gross margins were 54% for the first quarter, up from 51.4% in the prior year period and 51.5% in the previous quarter. The year-over-year and sequential improvement in gross margin was driven primarily by a favorable mix in revenue towards our higher margin subscription-based business, in addition to cost efficiencies within our delivery and support operations. As a reminder, we had a mutual contract termination in the fourth quarter of 2022, which negatively impacted gross margins by 150 basis points for that time period.

Total operating expenses for the first quarter were \$72.5 million or 47.4% of revenue compared to \$65.7 million or 48.9% of revenue in the first quarter of 2022 and \$72.7 million or 49.5% of revenue in the fourth quarter of 2022. The decrease in operating expenses as a percent of revenue was driven primarily from improved cost scaling to revenue within sales and marketing, as well as additional cost efficiencies realized in our research and development expense through the effective utilization of our global workforce and enhanced productivity. Sequential decline of sales and marketing as a percent of revenue was also a result of a decrease in marketing events when compared to the fourth quarter of 2022.

In May, we will have the return of our in-person annual client conference, CONNECT, where we will have over 1,000 guests from our customers and partners in attendance. This event will incur additional sales and marketing expenses of almost \$2 million in the second quarter and is reflected in our second quarter guidance.

Total adjusted EBITDA was \$16.5 million for the first quarter, up from \$8.1 million in the prior year period and \$8.4 million in the previous quarter. The year-over-year and sequential change in adjusted EBITDA saw a meaningful

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benefit from the improved mix of higher margin subscription revenue, cost effective utilization of our global workforce, broad-based efficiencies across the organization with the sequential change also benefiting from lower contract-related expenses.

We ended the first quarter with cash, cash equivalents and investments of \$271.7 million, down from \$433.4 million at the end of the fourth quarter. The decrease in cash was primarily a result of the use of over \$149 million for the privately negotiated repurchase of approximately \$171 million of convertible debt. In addition, we paid the remaining \$11 million in principal amount of our convertible debt, which matured during the first guarter of 2023.

While our first quarter typically reflects a use of cash from operations based on the timing of our annual bonus payout, in the first quarter of 2023, we generated positive cash flow from operations of \$3.9 million due to improved profitability and strong working capital management. We believe our continued focus and actions driving higher profitability and working capital management will translate into continued strength in our cash flow conversion for the remainder of the year.

Let me wrap up by sharing our second quarter and updated full year guidance. We forecast second quarter non-GAAP revenue in the range of \$153.1 million to \$155.1 million and full year non-GAAP revenue in the range of \$618 million to \$630 million, representing year-over-year growth of 9% to 11%. As I mentioned previously, while we continue to expect an acceleration in full year subscription revenue growth as compared to the prior year, our updated full year guidance reflects a reduction in our expectations with respect to lower margin discretionary services revenue, which has an immediate revenue impact.

We forecast second quarter adjusted EBITDA of \$14 million to \$16 million. And full year 2023 adjusted EBITDA of \$67 million to \$71 million, representing approximately 11% of non-GAAP revenue for the year. We raised our full year adjusted EBITDA guidance because we believe that despite expected revenue headwinds within services revenue, our increased mix of higher margin subscription revenue streams, combined with cost and efficiency initiatives implemented over the past few quarters, will generate adjusted EBITDA results exceeding our prior expectations.

In summary, for the first quarter, we delivered revenue and adjusted EBITDA results above our expectations, and an acceleration in subscription ARR driven by record digital banking bookings. We generated positive operating cash flow in what's typically a seasonally challenged quarter for us and reduced our debt balance, primarily through the repurchase of convertible debt at a meaningful discount. We're revising our revenue to incorporate lower discretionary services revenue concentrated in a few larger customers, and we continue to remain confident that the increasing contribution of subscription revenue and improving cost efficiencies will allow us to continue to deliver sustained growth and margin expansion in 2023 and beyond.

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. In closing, I want to reiterate my confidence in our business, our products and our ability to drive long-term value creation. Despite the disruptions in the banking space, we continued to drive acceleration in subscription revenue growth and delivered strong non-GAAP profitability results. We also had a record first quarter in terms of digital banking bookings, building on our momentum from a strong second half of 2022. And in this environment, where financial institutions are focused on customer retention and growing deposits, we're seeing record win rates and levels of demand for our digital banking solutions, which are proven to help financial institutions win and retain new customers.

I also want to emphasize my confidence in the long-term importance of regional and community financial institutions. There have always been big banks, but community focused banks and credit unions have always offered an agility and localized products and services that set them apart. Today, by being able to level the playing field with technology, I believe they are as viable, competitive and crucial as they've ever been. Community banking is integral to our economy and our way of life. We expect that to remain true long past what we believe will be a temporary disruption we're seeing in the market and our products have never been more important to our customers than they are right now.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll take our first question from Alex Sklar with Raymond James.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Great. Thank you. Matt, another really nice subscription bookings quarter. I just want to start with the demand environment broadly and specifically the linearity of bookings in the quarter kind of before versus after the kind of early March, some of the bank failures. I know bookings are normally back of the quarter weighted, but anything to flag in terms of percent of bookings that came in the final few weeks of March versus historical? Thanks.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Yeah. So, look – I'll answer the bookings question. Thanks, Alex. It was 35% of the bookings came after March 10, so March 10, the Silicon Valley Bank situation. So, the momentum continued and that kind of builds on the demand environment comments right now. If you think about – right now, we had record bookings – digital banking bookings in the first quarter after typically record bookings for the company in the fourth quarter of last year and a really strong second half of the third quarter. So, two and a half quarters of really strong bookings and the demand, the pipeline is strong still, RFP activity is up 40% from the prior quarter and the prior year, and we're just seeing a tremendous amount of demand for these products.

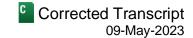
I would tell you that if you think about what's going on, prospects of ours have customers that have opened accounts at other banks because of the insurance – the insured account situation. They're getting to see the bigfour technology. And when they look at their existing legacy tech, the banks come back to us and say, we need a modern platform that works on mobile phones and tablets, has full feature functionality, retail, small business and commercial banking. And it really is driving a lot of demand in the pipeline for us. So, it takes a little bit to get your arms around that in the environment with the news around community and regional financial institutions. But the demand environment is as strong as it's been in a long time. We feel good about our position. Our win rates are as high as they've been in a significant period of time. So, that's it.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

That's a really good flag on the big-four kind of tech competition kind of driving demand for [ph] some of (00:26:53) your customers. I guess, David, just one follow up for you. I appreciate the color on subscription ARR

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bookings. That's a good call out. Is there anything that's changing in terms of kind of your ability to hit the Rule of 30 outlook exiting last year just given the change in discretionary revenue? Thanks.

David Mehok

end of 2024.

Chief Financial Officer, Q2 Holdings, Inc.

Not at all, Alex. In fact, one of the things that we talked about when we had our call three months ago was the fact that there is flexibility in that model. That Rule of 30 concept, Rule of 40 concept obviously provides us with flexibility. And we can modulate either one of the line items depending upon what the market gives us in one instance and the things that we can control and cost in the other. So, we feel really good now about our ability to continue to deliver on the combined EBITDA as well as growth rates as we act – as we get sort of towards the

I'll give you an example. This year, if you remember, when we gave our guidance originally, we were at about 21% to 22% in terms of those two metrics combined. We came down with our revenue growth rate based upon discretionary services. But with our increase in EBITDA guidance, we're roughly in that same range. So, it's an example this year of our ability to modulate, our ability to execute on those things that we control, which is cost in this instance. And we think we're going to be able to continue to do that to 2024 and hit that Rule of 30.

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Analyst, Raymond James & Associates, Inc.

All right. Thank you both for the color.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Thanks, Alex.

Operator: We'll take our next question from Andrew Schmidt with Citi Global Markets.

Andrew G. Schmidt

Analyst, Citigroup Global Markets, Inc.

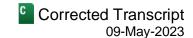
Hey, guys. Thanks for taking my questions, and Kirk, congrats on new role. Great to see. Great to see the resilience in the demand environment, something we have kind of thought about a lot as well. But maybe to put a finer point on it, since you do serve wide range of FIs across digital banking, digital lending, talk about if there are differences in demand pipeline, sales cycles across whether it's different types of FIs or different asset size institutions. And then, maybe as a quick follow up to that, if you could comment on just the overall health of your customer base since it sounds like you've talked to a lot of customers, what you're seeing there? Anything on those fronts will be helpful. Thanks a lot, guys.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Yeah. Sure, Andrew. I would say, welcome to Kirk as well. Really excited to have him on board or have him as the President. It doesn't matter right now whether you're a Tier 3, Tier 2 or Tier 1 customer. The thing I think that's differentiating is the ones that are thinking about using technology as a way to compete and differentiate, and that's where we're seeing the demand come from. Obviously, the ones that may not have as a strategic of a view as our customer base or the prospects that are out there aren't in play. But the ones that we've always gravitated

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towards are the ones that have a strategic view and have a long-term view in the marketplace. So, the demand has just been strong in all three categories, Tier 3, Tier 2 and Tier 1.

And the second part of the question was around? Oh, the health of the customers. We talked about it a little bit. I think all of the core processors and everybody have talked about the edge cases that occurred here, whether it's business model, runs on the bank, poor management, those are edge cases. The vast majority of our customers bank, individuals, small businesses, medium-sized businesses, they're main street lenders and depositors. And those folks just – they didn't see what these other financial institutions that have trouble have seen. And so, it's a matter I think we have to get through this storm and then we will realize that these guys are a critical part of the economy. They're where job growth comes from. They're where entrepreneurship goes.

So, we believe we have a very healthy customer base, the [ph] Bauer (00:30:51) ratings are all strong on our customers. Of course, you're going to have some of these edge cases that occur, but we feel really good about the health of our customers. We have a broad and diverse set of customers that are both credit unions, banks, big, small, mid-sized and banking, a lot of different businesses. So, feel really good about the customer health, it's just going to take a little time for people to get comfortable with it.

Andrew G. Schmidt

Analyst, Citigroup Global Markets, Inc.

Super helpful. Thank you for the commentary, Matt. And then if I could ask about just on the cost side, it's great to see the EBITDA performance for the full year despite the top line. It looks like there might have been some cost efficiencies that were accelerated or kind of some better execution there. Can you just talk about what kind of cost efficiency benefits that are embedded for this year and then what's the opportunity for just seeing kind of incremental benefit from those, because I know you do have a number of things going on? Any context there on the cost, that would be helpful. Thank a lot.

David Mehok

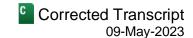
Chief Financial Officer, Q2 Holdings, Inc.

Yeah. Sure, Andrew. And this is something that we started last summer. It's not something that we've implemented over the course of the last few months, and we've just been building on a lot of those initiatives that we put in place about 9 to 10 months ago. I'll give you an example of some of those that are having the biggest impact. The first is utilization of global resources in a more effective manner. We're doing that across many areas of the business, and we're finding not only is it helping us in terms of our cost profile, but it's also helping us in terms of the overall output. We're seeing really high output from the teams that we're utilizing overseas. We're continuing to invest in those areas, and we found it to be highly effective across the board.

We've looked at our facilities footprint exiting last year. We've continued to execute on that in terms of reducing the overall footprint. You see about a \$3 million, \$3.5 million impact this year relative to last year in terms of some of the actions we've taken there. We've gotten more aggressive in terms of our ability to consolidate vendors and drive costs out from a procurement standpoint. And then, we're using automation in everything that we possibly can to improve a lot of the processes that we have and as a result the cost. As an example, in our customer care, we're using AI to help us better understand customer behaviors and drive a lot of efficiencies there.

So, there's a lot of that that's embedded in different areas of the business that are driving incremental areas of productivity and that's translating to costs. So as we're growing the business, we're not having to add heads. I mean, in some instances, as we may have somebody leave the company, we'll have to backfill those roles. And so, we feel really good about what we've seen through the first quarter in terms of our cost profile. And obviously,

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we have confidence that we're going to be able to continue to do the same thing going forward for the next three quarters, which is the result of the increased guidance in EBITDA.

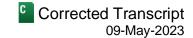
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| Got it. Thank you very much, David. Appreciate the comments. | |
| David Mehok Chief Financial Officer, Q2 Holdings, Inc. | A |
| Thank you, Andrew. | |
| Matthew P. Flake Chief Executive Officer & Director, Q2 Holdings, Inc. | A |
| Thanks, Andrew. | |
| Operator: We'll take our next question from Terry Tillman with Truist Securities | i. |
| Terry Tillman Analyst, Truist Securities, Inc. | Q |
| Yeah. Good afternoon. Thanks for taking my questions and I appreciate all the of I guess maybe – I don't know if this is for you, Matt or Kirk. And is Kirk going to a question or – I don't want to put him on the spot, but I just want to kind of know there. | answer questions if we ask him a |
| Kirk Coleman President, Q2 Holdings, Inc. | A |
| I'm here, Terry. | |
| Matthew P. Flake Chief Executive Officer & Director, Q2 Holdings, Inc. | A |
| He can answer your question. | |
| Terry Tillman Analyst, Truist Securities, Inc. | Q |
| Okay. All right. And I don't know if this is more for Matt right now, but I'll let anyb But you guys every quarter for a number of quarters have been talking about the commercial and small business banking. I mean, definitely something's afoot. I know the commercial and small business banking. | ese digital banking wins where it's |

Okay. All right. And I don't know if this is more for Matt right now, but I'll let anybody just attack it, or even David. But you guys every quarter for a number of quarters have been talking about these digital banking wins where it's commercial and small business banking. I mean, definitely something's afoot. I know you all have been working on this for years in terms of hardening that platform. But what I'm curious about is, is it a lot of legacy replacement opportunities? And just kind of where do you think we are in the innings of that? And where have you gotten to in terms of being able to scale to the much larger banks in terms of managing treasury and commercial banking services? And then I had a follow-up.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

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Yeah, I'll comment on the success in small, mid-size and commercial banking. Sometimes I have to remind people that our first line of code that we wrote in 2004 had ACH's wires, tax payments and entitlements built into it. But about 12 years ago, we made a significant investment into treasury and commercial banking capabilities, which takes you up above small business. And what we learned during that process is you can write the software and you can deliver the code, but the experience around delivering the software, converting from legacy systems, providing a support infrastructure around those customers, and integrating into the systems that are different than retail, it takes a long time.

And as we've shown you over the last – since we've gone public in 2014, with more than 75 customers above \$5 billion in assets, we are really moving into that area where we can handle larger commercial customers. And that success over the last couple of quarters is about a product that is very difficult to compete with in the marketplace. If you're a legacy tech player that hasn't been able to modernize your tech to where it works on mobile phones and tablets and has a sleek user interface and also is able to integrate to not only the commercial systems, but the retail systems; and then if you're down-market and you don't have any experience converting a \$10 billion, \$15 billion, \$20 billion bank off these systems, they're not going to take their chance with their crown jewels to go to somebody who's never done it before.

And so, we're in a really unique spot there competing with these legacy players. It's all legacy tech out there on the commercial side, Terry. In some cases, 25, 35 years old is what we're talking about as far as some of the – even older than that, some of the systems that they're using. So, feel really good about the demand environment there and doing well. So, it's a good place to be. And I think you're going to continue to see that success through this year and hopefully beyond that.

Terry Tillman

Analyst, Truist Securities, Inc.

That's great to hear. And I guess maybe, Kirk, to go ahead and put you on the spot then, and congrats on the new role. But you are a former – a bank technology executive. As you've had some time at Q2, what product or kind of market opportunity do you think is maybe least understood or underappreciated? Thank you.

Kirk Coleman

President, Q2 Holdings, Inc.

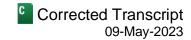
Yeah. Thanks, Terry. Appreciate the congratulations. I'd kind of point to two different things, just to double down on some of what Matt was talking about. The difference between just kind of a regular business account and treasury management services is pretty substantial in terms of the complexity of actually delivering that and scaling it in a way that's really important, not just for the largest institutions, but also for small institutions who are serving very specific segments and that sort of thing. And it takes a lot of at-bats to get really good at that, because you have to see all the different varieties. We have a really wonderfully diverse set of customers. And so, that gives us a lot of different things to work on with them. And so, that builds up over time. I think that's probably not as appreciated from the outside as what we see on the inside, the amount of investment that we've had to make over time.

That also bridges over into things like our PrecisionLender product, right, which is now transitioning fully into both sides of the balance sheet where we have treasury premium pricing capabilities, which in this environment, of course, is just critically important in terms of pricing, not just the loans, but the deposit relationships. And all of those treasury relationships will just kind of remember that, on the deposit side of the balance sheet, the real money is made when you can charge for treasury services. So, getting that really right and being able to customize it, particularly for your larger customers, is super important. So, I think that would be an arena, Terry,

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Adib Choudhury

Analyst, William Blair & Co. LLC



that I would point to [ph] as sources (00:38:35). I think the amount of R&D that had to go into building those kinds of products is probably not as well understood as we might like.

| Terry Tillman Analyst, Truist Securities, Inc. | C |
|--|----------|
| That's great. Thanks a lot. | |
| Matthew P. Flake Chief Executive Officer & Director, Q2 Holdings, Inc. | Α |
| Thanks, Terry. | |
| David Mehok Chief Financial Officer, Q2 Holdings, Inc. | Δ |
| Thanks, Terry. | |
| Operator: We'll take our next question from Bob Napoli with William | m Blair. |
| | |

Hey. Good afternoon, guys. This is Adib Choudhury on for Bob. Just in terms of the first question, could you just talk a little bit more about that decision, I guess, structurally to break out the President and CEO role and how we should think about the impact, if any, in terms of Q2's core strategy and go-to-market? Thanks.

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

Yeah, it won't have any impact on our go-to-market. It's just deepening the leadership bench, opening up the room for more voices and perspectives, which is a valuable thing for us to do at this stage and scale in the company. And it's focusing leadership on both the strategic and the operational sides of the business. Execution is critical to us. Our customers want to see it. I want to see it. My board wants to see it. The shareholders do. And I think with Kirk, laser-focused on the operational side of the business and me working with him to help him in any way I can, and him providing help for me and the team on the strategic side, it was a natural time for us to do it at this size, and I'm excited about [ph] it happening (00:39:50).

Adib Choudhury

Analyst, William Blair & Co. LLC

Thanks. Appreciate that. And then, just as a quick follow-up, just thinking about kind of capital allocation and M&A, could you kind of talk about your current appetite in the current environment and if you're starting to see more attractively priced assets and things that you're potentially interested in in terms of product-oriented capabilities or others? Thanks.

Jonathan Price

Executive Vice President-Emerging Businesses, Corporate & Business Development, Q2 Holdings, Inc.

Yeah. I mean – it's Jonathan. I would say we're starting to see the flow of inbound opportunities, but candidly, the quality of the assets and the value expectations aren't where we'd like them to be or we expect them to be as we get towards the end of this year and into next year. And that has taken longer. But to be fair, there's been a lot of other macro events that have occurred that might have delayed that from happening. So, we are seeing more

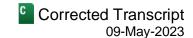
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inbound activity from the corp dev standpoint, but again, nothing that has excited us or got us to a point of action. And candidly, I think we're in a moment in time where we have to be pretty prudent when it comes to capital allocation, given the scarcity value of cash, and we have a good amount to be competitive and credible in these discussions. And so, we just have to be smart about doing the right deals. And so, that's sort of where we sit today on the corp dev front.

| Adib Choudhury Analyst, William Blair & Co. LLC | Q |
|--|---|
| Appreciate the comments. | |
| Matthew P. Flake Chief Executive Officer & Director, Q2 Holdings, Inc. | A |
| Thank you. | |
| David Mehok Chief Financial Officer, Q2 Holdings, Inc. | А |
| Thanks. | |
| Operator: Our next question comes from William McNamara with BTIG. | |
| William McNamara Analyst, BTIG LLC | Q |
| Hi. Thanks for taking my question. Just kind of wanted to know how you guys are seein customers for more automation or AI capabilities? | g current demand from |
| Matthew P. Flake Chief Executive Officer & Director, Q2 Holdings, Inc. | A |
| Kirk, you want to take that? | |
| Kirk Coleman President, Q2 Holdings, Inc. | А |
| Yeah. Hey, William. Thanks for the question. It's early, right? We're not even in the first pitch of the first inning when it comes to kind of where we are in the evolution of Al. We potential that it has for positively impacting our business and our products. But having s information security, compliance, privacy are all really important concerns. So, we're locally as we think about how we can move forward. Certainly, it's a conversation we're having I'd say just stay tuned on what some of the possibilities are going to be. | re excited about the said that, risk management, oking at all those aspects |
| William McNamara Analyst, BTIG LLC | Q |
| Great. Thank you. | |
| Operator: [Operator Instructions] We'll take our next question from Parker Lane with S | Stifel. |

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Jeffrey Parker Lane

Analyst, Stifel, Nicolaus & Co., Inc.

Yeah. Hey, guys. Thanks for taking the question. Wondering if you could talk a little bit more about the discretionary services spend and the headwinds you're facing there. I think we've talked in the past about back office automation, staff augmentation, [ph] efficiency (00:42:27) projects being the areas that people are looking to trim right now. Is it largely the same tune on that front? Or are you seeing incremental challenges, different areas and types of projects, scope of the work coming in and compressing here?

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Yeah. No, Parker, you answered it for me. That's the thing. Staff augmentation, efficiency projects, [ph] where (00:42:49) you're driving, you may have a double cost for a period of time, but you're going to save money in the long run. When March 10 happened, everybody just kind of took a pause and a break and said, we're going to have to evaluate what's coming down the pipe on discretionary spending. So, that's what it is. There is no change. Just March 10 added a different level of it for us. And so, it's something that – when you have a bunch of big customers, it's something that comes along with the territory, but the subscription revenue, obviously, we were really pleased with the results from that. And we continue to be pleased with that line of revenue, but we'll get through this discretionary spend and they'll pick it back up at some point. But right now, it's just a matter of – they're trying to sit back and watch what's going to happen.

Jeffrey Parker Lane

Analyst, Stifel, Nicolaus & Co., Inc.

Yeah, appreciate that, Matt. And then we've often talked about M&A being a tailwind to your story. I think, historically, you're on the right side of M&A. With the recent developments that we saw in March and subsequent events, has that had any impact on the M&A approval pipeline? And how are you thinking about that generally throughout 2023?

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.

Yeah, clearly, especially after coming off TD and First Horizon, that deal, it doesn't look like regulators want deals to get done. With that said, First Citizens is a customer of ours, and they acquired Silicon Valley Bank in the quarter. So, obviously, great opportunity for us. Look forward to working with First Citizens and Silicon Valley Bank on doing whatever we can to integrate those and make that conversion as simple as possible.

But M&A has, obviously, slowed down. But I think the reason we have been so successful in M&A, those reasons still exist. And when it picks back up, when consolidation happens, we're going to be in a good spot again, in my opinion. So, just a matter of kind of, like I said earlier, just weathering the storm, and we still have the most strategic customer base, I would argue, of a vendor out there, and those customers are going to go acquire other financial institutions to grow and get scale in this economy.

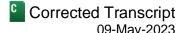
Jeffrey Parker Lane

Analyst, Stifel, Nicolaus & Co., Inc.

Understood. Thanks again for taking the question.

Matthew P. Flake

Chief Executive Officer & Director, Q2 Holdings, Inc.



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|---|---|
| Thanks, Parker. | |
| David Mehok Chief Financial Officer, Q2 Holdings, Inc. | A |
| Thanks, Parker. | |
| Operator: We'll take our next question from Alex Markgraff with Keyl | Banc Capital Markets. |
| Alex Markgraff Analyst, KeyBanc Capital Markets, Inc. | Q |
| Hey, all. Thanks for taking the question. Maybe just to pile on to the dekind of emerging business segment. So, for Jonathan, just kind of curi around the events in March. Just curious how your conversations more the last couple of months, and maybe how expectations for 2023 have evolved a bit. Thanks. | ious, you provided some helpful anecdotes to broadly have evolved with customers in |
| Jonathan Price | Λ |

Yeah. So, let's bifurcate between Innovation Studio and Helix. On the Innovation Studio side, we are seeing more demand for partners for access to the channel. So, they want to integrate with banks and credit unions. And as they've faced headwinds in their business, because of economic pressures, funding pressures, the demand for a single point of entry to many users like we have, over 21 million on the platform, we're seeing broad-based demand for our partners that's driving a lot of the success we're seeing on the Innovation Studio side.

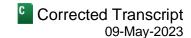
Executive Vice President-Emerging Businesses, Corporate & Business Development, Q2 Holdings, Inc.

When you look at Helix side, I think you have seen some impact on the net new environment in terms of the lengthening of sales cycles because of scrutiny around banks, especially post March, and all of our - in our model, our fintechs and brands are partnering with sponsor banks, and so that there is definitely a different level of diligence that goes into that. But the pipeline is still strong. I think, if anything, the demand for deposits is driving a renewed interest in what a lightweight core can do to help drive deposit-gathering strategies.

So, we feel really good about it. And as we talked about on the call, our existing customers are renewing with us. We're being very strategic in helping them navigate their profitability profiles, managing things like fraud. But it's a matter of, again, navigating this environment and making sure that we're there for our customers and in the right position to win new deals as they come up. But the pipeline does remain strong for the rest of the year. So, we're cautiously ontimistic

| cautiously optimistic. | |
|---|---|
| Alex Markgraff Analyst, KeyBanc Capital Markets, Inc. | Q |
| Great. Thank you. | |
| Jonathan Price Executive Vice President-Emerging Businesses, Corporate & Business Development, Q2 Holdings, Inc. | A |
| Thank you. | |
| Matthew P. Flake Chief Executive Officer & Director, Q2 Holdings, Inc. | А |

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Thanks, Alex.

David Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Thanks, Alex.

Operator: Thank you. And this does conclude the question-and-answer session. Thank you for participating in today's call and you may now disconnect.

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