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Q2 Holdings, Inc. (QTWO)

Investor Day

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MANAGEMENT DISCUSSION SECTION

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

Good morning. Thank you for joining us for our Investor Day. My name is Josh Yankovich, Head of Investor Relations here at Q2. We're excited to be speaking with you today from our headquarters here in Austin, Texas. And you'll be hearing from several members of our executive team.

Quickly before we begin, please be mindful that during today's discussion, we will be making forward-looking statements, including statements regarding our expectations for the future operating and financial performance of Q2 and with respect to our long-term financial plan, forces shaping the industries that we serve and our addressable market opportunity. These forward-looking statements are subject to significant risks and uncertainties. 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, including our most recent quarterly report on Form 10-Q and subsequent filings, as well as the slides that accompany the presentation today, a copy of which will be made available on our Investor Relations website following completion of the presentation.

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 also included in our periodic reports filed with the SEC and in the appendix to today's presentation.

Moving now to today's agenda. We will begin the event with Matt Flake, our CEO, who will share our vision of the future of this industry and how we are positioned to capture more of the market and help our customers succeed.

Then we will hear from Kim Rutledge, Executive Vice President of our People Organization to talk about our culture, talent acquisition and retention keys to our success.

Next, we will hear from Will Furrer, Chief Strategy Officer, who will share how we are innovating in order to land new business and expand relationships. We will then hear from Jonathan Price, Executive Vice President of Emerging Businesses, who will discuss how we are focused on solutions and strategies that are helping us create new layers of value within our business.

Following that, Adam Blue, our Chief Technology Officer, will cover our unique technology platforms and the competitive advantage they provide us. We will then move to David Mehok, our CFO, who will explain how all of these elements create a strong underlying financial model with the potential for high growth and expanding margins, before Matt wraps up with our presentation.

We will then conclude the event by answering your questions, which can be submitted at any point during today's presentation through the online submission portal located within the website you are using to view today's presentation.

With that, I'll pass it over to CEO, Matt Flake.

Matthew P. Flake

Chief Executive Officer, President & Director, Q2 Holdings, Inc.

Good morning. Thank you for joining us for our Investor Day 2021. Before we get started, I wanted to take a brief moment to thank our team members, our customers, and our shareholders. Without their faith in this company and our mission, we wouldn't be where we are today. And thank you for your attendance and your partnership. While I wish we could have done this in person, we decided a virtual format would give us the best chance to engage with as many of you as possible. We appreciate you being here.

I'm going to start today by sharing what we see as the future of this industry. The factors that are shaping it and how we have intentionally built the business designed to power the new frontier of financial services. Everything I'm going to share is based on the broad solution portfolio, deep domain expertise and robust customer set we have spent the last 17 years building. The timing of this event is fortuitous. The financial services industry is in a period of tremendous change, and we have identified three factors we believe are shaping our industry, informing our vision, and directing our strategy.

First, we are seeing unprecedented urgency to digitize the entire bank. And while we've built our business around this concept, COVID has accelerated this trend dramatically. Account holders and bank employees alike expect and in many cases need to be able to manage the financial experience anytime, anywhere and from any device where the retail, small business or commercial deposits are lending and I've never seen the financial institution executives and board members more aware of the need for and importance of digital transformation.

Second, the continued growth in the number of fintech companies and the innovation they bring to the market is setting a new bar for meaningful digital financial experiences. By unbundling the bank and making finance easy, these companies are having an outsized impact on the financial services industry. Fintechs are here to stay, and the relationship among traditional financial services companies and fintechs continues to evolve from one of competition to one of mutual partnership and enablement.

And the final force is the embedding of financial services into the daily lives and experiences of consumers and businesses. Major innovative brands recognize that incorporating banking into their strategy is an opportunity to

leverage the trust that their customers have placed in them, driving deeper engagement with those customers, all while generating additional revenue. These three forces are converging to create what we believe is a new frontier in financial services in which financial institutions, fintechs and brands will have new roles and interdependencies and will require new technology, new partners and new business models.

We believe that lasting value creation in financial services will be achieved by those companies that seize upon the opportunities that come from the convergence of these forces, and at Q2, we have built a strategic set of products and solutions that equip us to enable this convergence from digitizing the entire bank to facilitating partnerships among financial institutions and fintechs, to enabling brands to embed banking into their products and customer relationships. We believe this new frontier creates an expanded market opportunity for our business, which we have been thoughtfully building towards for several years.

At the time of our IPO, we were primarily focused on online and mobile banking. And we estimated our TAM at approximately $3.5 billion, that TAM has continued to grow. And by expanding our product portfolio into other areas of financial institution by commercial lending, we've been able to reach more financial institutions and more buying centers, which we believe expands our TAM to $13 billion today.

And we believe that with purpose-built solutions designed to facilitate the convergence I described earlier, Q2's long-term market opportunity is even greater, with an estimated TAM of approximately $23 billion by 2026.

To execute on this opportunity, we will rely on our time-tested strategy. We focus on innovating relentlessly, landing new business and expanding existing relationships. We believe this strategy positions us to achieve our long-term target of approximately $1.2 billion in revenue by 2026. And we believe we're in a unique position to capitalize on this opportunity because of our leadership in digitizing the entire bank and our ability to facilitate new partnerships between financial institutions, fintechs and brands. I'll expand on each of these areas now.

First, we are an established leader in digitizing the entire bank. With our broad and deep portfolio of solutions, we can help serve every major end customer segment, retail, small business and commercial across key aspects of the financial relationship from onboarding to banking to lending and more. It's this broad reach and expertise in financial services technology that we view as the first building block for success and the new frontier in financial services. And we have executed on this business incredibly well, resulting in a strong strategic customer set that we believe both validates our strategy and positions us for future success.

Today, we have more than 1,200 financial institution customers that span from community and regional banks and credit unions to global enterprise banks, demonstrating that our solution portfolio gives us access to every corner of the market. 150 of those are Tier 1 customers with greater than $5 billion in assets. For perspective, in 2014 when we IPO-ed, we only had 10 such customers. Many of these customers have grown to this designation during their time with Q2, and we see our ability to engage with Tier 1 customers and grow along with them as a differentiator.

And more than one-third of the top 100 US banks are now a customer of one Q2 solution or another, which can only happen when your solutions meet the rigorous availability, security and value requirements of the world's largest and most demanding institutions. And most of these customers are only utilizing a limited portion of our portfolio and are just beginning to realize the value of our solutions providing us substantial expansion opportunity.

Our customer set generates significant engagement through the digital channel. This year alone, we are on pace to facilitate more than 4 billion logins and the movement of nearly $2.5 trillion. The ability to operate at this scale

securely and reliably is valued at a premium by our customers and takes time and significant investment to build. In addition, we expect to price more than $4 trillion in commercial loans this year, which we believe gives us one of the largest commercial lending data sets in the country and positions us to empower commercial bankers and lenders to make their businesses more profitable.

And further demonstrating our differentiation in digitizing the entire bank, we are helping our customers win with our solutions. I've long said that we seek to partner with strategic financial institutions looking to use technology to their competitive advantage. Of the bank M&A deals announced in the first three quarters of 2021, in which a Q2 customer was a party, our customers were on the acquiring side or involved in a merger of equals in nearly 95% of the transactions. Furthermore, our banks grow deposits faster and operate more efficiently than their peers not using Q2 solutions, which reflects the value we can deliver by helping them win new customers and simplify their operations.

The second building block to capitalize on the new frontier is enabling financial institutions to partner with fintechs more easily to drive innovation. We are leveraging the strength of our digital banking offering and customer set to open our platform and create opportunities for mutually beneficial partnerships across the ecosystem. To accomplish this, we have opened our digital banking platform via our SDK and a suite of APIs. We call the Q2 Innovation Studio. It makes available to outside developers. The integrations and functionality we've built, making it easy for customers and technology partners to build on top of our platform.

While, we just formally announced Innovation Studio earlier this year we already have more than 50 technology partners, most of which are now available for deployment for our financial institution customers. By opening our platform we have doubled the number of developers working on it from our roughly 400 internal developers to a universe of more than 800 across our customers, development firms and technology partners. And we expect that number to continue to grow exponentially. This scale further helps us to build value and differentiation within our solutions. This approach means more innovation in our platform and faster than ever before, which our customers love, and it benefits our business too. It creates delivery efficiencies, accelerates time to revenue, increases stickiness with our customers and their account holders, and creates new opportunities for incremental high margin revenue for our business. We are using Q2 Innovation Studio to facilitate partnership between financial institutions and fintechs, building a win-win ecosystem for the new frontier and Jonathan will unpack this offering in more detail shortly.

And the final building block for Q2 to sit at the center of the new frontier is enabling innovative brands to embed banking solutions into their own products. We believe that we have built a significant head start in this area by investing in and scaling our Banking-as-a-Service business. Today, our Banking-as-a-Service platform supports innovative brands at scale. Our platform serves more than 10 million users, and our clients are generating 1 billion API calls a month, which is 10 times more than in 2019. We believe the movement by innovative brands to embed banking solutions into their products is still in its very early innings and will continue to gain momentum in the years ahead. And given the traction we already have in this space, I believe we have a substantial head start and competitive advantage enabling us to capitalize on the substantial TAM we associated with this opportunity.

In conclusion, we believe our industry is at the beginning of tremendous innovation and change. We see financial institutions, fintechs and brands converging and creating new opportunity for them and us, and we believe we are in a strong position to capitalize on this convergence. When it comes to digitizing the entire bank, we have a broad and deep solution portfolio that has enabled us to build a highly strategic customer base.

And we have used that position of strength to begin building a partnership ecosystem for financial institutions, fintechs and brands through our Q2 Innovation Studio and Banking-as-a-Service offerings. As a result, we see our

market opportunity grow and as we continue to execute on our core business and this exciting strategy positioning us for long-term growth. Of course none of this would be possible without the remarkable people that make this happen day-to-day.

And with that, I'm pleased to announce Kim Rutledge, Executive Vice President of our People Organization to talk through how we think about talent acquisition and development, diversity and culture.

Kim Rutledge

Executive Vice President-People, Q2 Holdings, Inc.

Thanks, Matt and good morning, everyone. Today I have the pleasure of speaking with you about the driver of all of our success our people. At Q2 our people and our culture have long been our greatest asset. And with some of the topics buzzing in my world lately, wage inflation, remote work and what some have called the great resignation, we believe our focus on people is more strategic and differentiated than ever. I'm incredibly proud of how we have handled the last 24 months and today I will discuss how we have positioned ourselves to continue retaining and attracting the very talented team members necessary to continue driving innovation.

I'll also touch on some of our ongoing efforts to ensure diversity and the inclusion, as well as our broader ESG initiatives, which will ultimately serve to further improve our business success.

At Q2 we don't just talk about our culture, we nurture it through how we grow our team, define our goals and reward our employees. We believe it is because of this emphasis that our culture has been regularly recognized in the markets where we operate. In Austin, Texas where our headquarters is located, we have been named the top workplace for 11 years straight and we've received similar awards in North Carolina, Lincoln and Minneapolis. Today, more than ever employees want to work somewhere with strong culture and sense of purpose. And we believe this recognition is a tailwind to our ability to hire and develop great people. Competing for global talent is essential for our long-term success. As we expand our workforce, we're focused on providing real development opportunities to our team members. Over 20% of our requisitions are filled internally and our promotion rate is also over 20%.

We hire hundreds of people per year to continue to build the talent on our teams. And since our global expansion in 2018 over 25% of our hiring has been outside of the US and our commitment to recruiting a diverse workforce helps us attract new talent and deliver stronger business results. Like any good people organization, our team is paying very close attention to attrition, market fluctuations and talent availability as we determine how to best support the business' success.

This focus on creating and continuously improving our company culture has become a virtuous cycle. Our accomplishments enhance our culture and then through attracting and retaining the right talent at the right time, we repeat those successes. And to further incentivize our team around business success, we ensure our employees have ownership through equity grants given to every new hire joining Q2 and ongoing grants to a significant number of employees. Additionally, we are rolling out an employee stock purchase plan in 2022 to our US employees to reinforce our commitment to employee stock ownership. For more than 17 years, Q2 has been defined by and recognized for our mission-driven and award-winning culture of collaboration, inclusion and transparency. Our employees are passionate about our company mission, it's core to who we are and why we do what we do. That commitment carries through to a broad set of community engagement and giving activities. These give additional meaning to our work, help us attract equally civic minded talent and bringing us together. Our employees support both company-sponsored events and create their own ways to support causes and communities that matter to them. You can see just a sample of the groups we support on the slide.

In 2021 alone, our employees have donated over 4,000 hours so far. We also are deeply committed to our numerous diversity, equity and inclusion initiatives. In fact, in 2020, we even modified our mission statement to specifically include our commitment to building more diverse communities, to us the inclusion of building more diverse communities was always inherent and now we've made it explicit.

We are committed to continuing to improve our representation in meaningful ways and are proud of the progress we've made in the last few years. 34% of our global employee population is female and 28% of our US population is non-white. In the last three years, our female employee representation at our director level and above has grown by almost 30%. Our board is 38% female and 13% non-white. Additionally, we have delivered $19 million to our employees in the form of raises in 2020 and so far in 2021.

After frequent evaluations and attention, we have achieved parity in pay and promotion rates between genders globally and have given focus to market movement, performance and equity in all of these moves and increase is given. While we are proud of our leadership in these critical areas, we also understand that creating more diverse, equitable and inclusive workplaces requires ongoing improvement and intentionality, and we will continue to evaluate our performance and enhance our efforts where needed.

Finally, earlier this year, we delivered our inaugural Environmental, Social and Governance report. If you haven't already, I would encourage you to read the report as we discuss how we are addressing ESG topics that matter most to our people, customers, partners and, of course, you our investors. It's also another step towards providing more transparency around our efforts and holding ourselves accountable for continued improvement. We know our work always continues, and we look forward to sharing our progress with you in the years to come.

Our people's passion for our mission is displayed in their excitement for executing on our strategy. To speak more about that, I'll hand it over to Will Furrer, our Chief Strategy Officer.

William M. Furrer

Chief Strategy Officer, Q2 Holdings, Inc.

Thanks, Kim. I'm excited to speak with you and share our strategy to thrive in the new frontier. The core of our strategy remains consistent. We will innovate with a clear focus on expanding from digital banking to the digital bank, which our market demands. And we are opening our platform to enable fintech access to our customers and our technology. We will also provide the technology and partnership models innovative brands need to bring financial services into their experiences. This relentless innovation will help us win new business across the markets we serve. And finally, we will expand relationships with existing customers by adding new solutions that enable them to drive real results in their business.

Evolving from digital banking to the digital bank is the centerpiece of our strategy. At Q2, we have assembled a set of strategic products and offerings that enable us to bring integrated end-to-end solutions to a market riddled with point product providers and legacy payments or processing companies. Our broad product portfolio, the strength of our customer relationships, the ability to deliver rapid innovation and integrations, as well as our vast data, enable us to win today and are the building blocks that we think will enable us to succeed in the new frontier of financial services.

It takes a comprehensive portfolio of products, from banking to lending to onboarding to security to deliver the digital bank. At Q2, we have already assembled award-winning solutions, helping consumer and commercial account holders open accounts where they can then pay, save, borrow, spend and manage. And as management of the digital channel becomes more important, our solutions are used by bank employees, helping them secure, price and report on digital channel engagement.

Our innovation for the digital bank is all about creating integrated end-to-end solutions that eliminate friction and create value. Here are some of the areas where we are creating differentiation by delivering an integrated solution suite. First, onboarding customers digitally is required for the new frontier, but opening a new account is just the beginning. Engagement and adoption of multiple products is what helps turn a new account for our customers into profitable relationships. That's why we designed a solution that streamlines account opening, direct deposit switch and activation of both debit and credit cards. Over the last several years, our customers have digitally opened nearly 1 million accounts and acquired direct deposit relationships for more than 5 million account holders, helping our customers build more profitable relationships.

And we are investing in financial wellness solutions. Our customers tell us that financial literacy and planning are critical to their missions. So we have built solutions that enable our customers to provide financial goals, planning, budgeting and a complete view of an account holder's financial position as part of a differentiated consumer banking experience. Using our solutions, our customers have aggregated nearly 2 million accounts from other financial institutions, and those accounts total more than $50 billion in assets, making them right for marketing campaigns from our customers.

And we are bringing innovation to commercial banking as well, leading banks and credit unions are moving up market into commercial banking. We think that digitization of every step in the commercial relationship from new account acquisition to annual account reviews is the new expectation. Using our integrated solution, commercial bankers have reduced treasury services onboarding by more than 50%, creating growth in this key account segment.

And our customer solutions are helping keep those customers more secure. Last year, we stopped nearly $300 million in business banking check fraud, helping their reputations and their businesses.

Our lending and relationship profitability solutions are also driving results, we all know that at some point consumers and commercial accounts alike will need a credit relationship and that relationship can be a significant profit center for financial institutions. That's why we include integrated lending and profitability solutions in the digital bank. This year, we have helped our lending and profitability clients price nearly 140,000 loans and year-to-date in an environment where banks have seen shrinking commercial loan volumes year-over-year, our loan pricing customers have actually grown their loan volumes and their commercial loan portfolios carry a return on equity 230 basis points higher than the industry average.

Finally, we are continuing to invest in data, helping our customers use it to drive success for their business. Adam Blue, our CTO, will be discussing this in detail later, but simply said, we have access to tremendous data. We use it to develop insights and we use them to tailor the experiences in our solutions. This strategy turns vast engagement data our customers generate into lasting value and differentiation.

We've been deliberate in the innovation and integrating the portfolio to deliver on the end-to-end digital bank. As a result, we are winning in every major segment of our market from community and regional banks and credit unions to enterprise and global banks.

Additionally, our broad portfolio of solutions gives us access to decision makers across the enterprises we serve. In other words, we offer proven solutions designed for the head of risk, lending, finance, operations, user experience and, of course, technology, helping us enter new opportunities and expand existing relationships.

And we are seeing how our investment in the evolution from digital banking to the digital bank is a key differentiator in helping us win. Seacoast Bank is an approximately $10 billion bank focused on consumer, SMB, and corporate banking. They're highly acquisitive. And over the last several years, they have seen tremendous growth. This opportunity was very competitive and included banking, onboarding, lending and data solutions in every category of the evaluation, multiple point and legacy solution providers were under consideration. Because we aligned our strategy and our solutions with theirs, we were awarded the business and with our continued innovation, and approach to integrating our products into value-creating solutions, the win with Seacoast was nearly double the average sales price for Tier 1 wins in 2017, despite the fact that the average asset size of that cohort was slightly larger than that of Seacoast. I had a chance to speak with Jeff Lee, Seacoast Chief Digital Officer, about the role that technology plays for a growth oriented bank and I wanted to share some of that interview with you now.

[Video Presentation] (00:28:50-00:30:31)

Now, to demonstrate how our focus on the end-to-end digital bank enables us to expand, I want to share another example. This one with Mercantile Bank of Michigan, a leading commercial bank in their markets, Mercantile has utilized our consumer, SMB and commercial digital banking solutions for several years. They needed to accelerate onboarding for valuable treasury services and selected our team to deliver a seamless integrated treasury onboarding and SMB lending solution. Our relationship with Mercantile has expanded over the years to almost five times the initial booking.

And we recently signed another long-term renewal with them. John Schulte is Mercantile's Chief Information Officer. He's been one of the executive sponsors of our partnership since it began. And his vision has helped make Mercantile such a strategic partner. I asked him to share a little bit about the importance of integrated solutions, particularly to help with the onboarding of key commercial accounts.

[Video Presentation] (00:31:37-00:32:54)

As you have seen, we are winning new business and expanding relationships with our end-to-end platform for the digital bank. The next building block in our path to the new frontier is opening this platform and allowing fintechs to easily embed their solutions into the digital bank. Opening our platform democratizes innovation, enables our customers, fintechs and third-party developers to create and deliver new cutting-edge experiences into the banking apps we design and manage on their behalf.

This strategy also enhances the innovation process and leverages not just the strength of our internal team, but the talent and efforts of the broader universe of developers. This enables partners and customers to create new innovative ideas, multiplying our innovation capacity. We believe this open approach is the path forward for our industry and by providing easy access to our customers and their account holders, fintechs now realize that working with Q2 gives them a valuable distribution channel for growth in this complex financial services ecosystem.

With this open strategy, we are also unlocking new revenue potential for our business. Now, in addition to selling software to financial institutions through Innovation Studio, we enable our banks to offer additional revenue-generating solutions to their account holders and we participate in a revenue share associated with these transactions. Jonathan and David will cover off on how we believe this will unlock substantial growth in our business in their upcoming sections.

To show the value of our opening our platform in action, I'll share a quick story from a customer of ours. Stanford Federal Credit Union has a diverse global membership. Based on feedback from those members, the innovation team determined international money movement was key. Using Q2 Innovation Studio, the team from Stanford partnered with Wise, a leading international money movement provider along with a third-party developer, and together delivered an elegant, fast, international wire solution inside their digital banking application.

And to really demonstrate the power of an integration project like this, I'll share a quick video from the Credit Union.

[Video Presentation] (00:35:19-00:36:21)

The final building block that we think leaders must have in the new frontier is the ability to enable brands to provide banking services directly to their customers. At Q2, we believe we have the technology, the expertise and the turnkey bank partners required to bring banking services to a brand. These partnerships can benefit our business, the brands with which we partner and the banks that support them. Although, it's still early innings, we are beginning to see the value of this opportunity represents for our business.

In closing, we are investing in the innovation we believe is required to win in the new frontier of financial services. We are building out the digital bank, delivering integrated end-to-end solutions that help us win in the markets we serve. We are using data to enhance our solutions and tailor the experiences we deliver. We are opening our platform to change the way Q2 and our customers innovate, while also developing the open technology required for our Banking-as-a-Service offering, areas we believe will unlock growth inside our business.

With our innovation, we are differentiating Q2 from point solution providers and winning new business, and we are creating value with our existing customers, using this innovation to drive deeper, stickier relationships with them. Thanks.

And with that, I'll hand it over to Jonathan to further unpack the business models underneath Q2 Innovation Studio and Banking-as-a-Service.

Jonathan Price

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

Thanks, Will. We believe we have entered a new frontier in financial services, the convergence of financial institutions, fintechs and brands means that each of these constituents is working to create unique products and distribute them in new ways. The result of these changing dynamics is that traditional players and new entrants are all now seeking to provide best-in-class financial experiences to consumers and businesses alike.

But there are significant challenges for everyone involved, banks and credit unions are facing a major innovation and competitive dilemma. New companies funded by record high levels of private capital have spawned a growing universe of providers that are giving rise to new competitive pressures. Meanwhile, financial institutions are operating in a tight interest rate environment while their customers' expectations are at all-time highs.

At the same time, new players see massive opportunity in adding banking products, but they also face substantial regulatory of hurdles and technology gaps to accomplish this strategy. These bidirectional challenges create an environment where cooperation, rather than competition, is the optimal solution, which gives rise to new partnership models and business opportunities for both sides.

Financial institutions want to bring best-in-class fintech experiences into their digital offerings for their account holders. We think of this as embedded fintech. At the same time, brands have started to look at adding banking functionality as a way to engage more deeply with their customers in highly personalized ways. We refer to this as embedded finance. Because Q2 has spent 17 years building the entire digital bank with end-to-end solutions and more than a thousand integrations, and because we have accumulated nearly 20 million end users across more than 450 digital banking customers, we are in a position to enable both of these opportunities; embedded fintech with Q2 Innovation Studio, and embedded finance with Banking-as-a-Service. We will review both of these offerings, but let's start with Q2 Innovation Studio.

The Q2 Innovation Studio provides our bank and credit union customers as well as fintechs with API and SDK based access to our online digital banking platform. And in doing so, we believe it creates real value for Q2 and our customers. At a basic level, the Innovation Studio does two things for our customers. First, it provides them with the ability to extend their digital banking environment with their own resources on their own schedule. With it, they can deliver innovation exponentially faster and differentiate their digital brand simply and securely.

Second, the Innovation Studio makes it fast and easy for any fintech to embed their offering into the Q2 platform, empowering our customers to harness the innovation that's being developed in the marketplace today. Through Q2 Innovation Studio, we are curating a large ecosystem of partners that get pre-integrated into our platform, allowing our customers to adopt and deploy new solutions in a matter of days or weeks instead of many months. Let me explain how this work in a little more detail.

Using Innovation Studio, we integrate a third-party product directly into our platform once. We then make these solutions available through two simple paths. First, if we take an example of a consumer app like credit scoring or a business solution like e-invoicing, the account holder simply navigates to a branded app store within the financial institution's digital experience. They then buy the application just like they would if they went directly to the partner's website. Alternatively, if a bank or credit union wants to add a solution to their standard digital offerings, the bank operator can simply navigate to a menu of available pre-integrated partners in our back-office tools and add it quickly to their online and mobile banking experience.

This point-and-click innovation paradigm delivers significant time and cost savings to our financial institution customers. The magic is in the integrate once, distribute to many approach enabled by Innovation Studio. We think the traditional workflow for a financial institution to partner with a fintech is broken. The historical process is complicated and time consuming, typically taking 9 to 15 months in the old paradigm.

Q2 Innovation Studio abstracts the complexity of the integration process and effort required to deliver new technologies. We are typically seeing a greater than 50% reduction in both time and costs associated with these deployments inside of digital banking. The result is that financial institutions more rapidly deliver innovative products to their customers, yielding more engagement and growth opportunities.

And some truly innovative partnerships are actually driving new revenue opportunities for our customers. Take, for example, NYDIG, a leading bitcoin custodial solution. We've integrated to empower our banks and credit unions with the ability to allow their account holders to buy, sell or hold bitcoin. We went from initial discussions to an executed partnership agreement to helping the first financial institution in the US execute a live trade in less than four months. And as account holders complete bitcoin transactions, the financial institution and Q2 participate in the transactional revenue, a model that applies to many of these third-party partners and creates a new source of revenue for us and our customers.

We believe the Innovation Studio expands our addressable market opportunity. By opening our platform, we are participating in large economic pools to which we otherwise wouldn't have access. The number of segments adjacent to the financial journey of a consumer or business are numerous. For consumers, key areas like financial wellness, credit monitoring, ID protection and insurance. For businesses, segments like accounting and invoicing, HR payroll and time tracking and business-to-business payments are just a few of the areas where we can bring our financial institution customers closer to the center of the financial lives of their account holders.

In summary, in addition to unlocking substantial TAM for Q2, we believe the Q2 Innovation Studio puts us in a category of our own, transforming our relationship with our customers from that of a vendor to a true strategic partner. We are strengthening our customers by delivering innovation much faster, while also enabling them to differentiate by building their own unique financial experiences. Q2 Innovation Studio is differentiating our digital banking offering, driving new wins and expanding existing relationships. And finally, we are laying the foundation for embedded fintech in this industry, by building what we believe will be the largest ecosystem of best-in-class consumer and business solutions, creating a win-win partnership model for the new frontier and financial services.

Before shifting gears to Banking-as-a-Service, I'd like to share a quick video from Tom Novak, the Chief Digital Officer at Visions Federal Credit Union. Visions is one of our most strategic digital banking clients, and their story really demonstrates the value of Innovation Studio in action.

[Video Presentation] (00:45:37-00:46:33)

It's stories like Tom's that really crystallize how powerful the Innovation Studio is for our customers and our business. And with that, let's turn to Q2 Banking-as-a-Service, where we are facilitating partnerships in the reverse direction, embedding finance into innovative brands by bringing them both the financial institution and the technology required to deliver this offering to their customers.

Consumers and businesses expect banking to be folded into their daily lives and experiences. Today, when you buy a phone, you can open a debit card to receive a better plan. You can finance purchases online at checkout in just a few clicks, and you can send payments to friends and family through social media applications. Given this expectation, innovative brands are increasingly considering ways to embed financial service capabilities into their products. And they recognize that there can be substantial value creation for them in pursuing this strategy. However, the hurdles for brands to achieve this strategy are two-fold, and they can be significant.

First, financial services remains highly regulated. Without a bank charter, these companies are extremely limited in their ability to issue accounts, ensure those accounts and move money. Second, the legacy technology infrastructure available to these companies modern, highly-capable development teams do not enable the creation of fast and personalized user experiences required to capture this opportunity. We think our approach to Banking-as-a-Service is unique in the market.

We combine a cloud-based real time core processing platform with the full package required to support it, from integrated issuer processing, to ID verification, to the financial institution partners themselves. These financial institutions issue accounts and cards holding insured deposits and move money on the company's behalf. And these institutions benefit from the deposits and the transactional revenue in these programs. The result of this total package is a flexible solution that enables our clients to build highly personalized financial experiences within their ecosystems.

And this approach is one of the reasons we went in the market. Acorns was one of the pioneers in micro investing, and our partnership has enabled them to add banking functionality to their application and expand

relationships with our customers. Just look at this response from Manning Field, Chief Business Officer at Acorns. When asked why his team selected Q2 Banking-as-a-Service, its flexible API-based and simple to work with. I also had the opportunity to speak with John Mileham from our client, Betterment. Betterment is one of the leading robo-advisors helping their customers automate investing. I asked John in short, how they conducted their vendor evaluation and why they selected Q2. Here's what he said.

John Mileham

Chief Technology Officer, Betterment

We did a full sort of build versus buy evaluation, and we talked to everybody that we could talk to in order to get smarter about the challenges that we faced. Ultimately, it came down to Q2 having a robust feature set, modern APIs, and a team that when we spoke to them, really felt like they could help us achieve our vision of this deeply integrated product into our broader product suite.

Jonathan Price

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

And when I asked what stood out to him about our relationship after a couple of years of partnership, this was his response.

John Mileham

Chief Technology Officer, Betterment

I mean, as Q2 knows well, building a robust banking core is not a small lift. So – and then also figuring out the right banking partners to work with in order to provide FDIC-insured accounts and all that stuff, it's not an easy thing either. So, by partnering with Q2, we found ourselves able to focus wholly on differentiating our product and providing a deeper integration with the rest of our product lines as opposed to doing that big lift of building that core functionality that already has been done so well by partners like YouTube.

From a product perspective, there's maybe not any one thing that makes like a banking product like Q2's like the thing that you need because I think customers have an incredibly high standard at this point for what a modern banking experience is. So in many ways, it was really about having that high level of service across all the capabilities that a modern banking system needs that really sort of sold us and continued to have us coming back.

Jonathan Price

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

Now that we've showed how we win in the market, let's talk about the model, which differs from our traditional subscription business. With Banking-as-a-Service, we land an account and as the client drives adoption of their BaaS-powered solutions, we generate incremental usage-based revenue that can greatly exceed the contracted minimum. Because of this usage-driven model, our go-to-market strategy is focused on established, innovative companies across many verticals that have large existing user bases. These companies have a built-in distribution model, leading marketing engines and a strong brand loyalty, enabling them to drive rapid, large-scale adoption of a BAAS program. The result is that we can create customer relationships that, once mature, can contribute many multiples of the initial deal in terms of revenue. As you can see, in some cases, even more than 10 times the initial booking.

Given these facts, we anticipate Banking-as-a-Service to play a significant role in Q2's growth and market opportunity in the years ahead. We believe this market to be in its early innings and we expect it to grow rapidly over time. And with our differentiated solution package, our go-to-market strategy, and the revenue expansion we

see within our large clients, we believe we are well positioned to achieve our Banking-as-a-Service five-year revenue target of greater than $100 million.

In closing, I want to reiterate why we're so excited about these emerging businesses and how they position us to facilitate the convergence that is taking place in financial services. First, we are using Q2 Innovation Studio to open up our banking platform, accelerating innovation for customers and differentiating our digital banking offering. By opening our platform, we are creating a partnership ecosystem for embedded fintech, enabling banks and credit unions to bring best-in-class innovation in financial services to their digital banking experience.

Next, we believe we are leading the charge in embedded finance, enabling some of the most successful and innovative brands to add banking products with our Banking-as-a-Service solutions. And these opportunities are both early. They add to our total addressable market today, and we believe the TAM will continue to grow rapidly over time, making both Innovation Studio and Banking-as-a-Service attractive growth levers for Q2's business over the long-term. Thank you very much.

And with that, I'll hand it over to Adam to unpack the technologies that power the strategies that we've shared with you today.

Adam D. Blue

Chief Technology Officer, Q2 Holdings, Inc.

We measure our investments in technology and our roadmap with a single question, do they serve the mission? After more than 15 years at Q2, I can say that every line of code serves our mission to build strong and diverse communities by strengthening their financial institutions.

Today, I'm going to share an overview of our technology and how we believe it creates differentiation for our customers and our business. This will also show why we believe we're positioned for success at the new frontier of financial services. We'll discuss both the technology used to power the digital bank, as well as the technology underneath our rapidly expanding Banking-as-a-Service offering.

While they're separate and distinct platforms, both are born from our deep expertise creating value with our technology for the financial services industry. As a fundamental technology philosophy, we believe in the power of the platform. That's why we have created two special purpose platforms we believe are required to capture the market opportunities ahead. One, use to power the digital bank we've built over the course of the last 17 years. For Q2, the digital bank means onboarding, lending, deposit services, retail, commercial, everything a bank needs to operate and grow their business. To build this platform, we've spent years integrating into virtually every legacy back-end solution in the financial services ecosystem.

The second platform is at the heart of our Banking-as-a-Service solutions. We designed this from the ground up as a modern, open-banking platform, enabling innovative brands, developers to quickly and easily access and utilize financial functions, all without the pain of legacy solution integration. We'll talk about our expansive solutions, and I'm here to talk about what sits underneath them, because we think it creates a substantial competitive advantage for us. The digital banking platform works because we have integrations to virtually every solution in the financial services ecosystem. More than a thousand of these integrations are in production today. Each financial institution we serve represents a specific combination of these integrations that must be orchestrated to provide great customer experience.

Because we work across banks and credit unions and from retail through commercial and treasury, we offer one of the broadest sets of integrations in the market. We believe our portfolio of integrations into this comprehensive

set of banking infrastructure and the data within them is one of the key differentiators for our business. We also believe that extracting integration value requires considerable time, talent and industry expertise, all of which we have in abundance here at Q2.

Our integrations into the hundreds of variations of core processing systems, mobile check deposit, wire, ACH, positive pay, check imaging and others that drive the workflows that make up the digital bank comprise our core strengths in the market and our ability to bring these integrations to bear, enabling each of our customers to offer a unique but cohesive digital experience made up of these backend integrations to their contracted vendors for each of these services.

Operating these integrations is equally important. And because we have a plug-and-play model for managing our integrations, our digital banking platform can be quickly installed, operated and extended at scale. It's this building of integrations to other systems and operating them at scale that informed our approach to our Banking-as-a-Service platform.

From its original design, it has been purpose-built to be open and easy to use and gives access to critical functions via an API layer. The exact opposite of the legacy technologies we work with to enable the digital bank. Innovative brands and their developers want to quickly embed banking functions like core processing, account management and cards, identity verification and risk management, and then easily access them via API. What we have done is enable the next generation of talented developers to quickly and easily bring banking features into their brand experiences, unlocking value and furthering differentiation for these brands and then in turn, Q2.

The flexibility of this platform gives us access to the expanding market of innovative companies in multiple verticals looking to embed banking products into the digital journeys that they offer, where we are the builders of the digital banking platform, we become the enablers for others to build on our Banking-as-a-Service platform. Because of this breadth, we're generating substantial engagement and have visibility into a vast amount of end-to-end banking activity and data. We have almost 20 million users on the digital bank and we are on pace to move $2.5 trillion this year alone. We have 13 billion minutes of engagement year-to-date and expect to handle more than 4 billion logins this year. Our solutions are on pace to price close to $4 trillion in commercial loans this year. And on the Banking-as-a-Service platform, we've accumulated more than 10 million users. We are supporting on that platform as well more than 10 billion API calls a month.

All of this engagement creates a flywheel that drives value for our customers and our business. Every time an account holder or banker engages with any of our solutions, they create data. We then utilize that data to develop and deliver insights. These insights help our customers run their business, drive personalization, and continue the cycle of creating deeper engagement with account holders, all of which generates more data, creating momentum for the flywheel.

At Q2, we've built a wide funnel of data. It comes from all of our integrations and solutions on both sides of the balance sheet, deposits, and lending. This flywheel enables us to do three things. First, using engagement and data, we create reusable units of insight. And with these, we create discrete, valuable, data-centric products. We can sell these products to our customers and use them to create further differentiation for our solutions in the market.

We have a proven track record of data product innovation around risk, fraud, relationship pricing and targeted marketing. Second, we allow these insights to guide our existing solutions and then enhance them. Because the flywheel continues to expand with more engagement and data, we're continually developing new insights and refining the overall quality of our products that make up the digital bank.

Third, this combination of products and data-driven insight achieves real, measurable outcomes and drives business results. I'd like to share just some of the results we're creating for customers with our data strategy.

We began employing machine learning on our data in 2008, using units of insight around payment flows and end user behavior to stop commercial banking fraud in real time. This year alone, our machine learning solutions have stopped approximately $1.5 billion in fraud for our customers before the money could leave the bank or credit union. On the critical commercial lending side, we use insights generated from trillions of dollars in loans to deliver intelligent coaching to lenders in real time, helping them win more business and drive more profitable relationships.

Our coaching network provides guidance to relationship manager to allow each of them to perform as effectively as the best among them. In the past year, using our solutions for pricing and profitability, our customers have won approximately 45,000 loans and have generated roughly $6 billion in estimated net income. We're also using data to help customers market to the right customer at the right time. Using our data and machine learning solutions, our customers are improving marketing success rates by more than 150% compared to what we believe is industry average. This helps them grow the number of products per customer, which is a key to their continued growth.

We've spent 17 years building this data flywheel across virtually every technology in the legacy financial services system, and we're learning from our seven petabytes of data to create reusable units of insight benefiting our customers, their account holders and ultimately Q2's business. We think the breadth of our solutions, integrations and data creates a substantial competitive advantage for Q2. And by opening our platform to others via Innovation Studio, we believe that we can multiply that competitive advantage by expanding the universe of innovators that can create value on our platform.

With Innovation Studio, we enable partners, customers and third-party developers, all to take advantage of that technology platform that we work to deliver since inception. It's easy, it's deep, and it's fast to value because it's rich in features and robust in its capabilities. It's built by engineers who are working hard to welcome new innovators to our mission. It creates positive impact, accelerating innovation for our business and for our customers. It's important to emphasize that unlike many studios in the market, ours wraps and exposes every integration into every back-end system we have. Reuse of the existing platform components in integrations is what makes our Innovation Studio so valuable.

This value makes developers and our ecosystems true partners in development and innovation on the platform. We are like Amazon Cloud for our customers. They can build code, test code, deploy features and deliver new experiences via the development environment and tools we provide. Using our integrations, scale and business logic that run in the same secure high-availability environment as the platform itself, our customers can tailor the experience of the digital bank. We manage the platform, operate it and enable ease of use and extension. We are helping them innovate faster than ever before. But just as important as speed, we also provide a stable and secure platform from which they can build.

As Matt mentioned, we've more than doubled the number of developers building on our platforms via Innovation Studio, including hundreds of developers focused on integrating and enhancing critical functionality like chat bots or international payments. We think that this growth is evidence of the demand for the services that the platform provides and an endorsement of its quality.

In closing, we believe the technology platforms that we've built to power our business deliver significant value and differentiation for Q2. We spent years building an expansive set of solutions designed to power the end-to-end digital bank, supported by more than a thousand integrations to virtually every system in our industry. This solution set creates a flywheel of engagement and data that we use to drive value for our customers and our business. We are opening our platform, sharing the years of work we've invested into our technology with a universe of developers that can help our customers deliver exponentially more innovation faster. We've applied our deep domain expertise to build a cloud-based platform that enables innovative brands to build banking into their products, paving the way for embedded finance.

With that, I will hand the call over to David Mehok, our CFO, to discuss how everything we've talked through today creates a strong financial model with high long-term growth and margin expansion potential.

David Mehok

Chief Financial Officer, Q2 Holdings, Inc.

Thanks, Adam. As you've heard throughout the day, our strategic imperatives are consistent and clear. And we've been innovating at a rapid pace and anticipating many of the changes we're seeing in financial services. We believe this foresight has positioned us well to capitalize on an immense opportunity ahead. In my time with you this morning, I want to clearly articulate where we see these opportunities, quantify them, and discuss how all of this fits into our value creation framework, resulting in strong, long-term revenue growth and margin expansion.

As Matt mentioned earlier, we believe our current TAM of approximately $13 billion will almost double to $23 billion by 2026. With less than 5% penetration of this current TAM, we see numerous opportunities going forward to increase our share of our existing base, as well as establish and build share in new markets. With our current customers alone, we see an addressable expansion opportunity of approximately $3 billion. In addition, we have an attractive opportunity to continue to win business with new customers. Finally, we see significant upside in our emerging areas of our business, where we're just now establishing a differentiated presence. Let me walk through each of these areas in more detail.

One of the most valuable assets we have is our 1,200-plus customers. Each one of them represents the unique opportunity to drive more revenue and effectively scale our costs with each passing year. The average contract duration for our digital banking platform customers is 5.5 years. This provides us with the ability to better understand our customers' business, build trust and find new areas to help them grow. Historically, we've seen our digital banking platform customers increase contracted recurring revenue by 43% over the first three years following their implementation. This comes through the sale of new solutions and incremental users that are added to the platform. From a profitability standpoint, when we go live with our customers, the margin profile is typically lower, as we incur numerous startup costs. These costs scale well over time, resulting in higher average gross margin at the time of renewal. For those digital banking customers that we've renewed through the first nine months of this year, they've averaged a 70% gross margin contribution upon renewal, which is highly accretive to our overall gross margins.

Our ability to retain our customers and expand our relationships with them is exemplified by our net revenue retention rate. Over the past four years, we've averaged 119%. Historically, this growth has been approximately evenly split between cross sale of additional solutions and increasing user growth, which is driven both organically and through customer-led mergers and acquisitions. This was partially offset by a low revenue churn rate of 5% to 6%.

As Matt mentioned, we're typically the beneficiary of customer-based M&A. In almost 95% of banking M&A transactions announced the first nine months of this year in which Q2 customers were involved, our customers

were the acquirer or the transaction has been a merger of equals. There are numerous variables that determine the incremental revenue impact from these acquisitions, but we believe this is another data point that highlights the potential for growth from our existing customer base.

The expansion opportunity we see from organic user growth and cross sales is also evident in the revenue growth profiles of our customers over time. The historical average revenue growth of our customers one year after onboarding is approximately 10%. This growth rate significantly increases over the next few years, resulting in an average growth rate of 60%, four years after onboarding them. Our ability to grow with our customers' digital journey is not just a projection, but something we've seen historically for more than a decade. And we have a long runway to continue to grow with our customers. We estimate the cross-sell opportunity with our existing customer base to be approximately $3 billion with the solutions we have today.

Looking at our digital banking customer base alone, we believe this opportunity is approximately $1 billion. We're also seeing increased opportunities with our digital lending customers to expand the existing application of these solutions as well as cross-sell digital banking solutions. In addition, we have more than 600 customers that currently utilize one of our solutions, but are not yet on digital banking or lending platforms. We believe we have an additional $1.5 billion opportunity just from expanding our relationship with these customers. Our breadth is not only a catalyst for growth with our existing customers, but also positions us well for new opportunities.

When evaluating the landscape for these new opportunities, it's become clear to us that customers want a proven partner that can provide a seamless integration between solutions that span across the entire digital bank, and we've seen an accelerated desire to purchase more of these solutions upfront. Exemplifying this, over the past five years, we've seen the average number of products included in our digital banking platform deals increase by over 40%. The median asset class of these customers in that time period has increased 76%, as we continue to win up market. These factors have resulted in an 80% increase in the average selling price of the deals we've won this year relative to where we were five years ago, reflecting both our broad set of solutions and our ability to win larger customer opportunities. We believe our market-leading breadth of digital banking and lending solutions puts us in a unique position to benefit from these trends and drive high win rates.

Our new business historically has been in the form of contracted recurring revenue. However, as Banking-as-a-Service and Innovation Studio offerings continue to grow, it's important to understand that they do so with a much different revenue model. The usage-based revenue from these customers has the potential to be many times larger than that of an initial booking. The typical opportunity in BaaS can have lower minimum revenue commitments as compared to a digital banking deal, but once our customers begin to activate these programs, the minimum threshold can be quickly reached, driving incremental usage revenue, and over the contractual term, these customers, we anticipate the revenue mix to shift largely towards usage-based revenue streams.

Our Q2 Innovation Studio offering has similar revenue multiplier effects, and we expect that over time, both BaaS and Innovation Studio will comprise a larger portion of our overall revenue growth, resulting in a greater amount of incremental revenue following go lives relative to what we've seen historically. These incremental usage-based revenue streams in excess of contractual minimums are not incorporated into reported backlog metric. While we feel backlog is a useful metric, it does not necessarily have a direct correlation to net new bookings or future transactional revenue.

To provide additional transparency, we'll now be disclosing our annualized recurring revenue metric or ARR. We'll do this on a go-forward basis at the close of every year. This metric will reflect an annualized version of subscription services and transactional revenue at the end of the reporting period. In addition, our ARR will also include all of the contractually committed recurring revenue in place at the end of that reporting period for

customers that have not yet gone live. Looking at this metric at the end of the third quarter of 2021, our ARR of $539.6 million represents a 25% compounded annual growth rate over the prior three years.

It's important to note that ARR should be viewed independently of revenue and deferred revenue as it's an operating metric and not intended to be combined with or replace those items. Other companies or industry may also calculate ARR differently, which may reduce its usefulness as a comparative measure. Our ARR performance tends to be correlated with new business mix of new bookings we've observed over the same period.

Through the first three quarters of 2021, we began to see net new bookings and cross-sale trend back towards the mix of total bookings we saw pre-pandemic. Combined net new bookings and cross-sale are projected to be over 60% of the total bookings mix for 2021, compared to a mix of under 50% in 2020. As we previously discussed, we're expecting net revenue growth in 2022 with a floor of approximately 15% to 16%, as a result of the impact of the pandemic on our bookings, particularly net new bookings in 2020 and the first half of 2021.

However, we believe the anticipated increase mix of new and cross-sales in the second half of 2021 and continued bookings improvement in 2022 will lead to revenue growth acceleration in 2023, which can be over 300 basis points off of that 15% or 16% growth rate.

But 2023 is just a start. Through the framework I've just discussed, we feel we're well-positioned to achieve our five-year target model of approximately $1.2 billion of revenue. To provide some additional context, we believe we can achieve this target through revenue growth from a combination of net new and expansion opportunities in our core business and an increasing contribution from growth in our BaaS and Innovation Studio offerings. For both BaaS and Innovation Studio, we believe we're in a very advantageous position to build on our current competitive advantages, but we need to continue to invest to position us for strong growth.

As these businesses grow, we believe they'll be accretive to our overall revenue growth and margin profile, as we see increasing contributions from higher-margin variable revenue streams. We expect that the long-term increase in margin rates that we project will not be linear. For the next 12 months, we'll be prioritizing the increasing investments in end-to-end solutions for the digital bank, our BaaS and Innovation Studio offerings, and expanding our marketing programs to capture the benefits of the rapid rates to digitization.

We expect that these investments in our business when combined with the lower 2022 growth rate expectations that we've disclosed will result in a relatively flat EBITDA margin profile in 2022 compared to 2021. Our long-term plan couples accelerated growth prospects in 2023 and beyond with expanding margins. We believe we'll be able to achieve margin expansion by continuing to drive efficiencies in COGS through the effective utilization of our hybrid cloud model, delivery through third parties, global resources, and automation, resulting in a streamlined cost structure and a better customer experience.

We anticipate a shift in revenue mix towards higher margin variable revenue streams over time, which will also provide a benefit to our gross margins. While we plan to continue to invest in R&D, we feel we can scale our sales and marketing expenses and deliver even more favorable cost scaling in G&A. In aggregate, we believe we're well positioned to achieve our long-term goal of being approximately a 20% EBITDA business in five years.

We believe these expanding profits will generate strong cash flow, and I want to discuss how we plan to effectively deploy this cash. Many of you have entrusted us with your capital, and we plan to use it wisely. Over the past year we've aggressively worked to improve the profile of our capital structure through our convertible placement last year at favorable terms and the retirement of some of our existing convertible debt that had

relatively less favorable terms. We built our cash position and cash equivalents to almost $400 million. And we believe we reached an inflection point that will allow us to generate positive free cash flow in 2022 with an attractive cash flow growth profile thereafter.

In addition to making the organic investments we've discussed, as we've done in the past, we expect to continue to evaluate strategic inorganic opportunities, which we believe address adjacent and pressing needs for our customers. In conclusion, we believe the trends in our market are highly favorable and that we're uniquely positioned to capture the opportunity created by these trends. Years of innovation and expanding relationships with our customers have earned their trust. This trust is translated to high net revenue retention rates and predictable recurring revenue streams from solutions required to deliver the digital bank.

This gives us the ability to fund investments that we believe will increase our total addressable market, accelerate revenue growth, improve margins and position Q2 favorably for years to come.

Thanks again for your attendance today. And with that, I'll turn it back over to Matt for some closing remarks.

Matthew P. Flake

Chief Executive Officer, President & Director, Q2 Holdings, Inc.

The financial services industry is transforming, and I believe we are uniquely equipped to capitalize on the convergence among financial institutions, fintechs and brands. Our broad solution portfolio enables us to digitize the entire bank. And as a result, we continue to perform favorably with strategic financial institutions of every size. We are investing in opening our platform via the Q2 Innovation Studio, helping financial institutions partner with fintechs for mutual benefit and creating new layers of value in our business. And we are enabling embedded finance at scale with our Banking-as-a-Service solutions, an opportunity we expect will be a key growth driver. We see these factors creating an expanding market opportunity for Q2, and given our track record of execution, we are confident in our ability to continue growing this business rapidly.

With that, thanks again for attending today. We'll now conclude the event with a Q&A session.

Josh Yankovich

Head-Investor Relations, Q2 Holdings, Inc.

As a reminder, if you'd like to submit a question, you can do so at any time through the online submission portal. Before I start with the first question, I'd like to turn it over to Matt to comment on the current quarter.

Matthew P. Flake

Chief Executive Officer, President & Director, Q2 Holdings, Inc.

Thanks, Josh and thanks everybody for attending. I also want to take a moment to thank everybody who's been part of this production. It's been a lot of work that's gone into it from in-person to doing it virtually. But I want to thank everybody who did that here, as well as the teams at Q2 and then even third parties we work with. So thank you very much.

So, on to the third quarter, we talked a lot about 2026 and the vision and the future of this company. But right now we're laser-focused on delivering a quarter that builds on what I talked about in the third quarter earnings call in November, which is momentum in the bookings from the previous five quarters that were hit by the pandemic. I believe that momentum will continue. We have – I think you will see sequential growth in bookings over the next quarter, and I believe that we have with David's targets, the floor that we put in place for 2022 and the 300 basis points of improvement still feel very good to us.

I want to remind everybody that there's still two weeks – a little more than two weeks left in the quarter, and those are a very important two weeks and we're working hard to get them done, but feel really good about the quarter that we are at a turning point from a bookings perspective, and I feel like we're really set up nicely for 2022 and beyond.

QUESTION AND ANSWER SECTION

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

All right. With that, we'll have our first question from Matt VanVliet with BTIG. You mentioned that most customers only use a fraction of the overall product portfolio. But can you give us a sense of what the current wallet share at customers is and how that breaks down across digital banking, add-on products and lending products?

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

I guess, I'll take that one, Josh. And when I said a fraction, I'll give you a little bit more context to that, Matt. Right now, if you look across the broad array of products that we have, we're about 25% penetrated for the average customer. There's some customers that are 50%, but on average it's 25%. And very specifically to your question on commercial versus retail, we're less than 50% right now customers that have both retail as well as commercial. And in fact, in many of those situations, customers are on what's called our corporate-lite solution, which gives us an opportunity to upgrade them as well. So, tremendous upside opportunity which was incorporated in that $3 billion cross-sell that we talked about.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Our next question is from Terry Tillman at Truist. Can you remind us of the importance of 4Q in terms of the seasonal new bookings activity and have the conversations been constructive, and does it seem like a propensity to make the required digital transformation investments is there among the potential buyers?

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

A

Yeah. Thanks, Terry. It's a great question. Q4, historically and for the history of this company has always been our biggest quarter and it – there's a end of year, there's a budget conclusion that occurs. And so, it's usually what drives the bookings for the year. And so, as I said earlier, feel really good about it. The buyers right now are focused on digital transformation. There's been a lot of decisions that have been backlogged over the last two years, and we're beginning to see those come to a head. And with our platform and the breadth of our platform and our ability to deliver digital transformation, I feel our message is really resonating with those buyers. And like I said, I feel really good about the fourth quarter and the pipeline looking forward.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. Our next question comes from an investor. What is the current revenue mix between BaaS, the core business and digital lending?

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

I'll take that one. So we're going to end this year roughly with a mix of 81% digital banking. Next year that's going to fall below 80%. And then as we work through that long-term planning frame work, we think we're going to be about two-thirds digital banking when we get to 2026. So obviously that's incorporating some very strong growth rates from both BaaS as well as the digital lending portfolios.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. Our next question is from Bob Napoli at William Blair. What are key investments being made into the tech stack? Are you moving into a single code base and multi-tenant tech stack and what is your view on the public versus the private cloud?

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

A

So, clearly I could take that, but I'd rather have Adam Blue, our CTO take that. So Adam, why don't you run with that?

Adam D. Blue
Chief Technology Officer, Q2 Holdings, Inc.

A

Thanks, Matt. So, when we think about the tech stack and the way in which we're moving forward, we have a strategy around distributed cloud. And part of that strategy is to continue to make improvements that we're already well into to collapse the surface of the software that we have deployed, moving towards single deployments for multiple customers. But we're doing that in a way that still preserves customer data isolation and the strongest possible security that our customers expect and understand that they'll get from us.

In addition, in 2022, we expect to move about 25% of our workloads into the public cloud as part of our distributed cloud strategy, because we believe there's a path that gets us further into public cloud, but the distributed cloud strategy is important in terms of keeping some workloads in the private cloud at this time because we feel we can get the best possible customer experience in that way.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Thank you. Next question is on the lending stats that we showed. Who are you competing with? Why would banks not use a product like this? And how do you feel about the net new business activity picking up in this product area?

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

A

Thank you for the question. Will, why don't you run with that one?

William M. Furrer
Chief Strategy Officer, Q2 Holdings, Inc.

A

Yeah, sure. We compete with many point solution providers in the lending space with our customers. We actually see that the solutions continue to deliver these results and we're continuing to see more and more activity in this area. The solutions that we're delivering are actually demonstrating that they're creating value. And so our

customers, as they look to grow and optimize their lending portfolios, are continuing to see the benefits of our lending and profitability solutions out in the market today.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Our next question comes from an investor. For the acquisition strategy going forward, what are the thoughts on the velocity of M&A, and any sense how important to future are acquisitions to that $1.2 billion 2026 revenue target?

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

A

So, I don't believe we incorporated acquisitions into the $1.2 billion target. So those aren't included in there. From a strategy perspective on M&A, right now we have a much bigger footprint to look at. If you think about traditional financial institutions, fintechs and brands, the spectrum which we can look at acquisitions is much different than it was five years ago. As far as the velocity in the marketplace, Jonathan runs Corp Dev. So Jonathan, do you want to comment on what you're seeing in the marketplace around M&A?

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

A

Yeah, sure. Thanks, Matt. So I would characterize right now we are looking at a lot, the pipeline is very robust, but we're in a challenging valuation environment where buying assets at today's levels require us to be very disciplined in what we look at. As far as the opportunity set though, it's really broad. As Matt mentioned, our portfolios is as broad as it's ever been. So whether it's opportunities in the BaaS space, in the lending arena and digital banking business, we see a lot. We see it in areas around governance, risk and compliance. We see it in areas around different areas within the lending stack that we don't play in today and then within payments and other rails around the BaaS business, we're seeing a lot of opportunity. The challenge for us is just how do we stay disciplined around valuation at a time when there's a lot of assets that we're looking at, but it's expensive to buy.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Our next question is from Bob Napoli, William Blair. The targets that we've provided today might have been below prior Investor Day targets. What is the rationale for that change and how committed or confident are you to the new targets that we've issued today?

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

I'll take that one. And just to level set for everybody, the last Investor Day we had was 2019, so that was pre-pandemic. So obviously we've had the pandemic transpire since that point in time. That has put pressure on different aspects of the financial model for sure, and margins are obviously a key component to that. That's one variable. The second big variable is hopefully you came away from the discussion that we've had with you today. The opportunities are immense for us going forward. And to capitalize on those opportunities, we need to invest and we will invest, particularly in our emerging businesses. So those investments that we're making now are going to push some short-term pressure on our margins, but we feel they're going to drive outsized returns longer term.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Our next question comes from an investor. Can you provide some color around the unit economics of the Innovation Studio and how large of a contributor that business could be as part of the overall revenue base?

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

A

Jonathan, why don't you take that? And if there is anything David wants to add, fire away.

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

A

Yes, so from a unit economic perspective, the model is actually pretty simple. We strike revenue share arrangements with these partners and depending on the type of partner it is, it's typically going to vary between 15% and 40% of the average sales price. And that comes to us as net margin, so it's very accretive to us. And so we think the model is very simple. We think it attracts a lot of partners and we think that our banks and credit unions want to utilize it. Small today in terms of total number of dollars, but it's growing rapidly, rapidly and we think this could be a big part of our business going forward.

I don't know, David, if you have any specific color around [indiscernible] (01:29:31)...

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah, the only thing I'd add to that is and it's related to Bob's question as well, how confident are we in our long-term targets, and we are confident because part of the driver behind that is mix. And within each product line, there is some mix components, and that includes the BaaS business. We feel like we're going to be mixing up to higher profit profile transaction business over the course of the next five years. That's going to help lift our overall margin base and certainly factors into the variables that Jonathan just talked about.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. Our next question comes from Andrew Schmidt at Citi. Could you remind us how the sales organization is structured across Q2's end markets, different size banks, credit unions versus BaaS? Are there opportunities to further optimize the go-to-market strategy?

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

A

So, great question, Andrew. Actually we hired Mike Volanoski, who is our Chief Revenue Officer this summer. And one of the things he's been working hard at is to create an enterprise selling motion for the team. And so as you go into 2022, we're going to begin to have reps that are account-based, name-based accounts for 10 billion and above, and then we will have account – below that we'll have account-based name approach. But we'll also have a territory. We have eliminated the difference between banks and credit unions, so you could have banks and credit unions in your patch. And what they'll do is, they'll go to all these customers and prospects with the hunters and farmers and look to sell digital banking, digital lending, profitability, and then some of the Innovation Studios will obviously be pushed through this group.

As far as the Banking-as-a-Service sales organization, there's a group that's focused on fintechs and brands to go drive more Banking-as-a-Service technology into those entities. We'll probably keep those entities separate for the foreseeable future until we gain more momentum. But we really want a focused group on the BaaS side of the business and the other team focused on digital lending, digital banking and profitability.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. The next question from Andrew is, could you discuss the product roadmap a little bit more? What parts of the platform are you targeting to receive the most organic or inorganic investment over the next few years? And are there any pieces of the digital transformation puzzle that you don't have today that would be beneficial to get into?

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

A

So, Will, why don't you talk about the roadmap a little bit more and the direction?

William M. Furrer
Chief Strategy Officer, Q2 Holdings, Inc.

A

Sure. I think as we stated earlier today that we're really focused on integrating end-to-end solutions, and those solutions are all focused around providing growth opportunities for our financial institution partners. We want to make sure that we can help them onboard new accounts and expand their relationship with them. We want to make sure that they can go upmarket into the commercial space and reduce friction as they onboard those customers and make them more profitable over time. So our focus around our product roadmap is really integrated end-to-end solutions that reduce friction and actually drive growth for our customers.

When we think about the investments that we're actually putting into these, our investments continue to be relatively balanced across our portfolio. In recent years we have been investing heavily in our commercial banking solutions, so that the strategic credit unions and banks that are moving upmarket towards those profitable customers are actually in a position to grow their business, whether that's through M&A or win new accounts. And that's been a strong area of investment for us in the last several years. Around pieces of the digital transformation that we could be missing, I suppose I'll turn that over to Jonathan to just discuss a little bit about how we would potentially look at rounding out our portfolio.

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

A

Yeah. So at the highest level from an M&A perspective, we really break it down between opportunities to enter new markets and how do we get deeper in our existing markets. And I talked a little bit about some of those existing markets in the prior question, areas like governance, risk and compliance, new areas within the digital lending value chain and within BaaS.

But there's – the other big area that we can do M&A is actually new markets altogether. So if you think about what we did when we first acquired our way into digital lending, there are other markets and financial services that we don't touch at all today, areas like digital wealth, digital insurance, capital markets as we move more and more into the upmarket financial institution space, are all opportunities for us long-term. Nothing that we're working on today that we think we're going to be in those markets immediately, but similar strategies when we move from digital banking to digital lending.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And our next question comes from an investor. What are some of the ways you work with your BaaS client base to drive engagement and create awareness of banking products?

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

A

Jonathan, you want to run with that?

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

A

Yeah. Well, it's a really good question because as we've interacted more and more with larger and more innovative brands in the BaaS space, what we're really seeing is their whole model is based on marketing effectively to convert their core customers to banking customers. And so we work with them every day to optimize those marketing programs and even looking at tools that we have to bring to them, things like ClickSWITCH, which was a recent acquisition we did in April of this year, where as they land more and more of these banking clients, landing the direct deposit and switching it from wherever that paycheck may sit to the fintech, our brand is really, really valuable as they think about the customer lifetime value of those accounts. And so whether it's things like ClickSWITCH, whether it's marketing programs, whether it's working with our banks and our own roadmap to see what we can do better to target their bases better, that's something we do all day, every day in that business.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And our next question is there's lots of discussion around banks facing competition from fintechs. But can you talk about what you're seeing from a competitive perspective?

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

A

I think that's from a competitive perspective in the marketplace, it really hasn't – the dynamic hasn't changed much in the competitive environment. We compete with people on digital banking solutions. That breaks up to retail as well as commercial banking focused. We have competitors on the lending side that Will talked about earlier. As far as the profitability solution, we've a pretty unique area there. There's not many people that have the depth and the breadth of the product that we have on the profitability side.

So we continue to win in those markets, our story of digital transformation and the breadth of our products and our experience and our ability to point to successes. We talked about last quarter how we had a greater than $1 billion bank that signed a digital transformation contract with us. That is beginning to be bigger and bigger part of the conversations we're having with prospects and our customers as we speak. So the expansion roadmap as well as the net new side of things where we can provide a roadmap to a customer or a prospect that can get them to be able to digitize all of the banking experiences is really resonating well. And so we continue to compete in a favorable way. And I think you'll see our win rates stay the same, if not maybe even increase in the fourth quarter.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And next question is for David. Can you help bridge the 60% gross margin outlook versus the 52% gross margin today? With 70% gross margin on renewals and accretive variable revenue streams, what are the big puts and takes to get to that target?

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah, I think there's three big drivers in bridging us from where we are today to that 60% target. The first one is the mix, and I talked about the mix from Jonathan's standpoint in the BaaS business and the transactional mix to higher-margin transactional business that's going to help lift the overall margin profile. There's also going to be mix over time to some of the other higher growth areas of the business like digital lending. We see that mix over time providing a lift to margins, particularly over the next five years.

Then there's also going to be some margin efficiencies we're going to gain from a delivery standpoint or implementations. Today we're starting to utilize global resources more effectively. We're starting to utilize third parties more effectively. We're finding ways to effectively deliver to our customers much more so than we have in the past. That's going to help us take those services margins and drive them up over the course of the next few years.

And the final one is in regards to our data center or hosting business. And Adam alluded to this previously. We certainly feel there's opportunities to get more efficient there, and that includes moving some workloads out to the public cloud without compromising security, without compromising reliability. So those three things combined are going to be the biggest drivers to that gross margin lift.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. Our next question is on the lending side. Who are you replacing when you win new deals? Are they mostly homegrown solutions or are other third-party vendors versus core-based add-on solutions?

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

A

Yeah, I'll take that one. I think mostly what you see is legacy processes that have been put in place, whether it's homegrown solutions or there may not even be any technology involved, it may be the paper flow from the customer all the way to the back office, what we're bringing to the table is a modern user experience, whether it's on a mobile phone, a tablet or a desktop that allows the borrower to begin the process to make it easier for them. And then we automate that workflow all the way through to the bank operations folks, so that they can do a full service loan from the borrower all the way to the approval process. So you're replacing some of those people in all those scenarios, but primarily it's legacy technology that doesn't work on browsers and mobile phones and tablets that we're replacing.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And our next question comes from Tom Roderickat Stifel. With BaaS targeting a $100 million run rate in a few years, how far do we have to go to get there? And what needs to happen to make that a reality? What is the run rate of BaaS today? And how much do key logo fintech partners have to contribute to help this business scale?

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

A

Jonathan or David, which one of you guys want to...

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

A

Yeah. I mean I'm happy to talk about it...

[indiscernible] (01:38:53)

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

A

Yeah. So when you think about like how this happens, we think it very much happens by targeting large fintechs like you mentioned. And at the end of the day, it comes with how do we land these logos, work with them to stand up their anchor products and then market those effectively to their end users and ultimately roll out more and more products with them. At the end of the day, this is a game of users and usage. And so we have to go and target these accounts, work with them to optimize their conversion rates and ultimately help make them successful. And so I think we're on the path to doing that. We feel very good about this business and the growth trajectory.

David has talked historically about the mix of the business roughly today, and so we got a long way to go to get to north of the $100 million, but we see that path and we're confident in it. And what's important is that we won a lot of large meaningful logos that have started to scale rapidly. And our job is to go help them scale even more and win new logos to go do the same with.

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah. And I think, you mentioned and we've disclosed this in the past, last year, 2020, we disclosed the BaaS is approximately 3% of our business. Longer term, we look at that model we put forward by 2026, we see that as 8% to 12% of the business. So, huge growth opportunities ahead and obviously mixing up as a percentage of our overall revenue base.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And our next question is, has Omicron had any impact on bookings or demand in recent conversations with customers?

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

A

So I'll take that one. At this point. There's been some meetings that have been canceled, I don't know whether it's Omicron or Delta or surges in certain regions, but I haven't seen it slow down any of the bookings in the fourth quarter. Who knows what's going to happen in the first quarter, but it's – I think we've gotten to a point in our third year in the pandemic that we can move to a Zoom environment or move to an in-person environment relatively quickly. So I don't anticipate it hitting us in the fourth quarter.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great, our next question is from Alex Sklar over at Raymond James. Can you talk about the expansion motion as it relates to BaaS, outside of transaction growth? Are there any early examples of fintechs or brands having success with the initial product launching more products?

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

A

Jonathan Price, do you want to take that one?

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

A

Yeah, sure. So it's a really important question because if you're going to get more users and more activity with those users, you have to have more product over time. And so we've seen a lot of our early fintechs launch with either a simple savings account and try and convert them to savings users. And then over to DDA and debit card. And so that's typically the starting point that we see, but it goes way beyond that now in the roadmap and what we're seeing today, whether it's things like early ACH where we can deliver payroll to a small business customer and their end employees faster whether it's business DDA with business accounts, which we're headed to in 2022, things like child banking. And so at the end of the day, it's all about engagement and maximizing that. And it's very important that both our customers and us work together to go launch and be successful with each of these products.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And our next question is from an investor. Can you provide an update on the lending business, specifically PrecisionLender?

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

A

Yes. So I'll take that then I want, Will dive a little deeper because he's done a lot of work on the value of our profitability solutions and our lending in the marketplace. But at a high level, I would tell you that right now we are – we feel very good about where PrecisionLender is. If you think about it that pipeline got hit the hardest as the pandemic started in February and March of 2020. A lot of the deals that we had were in Europe and they got pushed to the side. We think they're going to come back, probably, in 2022. But in general, the momentum that's been created in North America by the PrecisionLender, you saw some of it last quarter. And I think you're going to have another solid quarter in Q4. It really is – they're really hitting their strides. The team really fought through really tough 2020 to build some momentum in 2021, and I'm looking forward to the 2022 results for PrecisionLender as well as the fourth quarter like I said, there's two more weeks that are really important.

Will, you want to add anything else on the lending business or PrecisionLender and some of the differentiation we're seeing?

William M. Furrer
Chief Strategy Officer, Q2 Holdings, Inc.

A

Sure. I think when you look at the PrecisionLender business, the value that's actually being unlocked with that solution is actually coming from its integration with the lending solution, as well as within the digital banking

solution. So the journey of a commercial banker all the way from meeting a new client, all the way to engaging with them and onboarding them for non-interest fee generating solutions like treasury services and then reviewing that account on an annual basis is really the motion that the commercial banker is going through on a daily basis. PrecisionLender being integrated into those other solutions is what's unlocking new growth opportunities, new accounts and the ability to optimize each and every one of those commercial banking relationships when they are up for renewal. And so we're actually seeing it as a standalone business. It's achieving great success as we integrate it with our solutions and the workflows of the commercial banker, that's really where we're seeing it unlock incremental value for our business as well as for our customers.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And our next question is, how should we think about assessing the new ARR metric going forward? Should we view that as a leading indicator for revenue growth? How often will you be disclosing that metric and what are your expectations for ARR at the end of the fourth quarter 2021?

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

All right. I hope I can remember all four pieces of that. First with the ARR metric, one of the things that we did was reached out to all of you to understand what you thought would be a metric we could disclose that would provide more transparency into the business and we also did some benchmarking from an industry standpoint. We looked at what others are doing out there and quite frankly, there's a lot of definitions around ARR. So where we've anchored on with ARR is, how can we give you a number or a metric that's going to have a high correlation to future revenue growth. And the definition that we presented and what we disclosed, we feel has that high correlation.

One of the things that we're going to be doing is disclosing this on an annual basis going forward and I think the other part of that question was Q4, yeah, we're not we're not going to forecast that number. So obviously we'll disclose it at the end of the quarter, but you can see obviously the historical growth rates that we show there and I think it's a CAGR of 25% historically and year-over-year, I think the CAGR is – I mean, the growth rate from 2021, Q3 2021 to Q3 2020 is about 16%, 17%. So that gives you an indication of some of the growth metrics that we see coming from ARR and how you can correlate that to future growth rate for the business.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

And our next question comes from an investor. How should we think about KPI guidelines? What are key metrics that we are tuned into right now to guide and hold ourselves accountable?

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

A

So as far as KPI guidelines – [ph] they're not on the (01:45:29) reporting numbers, I would assume. From a KPI perspective, number one, customer health. Are our customers happy? Are they not happy? Are they engaged? And the ones that are happy how do we make them happier and the ones that aren't, how do we make them happy? So, we put a lot of energy into that, whether it's NPS or other metrics that we have around, just resolutions of issues that drives the business.

Obviously, employee engagement is critical with what's going on in the marketplace right now, we are – Kim does an amazing job of tracking employee engagement, how they feel about the business? Are they engaged and

behind the mission? From a business perspective, bookings, margin improvement, scale, how are we doing those? We drive all of those and then all of the accountability comes out with our guidance as we put it out. And I think over the last 31, 32 quarters, we've done a good job of executing and being very transparent about how we feel we're going to do in quarters and years ahead. So the confidence that we present in our 2022 guide, as well as one we're talking about 2023, you should be pretty confident that we feel good, that we can accomplish those.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. Our next question is how have tight labor markets impacted plans for hiring and sales, R&D and other key roles? Where are you tracking for 2021 hiring plans and how much head count is expected to be added in 2022?

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

A

So that's a great question for Kim to answer. So Kim?

Kim Rutledge
Executive Vice President-People, Q2 Holdings, Inc.

A

Sure, I'd love to take that. So we've been very pleased with our success so far in Austin and our other markets. In terms of hiring for 2021, we are absolutely competitive. We've been investing a lot into our employees and into hitting our targets for compensation for benefits and continue to make investments there at insulating us would be too strong. We certainly are seeing some of the dynamic behavior that's going on in the talent marketplace. With that, we've got a great story. We anchor on our mission and our employees do a great job of selling that to our candidates. And so we've been able to make sure that we're able to hit our hiring targets.

With all of that noted, we're probably going to see growth next year in the low-to-mid double digits, and we'll continue to evaluate how we can be competitive in those markets. We've got several ideas as we go into 2022 that will continue to elevate our ability to attract great talent.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. Our next question for the non-BaaS parts of the platform, could you discuss your strategy in terms of single tenant versus multi-tenant architecture? If there's a large portion of your customers on single tenant, does this affect your gross margin efficiencies?

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

A

So why don't we have Adam, take the discussion on the strategy in terms of single tenant versus multi-tenant? And then David, do you want to take the single tenant efficiency and gross margin? And Will, if you have any comments you want out on the strategy side, feel free to chime in, but Adam, why don't you to go first on that.

Adam D. Blue
Chief Technology Officer, Q2 Holdings, Inc.

A

Great. Thanks, Matt. So thinking about the non-BaaS parts of the platform, which would be around lending, customer acquisition and digital banking, the lending and customer acquisition platforms are predominantly public cloud based, and so they already have a lot of the benefit of the public cloud architecture, and they tend to be a multi-tenant in deployment style. On the direct banking side around digital banking, when we deliver those

applications, we have opportunities to continue to move them towards single tenant like models, while still preserving isolation and execution, independence for security and for minimization of failure domain for customers. And so as we do that, we expect to get efficiencies in both deployment and supporting, which then could have carry on effects in the business.

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah, just to add on, I mean, we truly believe that the hybrid cloud model that we have is [indiscernible] (01:49:20) competitive advantage and it's all about workloads, Andrew, and Adam alluded to this before, and I talked about it in terms of the gross margin bridge. But our ability to find specific workloads to move out to a multi-tenant environment is going to allow us to improve our gross margin profile over time. And what will typically happen is the year that we migrate those workloads, there might be some incremental costs and then the year after you see the benefits and obviously from there forward you will continue to see it.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And our next question, how much of your digital banking and lending solution set is applicable across the entire market? Are you now selling your full suite of digital banking and lending to enterprise customers all the way down to smaller regional and community banks?

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

A

Will, why don't you take that?

William M. Furrer
Chief Strategy Officer, Q2 Holdings, Inc.

A

Sure. Our digital banking and lending solutions are applicable virtually across the entire market that is out there. Clearly, our go-to-market strategy when we think about our enterprise, banks and global banks focuses on our lending and profitability solutions. That's how we actually lead into those markets. For everyone else, our entire solution set is available and is actually up and running in those markets. So when you look at regional banks, the larger community banks, as well as credit unions, our entire solution set is available in those markets. What we're starting to see and what it demonstrates, especially in the enterprise banks, is that there's tremendous opportunity for us to go into those markets with incremental solutions, and we are starting to see the large enterprise banks come and selectively choose to work with us because of our demonstrated scale, our proven performance, as well as the security and uptime and reliability of our applications.

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

A

I would just add that I think that the – we want to remember we said in the script earlier, but we want to highlight that we want to win customers that think about technology as a way to compete and differentiate and that is more important than signing every single bank or credit union that wants to buy technology. We want the ones that want to use it as a differentiator and I think that is paid off if you look at our – the M&A activity, they are investing in technology and they believe it is the way to grow and sustain their business as opposed to selling their business. So all of those things plus alignment around and targeting those financial institutions, no matter what the size is, it could be a small bank or a small credit union, it could be a large financial institution as long as they have the mentality of technology is the great equalizer. We think we're a very good fit.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. Our next question is, can you disclose the number of products that Q2 offers and what is the average customer use?

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

Sure, I can handle that and it's actually very related to an early question that we had, we currently have – we've got our filing from last year, we have 30 products that we disclosed. Right now, the average customer has 7 or 8 of those products And as I said, there's some that are north of 15, but on average it's about 7 to 8 or that equates to the 25% that I referenced earlier.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great. And our next question, in your BaaS business, can you explain how the monetization of that business works? What is the revenue split look like for each of you, your customer and the financial institution partner?

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

A

Jonathan why don't you go ahead with that?

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

A

Yeah. So in its simplest form, the monetization model for Q2 is very simply, we get a subscription fee for access to our product, which is called CorePro, we get a base subscription fee that's becoming less and less a part of the model because if you think about a fintech or a brand launching one of these programs, they're typically starting with user number one or their first piece of plastic if they're issuing a debit card. And so they're generally not willing to pay big minimums upfront. And we've pivoted our model accordingly. So the first lever is the subscription fee, but that comes with a set number of users as they grow their program and the users go above those minimums we get excess user fees for every incremental user. And so that's another big lever of our model.

And then the final area is transactional revenues, and that's tied to whatever the program may be, if it's a debit program there's going to be things like transaction fees where we participate in those economics, depending on who the issuer processor is, there's going to be interchange depending on the client and the revenue share arrangements there. And so we are participating in each of those revenue streams, depending on the product again. When you think about the other stakeholders here, the financial institution, they benefit in a lot of ways too, they have opportunities to get deposit and fee income. They have opportunities to participate in the revenue – sorry in the interchange share as well.

And then when you think about the fintech or the brand, when they launch a model like this, if we use the debit example, their primary source of revenue will be the interchange. They will get the largest component of that revenue stream so.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

A

Great, and this is our final submitted question. David, what will drive the revenue reacceleration in 2023? Is that really coming from net new deals that are being signed right now ?

David Mehok
Chief Financial Officer, Q2 Holdings, Inc.

A

Yeah, there's quite a few drivers, but the biggest of which is the improved bookings environment that we saw in Q3 that Matt references, continued momentum within Q4 and how we're projecting out for the first half of next year. Remember, the time to revenue for our model is typically 9 to 15 months. So you have to make sure you're understanding that lag as you're modeling out revenue relative to some bookings assumptions. We're seeing strong bookings right now. We believe we're going to continue to see that in the first half that manifest itself in revenue acceleration in 2023. And then finally, make no mistake, the investments that we're making, these emerging businesses we feel are going to have very strong returns 2023 and beyond. So as you think about our Innovation Studio and our BaaS businesses, we see long-term growth opportunities there that we think are significant.

Josh Yankovich
Head-Investor Relations, Q2 Holdings, Inc.

Great. And that's all the questions we have for now. So I'll turn it over to Matt for closing comments.

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

Yeah. I want to thank the investors for attending today, the analysts. I also want to make sure that I thank the customers of Q2, the team members of Q2, we have a very bold vision for the future. And I think if you couple our track record of execution, the technology we have and the team that puts this together and has a track record of execution, we are very well-positioned to execute not only in 2022, but beyond that. So we're very excited about closing out this quarter and getting into 2022. We certainly do appreciate the investment in the business and we look forward to seeing you in February on our earnings call. So thank you very much and once again, thank you to everybody here who put this together. I hope everybody has a great holiday season.