

Q2 Holdings, Inc.
Form 10-Q
August 08, 2018

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One),

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2018.

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Q2 Holdings, Inc.

(Exact name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of
Incorporation or Organization)

001-36350

(Commission File Number)

20-2706637

(IRS Employer

Identification No.)

13785 Research Blvd., Suite 150

Austin, Texas 78750

(512) 275-0072

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Edgar Filing: Q2 Holdings, Inc. - Form 10-Q

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 42,873,043 shares of Common Stock, \$0.0001 par value per share as of July 31, 2018.

Table of Contents

TABLE OF CONTENTS

	PAGE
<u>PART I: FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements.</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of June 30, 2018 (unaudited) and December 31, 2017</u>	<u>3</u>
<u>Condensed Consolidated Statements of Comprehensive Loss for the Three and Six Months Ended June 30, 2018 and 2017 (unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017 (unaudited)</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	<u>6</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	<u>30</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk.</u>	<u>47</u>
Item 4. <u>Controls and Procedures.</u>	<u>48</u>
<u>PART II: OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings.</u>	<u>49</u>
Item 1A. <u>Risk Factors.</u>	<u>49</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	<u>50</u>
Item 3. <u>Defaults Upon Senior Securities.</u>	<u>51</u>
Item 4. <u>Mine Safety Disclosures.</u>	<u>51</u>
Item 5. <u>Other Information.</u>	<u>51</u>
Item 6. <u>Exhibits.</u>	<u>51</u>
<u>SIGNATURES</u>	<u>53</u>

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

Q2 HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	June 30, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 176,738	\$ 57,961
Restricted cash	2,315	2,315
Investments	101,974	41,685
Accounts receivable, net	26,996	13,203
Contract assets, current portion	1,196	—
Prepaid expenses and other current assets	4,691	3,115
Deferred solution and other costs, current portion	10,402	9,246
Deferred implementation costs, current portion	3,066	3,562
Total current assets	327,378	131,087
Property and equipment, net	36,727	34,544
Deferred solution and other costs, net of current portion	15,966	12,973
Deferred implementation costs, net of current portion	9,492	8,295
Intangible assets, net	9,079	12,034
Goodwill	12,876	12,876
Contract assets, net of current portion	6,074	—
Other long-term assets	1,171	1,006
Total assets	\$ 418,763	\$ 212,815
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 6,639	\$ 7,621
Accrued liabilities	7,688	10,562
Accrued compensation	7,100	11,511
Deferred revenues, current portion	33,159	38,379
Total current liabilities	54,586	68,073
Convertible notes, net of current portion	177,562	—
Deferred revenues, net of current portion	19,238	28,289
Deferred rent, net of current portion	8,248	9,393
Other long-term liabilities	823	438
Total liabilities	260,457	106,193
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock: \$0.0001 par value; 5,000 shares authorized; no shares issued or outstanding as of June 30, 2018 and December 31, 2017	—	—
Common stock: \$0.0001 par value; 150,000 shares authorized; 42,850 issued and outstanding as of June 30, 2018 and 41,994 shares issued and 41,967 shares outstanding as of December 31, 2017	4	4
Treasury stock at cost: Zero shares at June 30, 2018 and 27 shares at December 31, 2017	—	(855)

Edgar Filing: Q2 Holdings, Inc. - Form 10-Q

Additional paid-in capital	310,163	259,726
Accumulated other comprehensive loss	(161)	(139)
Accumulated deficit	(151,700)	(152,114)
Total stockholders' equity	158,306	106,622
Total liabilities and stockholders' equity	\$418,763	\$ 212,815

The accompanying notes are an integral part of these condensed consolidated financial statements.

3

Table of Contents

Q2 HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(unaudited)

(in thousands, except per share data)

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Revenues	\$58,574	\$47,625	\$113,382	\$92,159
Cost of revenues ⁽¹⁾	29,303	24,328	56,280	47,100
Gross profit	29,271	23,297	57,102	45,059
Operating expenses:				
Sales and marketing ⁽¹⁾	12,108	11,096	23,074	20,974
Research and development ⁽¹⁾	11,756	9,922	22,913	19,573
General and administrative ⁽¹⁾	10,798	9,268	21,094	17,720
Acquisition related costs	258	351	514	699
Amortization of acquired intangibles	368	373	736	744
Unoccupied lease charges	658	—	658	—
Total operating expenses	35,946	31,010	68,989	59,710
Loss from operations	(6,675)	(7,713)	(11,887)	(14,651)
Other income (expense):				
Interest and other income	755	129	954	237
Interest and other expense	(2,860)	(20)	(4,082)	(94)
Total other income (expense), net	(2,105)	109	(3,128)	143
Loss before income taxes	(8,780)	(7,604)	(15,015)	(14,508)
Benefit from (provision for) income taxes	153	(217)	340	(353)
Net loss	\$(8,627)	\$(7,821)	\$(14,675)	\$(14,861)
Other comprehensive income (loss):				
Unrealized gain (loss) on available-for-sale investments	2	(29)	(22)	(30)
Comprehensive loss	\$(8,625)	\$(7,850)	\$(14,697)	\$(14,891)
Net loss per common share, basic and diluted	\$(0.20)	\$(0.19)	\$(0.35)	\$(0.36)
Weighted average common shares outstanding:				
Basic and diluted	42,605	41,064	42,389	40,848

⁽¹⁾ Includes stock-based compensation expenses as follows:

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Cost of revenues	\$1,065	\$819	\$2,080	\$1,543
Sales and marketing	1,428	812	2,654	1,443
Research and development	1,566	1,033	2,922	1,978
General and administrative	2,945	2,358	5,443	4,255
Total stock-based compensation expenses	\$7,004	\$5,022	\$13,099	\$9,219

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

Q2 HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	Six Months Ended	
	June 30,	
	2018	2017
Cash flows from operating activities:		
Net loss	\$(14,675)	\$(14,861)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of deferred implementation, solution and other costs	4,265	3,514
Depreciation and amortization	7,752	7,227
Amortization of debt issuance costs	346	28
Amortization of debt discount	3,089	—
Amortization of premiums on investments	21	151
Stock-based compensation expenses	13,099	9,219
Deferred income taxes	(61)	) 234
Allowance for sales credits	38	34
Loss on disposal of long-lived assets	—	4
Unoccupied lease charges	658	—
Changes in operating assets and liabilities:		
Accounts receivable, net	(13,831)	) (2,806)
Prepaid expenses and other current assets	(1,718)	) (853)
Deferred solution and other costs	(5,965)	) (2,896)
Deferred implementation costs	(2,761)	) (2,689)
Contract assets	(2,212)) —
Other long-term assets	(225)	) (82)
Accounts payable	(825)	) 1,197
Accrued liabilities	(3,312)	) (7,827)
Deferred revenues	(4,295)	) 727
Deferred rent and other long-term liabilities	(672)	) (581)
Net cash used in operating activities	(21,284)	) (10,260)
Cash flows from investing activities:		
Purchases of investments	(74,389)	) (15,778)
Maturities of investments	14,058	13,659
Purchases of property and equipment	(11,154)	) (7,625)
Business combinations and asset acquisitions, net of cash acquired	(150)	) (3,816)
Capitalized software development costs	—	) (762)
Increase in restricted cash	—	) (1,600)
Net cash used in investing activities	(71,635)	) (15,922)
Cash flows from financing activities:		
Proceeds from issuance of convertible notes, net of issuance costs	223,185	—
Purchase of convertible notes bond hedge	(41,699)) —
Proceeds from issuance of warrants	22,379	—
Proceeds from exercise of stock options to purchase common stock	7,831	5,780
Net cash provided by financing activities	211,696	5,780
Net increase (decrease) in cash, cash equivalents, and restricted cash	118,777	) (20,402)
Cash, cash equivalents, and restricted cash, beginning of period	60,276	57,788

Edgar Filing: Q2 Holdings, Inc. - Form 10-Q

Cash, cash equivalents, and restricted cash, end of period	\$179,053	\$37,386
Supplemental disclosures of cash flow information:		
Cash paid for taxes	\$130	\$128
Cash paid for interest	\$—	\$68
Supplemental disclosure of non-cash investing and financing activities:		
Shares acquired to settle the exercise of stock options	\$(96)	\$(181)
Reconciliation of cash, cash equivalents, and restricted cash as shown in the statement of cash flows:		
Cash and cash equivalents	\$176,738	\$34,471
Restricted cash	2,315	2,915
Total cash, cash equivalents, and restricted cash	\$179,053	\$37,386

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

1. Organization and Description of Business

Q2 Holdings, Inc. and its wholly-owned subsidiaries, collectively the "Company," is a leading provider of secure, cloud-based digital banking solutions. The Company enables regional and community financial institutions, or RCFIs, to deliver a robust suite of integrated digital banking services to more effectively engage with their consumer and commercial account holders who expect to bank anytime, anywhere and on any device. The Company delivers its solutions to the substantial majority of its customers using a software-as-a-service, or SaaS, model under which its RCFI customers pay subscription fees for the use of the Company's solutions. The Company was incorporated in Delaware in March 2005 and is a holding company that owns 100% of the outstanding capital stock of Q2 Software, Inc. The Company's headquarters are located in Austin, Texas.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

These interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, and Securities and Exchange Commission, or SEC, requirements for interim financial statements. The interim unaudited condensed consolidated financial statements include the accounts of Q2 Holdings, Inc. and its direct and indirect wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

In the Company's opinion, the accompanying interim unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting of normal, recurring adjustments, necessary for a fair presentation. Certain information and disclosures normally included in the notes to the annual consolidated financial statements prepared in accordance with GAAP have been omitted from these interim unaudited condensed consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these interim unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the accompanying notes for the fiscal year ended December 31, 2017, which are included in the Company's Annual Report on Form 10-K, filed with the SEC on February 16, 2018. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results to be expected for the year ending December 31, 2018 or for any other period.

Effective January 1, 2018, the Company adopted the requirements of Accounting Standards Update ("ASU") No. 2014-09 "Revenue from Contracts with Customers (Topic 606)," or the new revenue standard, and ASU No. 2016-18 "Statement of Cash Flows (Topic 230): Restricted Cash." All amounts and disclosures set forth in this Form 10-Q have been updated to comply with the new standards.

Reclassifications

Certain amounts appearing in the prior year's Condensed Consolidated Statements of Cash Flows have been reclassified to conform to the current year's presentation.

Use of Estimates

The preparation of the accompanying interim unaudited condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the interim unaudited condensed consolidated financial statements, and the reported amounts of revenues and expenses. Significant items subject to such estimates include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, variable consideration, and other revenue items requiring significant judgment; stock-based compensation; the carrying value of goodwill; the fair value of acquired intangibles; the capitalization of software development costs; the useful lives of property and equipment and long-lived intangible assets; and income taxes. In accordance with GAAP, management bases its estimates on historical experience and on various other assumptions that management believes are reasonable under the circumstances. Management regularly evaluates its estimates and assumptions using

historical experience and other factors; however, actual results could differ significantly from those estimates.

6

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

Cash and Cash Equivalents

The Company considers all highly liquid investments acquired with an original maturity of ninety days or less at the date of purchase to be cash equivalents. Cash equivalents are stated at cost or fair value based on the underlying security.

Restricted Cash

Restricted cash consists of deposits held as collateral for the Company's secured letters of credit issued in place of the security deposit for the Company's corporate headquarters.

Investments

Investments consist primarily of U.S. government agency bonds, corporate bonds, commercial paper, certificates of deposit and money market funds. All investments are considered available for sale and are carried at fair value.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents, restricted cash, investments and accounts receivable. The Company's cash and cash equivalents, restricted cash and investments are placed with high credit quality financial institutions and issuers, and at times may exceed federally-insured limits. The Company has not experienced any loss relating to cash and cash equivalents or restricted cash in these accounts. The Company provides credit, in the normal course of business, to a number of its customers. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. No individual customer accounted for 10% or more of revenues for each of the three and six months ended June 30, 2018 and 2017. No individual customer accounted for 10% or more of accounts receivable, net, as of June 30, 2018 and December 31, 2017.

Contract Balances

The timing of revenue recognition, billings and cash collections can result in billed accounts receivable, unbilled receivables (contract assets), and deferred revenues (contract liabilities). Billings scheduled to occur after the performance obligation has been satisfied and revenue recognition has occurred result in contract assets. Contract assets that are expected to be billed during the succeeding twelve-month period are recorded in contract assets, current portion, and the remaining portion is recorded in contract assets, net of current portion on the accompanying condensed consolidated balance sheet at June 30, 2018. A contract liability results when the Company receives prepayments or deposits from customers in advance for implementation, maintenance and other services, as well as initial subscription fees. Customer prepayments are generally applied against invoices issued to customers when services are performed and billed. The Company recognizes contract liabilities as revenues when the services are performed, and the corresponding revenue recognition criteria are met. Contract liabilities that are expected to be recognized as revenues during the succeeding twelve-month period are recorded in deferred revenues, current portion, and the remaining portion is recorded in deferred revenue, net of current portion, on the accompanying condensed consolidated balance sheets at the end of each reporting period.

Accounts Receivable

Accounts receivable are stated at net realizable value, including both billed and unbilled receivables to customers. Unbilled receivable balances included in accounts receivable arise primarily when the Company provides services in advance of billing for those services. Generally, billing for revenues related to the number of registered users and the number of transactions processed by the Company's registered users that are included in the Company's minimum subscription fee occurs in the month the revenue is recognized, resulting in accounts receivable. Billing for revenues relating to the number of registered users and the number of transactions processed by the Company's registered users that are in excess of the Company's minimum subscription fees are, generally, billed in the month following the month the revenues were earned, resulting in an unbilled receivable. Included in the accounts receivable balances as of June 30, 2018 and December 31, 2017 were unbilled receivables of \$2.9 million and \$2.1 million, respectively.

The Company assesses the collectability of outstanding accounts receivable on an ongoing basis and maintains an allowance for doubtful accounts for accounts receivable deemed uncollectable. As of June 30, 2018 and December 31, 2017, the Company did not provide for an allowance for doubtful accounts, as all amounts outstanding were deemed collectable. Historically, the Company's collection experience has not varied significantly, and bad debt expenses have been insignificant.

7

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

The Company maintains a reserve for estimated sales credits issued to customers for billing disputes or other service-related reasons. This allowance is recorded as a reduction against current period revenues and accounts receivable. In estimating this allowance, the Company analyzes prior periods to determine the amounts of sales credits issued to customers compared to the revenues in the period that related to the original customer invoice. This estimate is analyzed quarterly and adjusted as necessary. The allowance for sales credits was \$0.3 million at June 30, 2018 and \$0.2 million at December 31, 2017.

Deferred Revenues

Deferred revenues primarily consist of amounts that have been billed to or received from customers in advance of revenue recognition and prepayments received from customers in advance for implementation, maintenance and other services, as well as initial subscription fees. The Company recognizes deferred revenues as revenues when the services are performed and the corresponding revenue recognition criteria are met. Customer prepayments are generally applied against invoices issued to customers when services are performed and billed.

The net decrease in the deferred revenue balance for the six months ended June 30, 2018 is primarily driven by the recognition of \$22.5 million of revenue that was included in the deferred revenue balance at December 31, 2017 and an \$8.0 million decrease from the adoption of the new revenue standard and the related netting of contract assets and liabilities on a contract-by-contract basis, partially offset by cash payments received or due in advance of satisfying the Company's performance obligations of \$16.2 million. Amounts recognized from deferred revenues represent primarily revenue from the sale of subscription and implementation services.

The Company's payment terms vary by the type and location of its customer and the products or services offered, and the term between invoicing and when payment is due is not significant. For certain products or services and customer types, the Company requires payment before the products or services are delivered to the customer.

On June 30, 2018, the Company had \$764.6 million of remaining performance obligations, which represents contracted revenue minimums that have not yet been recognized, including amounts that will be invoiced and recognized as revenue in future periods. The Company expects to recognize approximately 53% percent of its remaining performance obligations as revenue in the next 24 months, an additional 39% percent in the next 25 to 48 months, and the balance thereafter.

Deferred Implementation Costs

The Company capitalizes certain personnel and other costs, such as employee salaries, benefits and the associated payroll taxes that are direct or incremental to the implementation of its solutions. The Company analyzes implementation costs that may be capitalized to assess their recoverability, and only capitalizes costs that it anticipates to be recoverable. The Company assesses the recoverability of its deferred implementation costs by comparing the greater of the amount of the non-cancellable portion of a customer's contract and the non-refundable customer prepayments received as it relates to the specific implementation costs incurred. The Company begins amortizing the deferred implementation costs for an implementation once the revenue recognition criteria have been met, and the Company amortizes those deferred implementation costs ratably over the expected period of customer benefit, which has been determined to be the estimated life of the technology, which the Company estimates to be five to seven years. The Company determined the period of benefit by considering factors such as historically high renewal rates with similar customers and contracts, initial contract length, an expectation that there will still be a demand for the product at the end of its term, and the significant costs to switch to a competitor's product, all of which are governed by the estimated useful life of the technology.

The portion of deferred implementation costs expected to be amortized during the succeeding twelve-month period is recorded in current assets as deferred implementation costs, current portion, and the remainder is recorded in long-term assets as deferred implementation costs, net of current portion on the condensed consolidated balance sheet. The Company capitalized implementation costs in the amount of \$1.5 million and \$1.4 million during the three months ended June 30, 2018 and 2017, respectively, and recognized \$1.2 million and \$1.1 million of

amortization during the three months ended June 30, 2018 and 2017, respectively. The Company capitalized implementation costs in the amount of \$3.1 million and \$2.7 million during the six months ended June 30, 2018 and 2017, respectively, and recognized \$2.4 million and \$2.0 million of amortization during the six months ended June 30, 2018 and 2017, respectively. Amortization expense is included in cost of revenues in the accompanying condensed consolidated statements of operations.

8

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

Deferred Solution and Other Costs

The Company capitalizes sales commissions and other third-party costs, such as third-party licenses and maintenance related to its customer agreements. The Company capitalizes sales commissions because the commission charges are so closely related to the revenues from the non-cancellable customer agreements that they should be recorded as an asset and charged to expense over the same period that the related revenue is recognized. Under the new revenue standard, the Company capitalizes commissions and bonuses for those involved in the sale, including direct employees and indirect supervisors, as these are incremental to the sale. The Company typically pays commissions in two increments. The initial payment is made after the contract has been executed and the initial deposit received from the customer, and the final payment is made upon commencement date. The Company requires that an individual remain employed to collect a commission when it is due. The service period between the first and second payment is considered to be a substantive service period, and as a result, the Company expenses the final payment when made. The Company begins amortizing deferred solution and other costs for a particular customer agreement once the revenue recognition criteria are met and amortizes those deferred costs over the expected period of customer benefit, which has been determined to be the estimated life of the technology. The Company determined the period of benefit by considering factors such as historically high renewal rates with similar customers and contracts, initial contract length, an expectation that there will still be a demand for the product at the end of its term, and the significant costs to switch to a competitor's product, all of which are governed by the estimated useful life of the technology.

The Company analyzes solution and other costs that may be capitalized to assess their recoverability and only capitalizes costs that it anticipates being recoverable. The portion of capitalized costs expected to be amortized during the succeeding twelve-month period is recorded in current assets as deferred solution and other costs, current portion, and the remainder is recorded in long-term assets as deferred solution and other costs, net of current portion. The Company capitalized \$1.5 million and \$0.7 million in deferred commissions costs during the three months ended June 30, 2018 and 2017, respectively, and recognized \$0.8 million and \$0.7 million of amortization during the three months ended June 30, 2018 and 2017, respectively. The Company capitalized \$3.9 million and \$2.1 million in deferred commissions costs during the six months ended June 30, 2018 and 2017, respectively, and recognized \$1.7 million and \$1.5 million of amortization during the six months ended June 30, 2018 and 2017, respectively. Amortization expense is included in sales and marketing expenses in the accompanying condensed consolidated statements of operations.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated on a straight-line basis over the estimated useful lives of the related assets. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful lives of the related assets. Maintenance and repairs that do not extend the life of or improve an asset are expensed in the period incurred.

The estimated useful lives of property and equipment are as follows:

Computer hardware and equipment	3 - 5 years
Purchased software and licenses	3 - 5 years
Furniture and fixtures	7 years
Leasehold improvements	Lesser of estimated useful life or lease term

Purchase Price Allocation, Intangible Assets, and Goodwill

The purchase price allocation for business combinations and asset acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the identifiable tangible and intangible assets acquired and liabilities assumed based on their respective fair values. The Company early adopted ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business" as of January 1, 2017. Under ASU 2017-01, the Company first determines whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If this threshold is met, the single asset or group of

assets, as applicable, is not a business. If it is not met, the Company determines whether the single asset or group of assets, as applicable, meets the definition of a business.

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

In connection with the Company's acquisitions of Centrix Solutions, Inc., or Centrix, in July 2015, Smarty Pig, LLC, doing business as Social Money, or Social Money, in November 2015, and an asset purchase in January 2017, the Company recorded certain intangible assets, including acquired technology, customer relationships, trademarks, non-compete agreements and assembled workforce. Amounts allocated to the acquired intangible assets are being amortized on a straight-line basis over the estimated useful lives. The Company periodically reviews the estimated useful lives and fair values of its identifiable intangible assets, taking into consideration any events or circumstances which might result in a diminished fair value or revised useful life.

The excess purchase price over the fair value of assets acquired is recorded as goodwill. The Company tests goodwill for impairment annually in October, or whenever events or changes in circumstances indicate an impairment may have occurred. Because the Company operates in a single reporting unit, the impairment test is performed at the consolidated entity level by comparing the estimated fair value of the Company to the carrying value of the Company. The Company estimates the fair value of the reporting unit using a "step one" analysis using a fair-value-based approach based on the market capitalization or a discounted cash flow analysis of projected future results to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Determining the fair value of goodwill is subjective in nature and often involves the use of estimates and assumptions including, without limitation, use of estimates of future prices and volumes for the Company's products, capital needs, economic trends and other factors which are inherently difficult to forecast. If actual results, or the plans and estimates used in future impairment analyses are lower than the original estimates used to assess the recoverability of these assets, the Company could incur impairment charges in a future period.

Revenues

Revenues are recognized when control of the promised goods or services is transferred to the Company's customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services over the term of the agreement, generally when the Company's solutions are implemented and made available to the customers. The promised consideration may include fixed amounts, variable amounts or both. Revenues are recognized net of sales credits and allowances.

Revenue-generating activities are directly related to the sale, implementation and support of the Company's solutions within a single operating segment. The Company derives the majority of its revenues from subscription fees for the use of its solutions hosted in the Company's data centers, transaction revenue from bill-pay solutions, as well as revenues for customer support and implementation services related to the Company's solutions. The Company recognizes the corresponding revenues over time on a ratable basis over the customer agreement term. The Company accounts for revenue in accordance with the new revenue standard, Revenue from Contracts with Customers, which was adopted on January 1, 2018, using the modified retrospective method.

The following tables disaggregate the Company's revenue by major source:

	Three Months Ended June 30, 2018			
	Subscription	Transactional	Services and Other	Consolidated
Total Revenues	\$41,164	\$ 8,902	\$ 8,508	\$ 58,574
	Six Months Ended June 30, 2018			
	Subscription	Transactional	Services and Other	Consolidated
Total Revenues	\$79,367	\$ 17,519	\$16,496	\$ 113,382
Subscription Revenues				

The Company's software solutions are available for use as hosted application arrangements under subscription fee agreements without licensing perpetual rights to the software. Subscription fees from these applications, including contractual periodic price increases, are recognized over time on a ratable basis over the customer agreement term beginning on the date the Company's solution is made available to the customer. Amounts that have been invoiced are recorded in accounts receivable and deferred revenues or revenues, depending on whether the revenue recognition criteria have been met. Periodic price increases are estimated at contract inception and result in contract assets as revenue recognition may exceed the amount billed

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

early in the contract. Additional fees for monthly usage above the levels included in the standard subscription fee are recognized as revenue in the month when the usage amounts are determined and reported.

A small portion of the Company's customers host and manage the Company's solutions on-premises or in third-party data centers under term license and maintenance agreements. Term licenses sold with maintenance entitle the customer to technical support, upgrades and updates to the software on a when-and-if-available basis. Under the new revenue standard, the Company recognizes software license revenue once the customer obtains control of the license, which generally occurs at the start of each license term. The Company recognizes the remaining arrangement consideration for maintenance revenue over time on a ratable basis over the term of the software license. If the expected length of time between when the Company transfers the software license to the customer and when the customer pays for it results in a significant financing component, the Company adjusts the promised amount of consideration for the effects of the time value of money, which reflects the price the customer would have paid when the license was transferred. Revenues from term licenses and maintenance agreements and the related financing component were not significant in the periods presented.

Transactional Revenues

The Company earns the majority of its transactional revenues based on the number of bill-pay transactions that registered users initiate on its solutions. The Company recognizes revenue for bill-pay transaction services in the month incurred based on actual transactions.

Services and Other Revenues

Implementation services are required for each new Q2 platform and Centrix standalone contract, and there is a significant level of integration and configuration for each customer. The Company's revenue for upfront implementation services are billed upfront and recognized over time on a ratable basis over the customer agreement term for its hosted application agreements. Upfront implementation services for on-premises agreements are recognized at commencement date.

Professional services revenues, which primarily consist of training, advisory services, core conversion services, web design, and other general professional services, are generally billed and recognized when delivered.

Certain out-of-pocket expenses billed to customers are recorded as revenues rather than an offset to the related expense. Revenues recorded from out-of-pocket expense reimbursements totaled approximately \$0.4 million for each of the three months ended June 30, 2018 and 2017 and \$0.8 million for each of the six months ended June 30, 2018 and 2017. The out-of-pocket expenses are reported in cost of revenues.

Significant Judgments

Performance Obligations and Standalone Selling Price

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of accounting in the new revenue standard. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. The Company has contracts with customers that often include multiple performance obligations, usually including multiple subscription and implementation services. For these contracts, the Company accounts for individual performance obligations separately if they are distinct by allocating the contract's total transaction price to each performance obligation in an amount based on the relative standalone selling price, or SSP, of each distinct good or service in the contract. In determining whether implementation services are distinct from the subscription services, the Company considered various factors including the significant level of integration, interdependency, and interrelation between the implementation and subscription service, as well as the inability of the customer's personnel or other service providers to perform significant portions of the services. The Company has concluded that the implementation services included in contracts with multiple performance obligations are not distinct and, as a result, the Company defers any arrangement fees for implementation services and recognizes such amounts over time on a ratable basis as one performance obligation with the underlying subscription revenue for the initial agreement term of the hosted

application agreements.

The majority of our revenue recognized at any particular point in time is for professional services and usage revenue. These services are performed within a relatively short period of time and are recognized at the point in time in which the customer obtains control of the asset, which is generally upon completion of the service.

11

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

Judgment is required to determine the SSP for each distinct performance obligation. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The primary method used to estimate SSP is the adjusted market assessment approach, which considers its overall pricing objectives, market conditions and other factors, including the value of the Company's contracts, its discounting practices, the size and volume of its transactions, customer characteristics, price lists, go-to-market strategy, historical standalone sales and agreement prices, and the number and types of users within its contracts.

Variable Consideration

The Company recognizes usage revenue related to users accessing its products in excess of contracted amounts and bill-pay transactions that registered users initiate on its solutions. Judgment is required to determine the accounting for these types of revenue. The Company considers various factors including the degree to which usage is interdependent or interrelated to past services, costs per user over the contract to the Company, and contractual price per user changes and their relationship to market terms, forecasted data, and the Company's cost to fulfill the obligation. The Company has concluded that both types of usage revenue meet the variable consideration exception and recognizes each on a monthly or quarterly basis, as defined per agreement, as determined and reported. This allocation reflects the amount the Company expects to receive for the services for the given period.

The Company sometimes provides credits or incentives to its customers. Known and estimable credits and incentives represent a form of variable consideration, which are estimated at contract inception and reduce the revenues recognized for a particular contract. These estimates are updated at the end of each reporting period as additional information becomes available. The Company believes that there will not be significant changes to its estimates of variable consideration.

Other Considerations

The Company evaluates whether it is the principal (i.e., report revenues on a gross basis) or agent (i.e., report revenues on a net basis) for vendor reseller agreements. Generally, the Company reports revenues from these types of contracts on a gross basis, meaning the amounts billed to customers are recorded as revenues, and expenses incurred are recorded as cost of revenues. Where the Company is the principal, it first obtains control of the inputs to the specific good or service and directs their use to create the combined output. The Company's control is evidenced by its involvement in the integration of the good or service on its platform before it is transferred to its customers and is further supported by the Company being primarily responsible to its customers and having a level of discretion in establishing pricing. Revenues provided from agreements in which the Company is an agent are immaterial.

Cost of Revenues

Cost of revenues is comprised primarily of salaries and other personnel-related costs, including employee benefits, bonuses and stock-based compensation, for employees providing services to the Company's customers. Costs associated with these services include the costs of the Company's implementation, customer support, data center and customer training personnel, as well as costs related to research and development personnel who perform implementation and customer support services. Cost of revenues also includes the direct costs of bill-pay and other third-party intellectual property included in the Company's solutions, the amortization of deferred solution and services costs, co-location facility costs and depreciation of the Company's data center assets, an allocation of general overhead costs and referral fees. Direct costs of third-party intellectual property include amounts paid for third-party licenses and related maintenance that are incorporated into the Company's software and the amortization of acquired technology from the Company's recent acquisitions, with the costs amortized to cost of revenues over the useful lives of the purchased assets.

The Company capitalizes certain personnel costs that are direct or incremental to the implementation of its solutions to the extent those costs are considered to be recoverable from future revenues. The Company amortizes the costs for a particular implementation once revenue recognition commences, and the Company amortizes those implementation costs over the expected period of customer benefit, which has been determined to be the estimated life of the

technology. Other costs not directly recoverable from future revenues are expensed in the period incurred.

12

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

Software Development Costs

Software development costs include salaries and other personnel-related costs, including employee benefits and bonuses attributed to programmers, software engineers and quality control teams working on the Company's software solutions. The costs related to software development that are incurred between reaching technological feasibility of a solution and the point at which the solution is ready for general release are capitalized and are included in intangible assets, net on the condensed consolidated balance sheet. Capitalized software development costs are computed on an individual product basis, and products available for market are amortized to cost of revenues over the products' estimated economic lives. The Company recognized \$0.2 million and \$0.1 million of amortization of capitalized software development costs for the three months ended June 30, 2018 and 2017, respectively, and \$0.4 million and \$0.2 million of amortization of capitalized software development costs for the six months ended June 30, 2018 and 2017, respectively, and all of the related individual products reached general release in 2017. The Company capitalized zero and \$0.2 million of software development costs in the three months ended June 30, 2018 and 2017, respectively, and capitalized zero and \$0.8 million of software development costs during the six months ended June 30, 2018 and 2017, respectively.

Research and Development Costs

Research and development costs include salaries and other personnel-related costs, including employee benefits, bonuses and stock-based compensation, third-party contractor expenses, software development tools, an allocation of facilities and depreciation expenses and other related expenses incurred in developing new solutions and upgrading and enhancing existing solutions. Research and development costs are expensed as incurred.

Advertising

All advertising costs of the Company are expensed the first time the advertising takes place. Advertising costs were \$0.4 million and \$0.1 million for the three months ended June 30, 2018 and 2017, respectively, and \$0.8 million and \$0.3 million for the six months ended June 30, 2018 and 2017, respectively.

Sales Tax

The Company presents sales taxes and other taxes collected from customers and remitted to governmental authorities on a net basis and, as such, excludes them from revenues.

Comprehensive Loss

Comprehensive loss includes net loss as well as other changes in stockholders' equity that result from transactions and economic events other than those with stockholders. Other comprehensive loss consists of net loss and unrealized gains and losses on available-for-sale investments.

Stock-Based Compensation

Stock options, restricted stock units, and market stock units awarded to employees, directors, executives and consultants are measured at fair value at each grant date. The Company recognizes compensation expense ratably over the requisite service period of the option or restricted stock unit award. As of January 1, 2017, the Company no longer uses a forfeiture rate to recognize compensation expense as a result of the adoption of ASU No.

2016-09, "Improvements to Employee Share-Based Payment Accounting." Generally, options vest 25% on the one-year anniversary of the grant date with the balance vesting monthly over the following 36 months, and restricted stock unit awards vest in four annual installments of 25% each. Market stock units are performance-based awards that cliff vest based on the Company's stockholder return relative to the total stockholder return of the Russell 2000 Index, or Index, over a three-year period on the anniversary of the date of grant. Up to one-third of the target shares of our common stock subject to each market stock unit award are eligible to be earned after the first and second years of the performance period and up to 200% of the full target number of shares subject to each market stock unit award are eligible to be earned after the completion of the three-year performance period (less any shares earned for years one and two) based on the average price of the Company's common stock relative to the Index during the performance period.

The Company values stock options using the Black-Scholes option-pricing model, which requires the input of subjective assumptions, including the risk-free interest rate, expected life, expected stock price volatility and dividend yield. The risk-free interest rate assumption is based upon observed interest rates for constant maturity U.S. Treasury securities consistent with the expected term of the Company's employee stock options. The expected life represents the period of time the stock options are

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

expected to be outstanding and is based on the simplified method. Under the simplified method, the expected life of an option is presumed to be the mid-point between the vesting date and end of the contractual term. The Company used the simplified method due to the lack of sufficient historical exercise data to provide a reasonable basis upon which to otherwise estimate the expected life of the stock options. Due to the Company's limited history as a public company, expected volatility is based on historical volatilities for publicly traded stock of comparable companies over the estimated expected life of the stock options. The Company assumed no dividend yield because it does not expect to pay dividends in the near future, which is consistent with the Company's history of not paying dividends.

The Company values restricted stock units at the closing market price on the date of grant and recognizes compensation expense ratably over the requisite service period of the restricted stock unit award.

The Company estimates the fair value of market stock units on the date of grant using a Monte Carlo simulation model. The determination of fair value of the market stock units is affected by the Company's stock price and a number of assumptions including the expected volatility and the risk-free interest rate. The Company's expected volatility at the date of grant was based on the historical volatilities of its stock and peer firms' stocks and the Index over the performance period. The Company assumed no dividend yield and recognizes compensation expense ratably over the performance period of the market stock unit award. The Company recognizes compensation expense using the graded attribution method on a straight-line basis over the requisite service period for each market stock unit award.

Convertible Senior Notes

In February 2018, the Company issued \$230.0 million principal amount of convertible senior notes due in February 2023, or the Convertible Notes. In accounting for the issuance of the Convertible Notes, the Company separated each of the Convertible Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value, as of the date of issuance, of a similar debt without the conversion option. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability components from the total initial proceeds. The difference between the par amount of the Convertible Notes and the carrying amount of the liability component represents debt discounts that are amortized to interest expense over the respective terms of the Convertible Notes using the effective interest rate method. The equity components are not remeasured as long as they continue to meet the conditions for equity classification. In accounting for the issuance costs related to the Convertible Notes, the Company allocated the total amount of issuance costs incurred to liability and equity components based on their relative values. Issuance costs attributable to the liability components are amortized to interest expense over the respective terms of the Convertible Notes using the effective interest rate method. The issuance costs attributable to the equity components were netted against the respective equity components in additional paid-in capital.

Income Taxes

Deferred income taxes are provided for the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes and operating loss carryforwards and credits using enacted tax rates expected to be in effect in the years in which the differences are expected to reverse. The Company assesses the likelihood that deferred tax assets will be realized and recognizes a valuation allowance if it is more likely than not that some portion of the deferred tax assets will not be realized. This assessment requires judgment as to the likelihood and amounts of future taxable income by tax jurisdiction. To date, the Company has provided a valuation allowance against its deferred tax assets as it believes the objective and verifiable evidence of its historical pretax net losses outweighs any positive evidence of its forecasted future results. Although the Company believes that its tax estimates are reasonable, the ultimate tax determination involves significant judgment that is subject to audit by tax authorities in the ordinary course of business. The Company will continue to monitor the positive and negative evidence, and it will adjust the valuation allowance as sufficient objective positive evidence becomes available. No tax related impact was recorded in the financial statements as a

result of the adoption of the new revenue standard.

The Company evaluates its uncertain tax positions based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is more likely than not to be realized. Potential interest and penalties associated with any uncertain tax positions are recorded as a component of income tax expense. Through June 30, 2018, the Company has not identified any material uncertain tax positions for which liabilities would be required to be recorded.

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

Basic and Diluted Net Loss per Common Share

The following table sets forth the computations of net loss per share for the periods listed:

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Numerators:				
Net loss	\$ (8,627)	\$ (7,821)	\$ (14,675)	\$ (14,861)
Denominators:				
Weighted-average common shares outstanding, basic and diluted	42,605	41,064	42,389	40,848
Net loss per common share, basic and diluted	\$ (0.20)	\$ (0.19)	\$ (0.35)	\$ (0.36)

Due to net losses for the three and six months ended June 30, 2018 and 2017, basic and diluted net loss per share were the same, as the effect of all potentially dilutive securities would have been anti-dilutive. The following table sets forth the anti-dilutive common share equivalents that were excluded for the periods listed:

	As of June	
	30,	
	2018	2017
Stock options, restricted stock units, and market stock units	5,032	5,751

Because the Company has the intention and ability to settle the principal amount of its Convertible Notes in cash, the treasury stock method is expected to be used for calculating any potential dilutive effect of the conversion spread on diluted net income per share, if applicable. The conversion spread will have a dilutive impact on diluted net income per share of common stock when the average market price of common stock for a given period exceeds the conversion price of \$57.38 per share for the Convertible Notes. The Warrants will have a dilutive effect when the average market price of common stock for a given period exceeds the Warrant's strike price of \$78.75 per share.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued ASU No. 2014-09, which amends the existing accounting standards for revenue recognition. ASU 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled to when products are transferred to customers. ASU 2014-09 was modified by subsequently issued ASUs 2015-14, 2016-08, 2016-10, 2016-12 and 2016-20. Topic 606 also includes Subtopic 340-40, Other Assets and Deferred Costs - Contracts with Customers, which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, the Company refers to ASU 2014-09, as amended, and Subtopic 340-40 as the "new revenue standard." On January 1, 2018, the Company adopted the new revenue standard for all contracts which were not completed as of January 1, 2018, using the modified retrospective method. Adoption of the new revenue standard resulted in changes to the Company's accounting policies for revenue recognition, contract balances, accounts receivables, deferred revenues, deferred implementation costs, and deferred solution and other costs. The Company recognized the cumulative effect of initially applying the new revenue standard as a positive adjustment to the opening balance of accumulated deficit on the condensed consolidated balance sheet in the amount of \$15.8 million, which reflects the acceleration of revenues and deferral of incremental commission costs of obtaining subscription contracts. The comparative information in prior periods presented has not been restated and continues to be reported under the accounting standards in effect for those periods.

The most significant impact of adoption of the new revenue standard relates to the accounting for arrangements that include contractual provisions providing for periodic price increases in subscription fee arrangements. Under previous GAAP, the Company accounted for periodic price increases in the period in which they occurred, and under the new revenue standard, the Company recognizes revenue from periodic price increases on a ratable basis over the term of the contract. Additionally, under previous GAAP, for contracts in which customers host and manage the Company's solutions on-premises or in third-party data centers under term license and maintenance agreements, the Company

recognized the entire arrangement consideration monthly over the term of the software license as the Company did not have VSOE of fair value for the license and maintenance. Under the new standard, the Company recognizes software license revenue once the customer obtains control of the license, which generally occurs at the commencement of each license term. Under previous GAAP, the Company also deferred only

15

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

direct and incremental commission costs to obtain a contract and amortized those costs over the term of the related contract. Under the new standard, the Company defers additional incremental costs related to the customer contract and amortizes those costs over the expected period of customer benefit. Also, a portion of the commission payment is now being expensed as incurred.

The cumulative effect of the changes made to the Company's condensed consolidated January 1, 2018 balance sheet for the adoption of the new revenue standard were as follows:

	Balance at December 31, 2017	Adjustments due to the new revenue standard	Balance at January 1, 2018
Balance sheet			
Assets			
Contract assets, current portion	\$—	\$ 517	\$517
Deferred solution and other costs, current portion	9,246	64	9,310
Deferred solution and other costs, net of current portion	12,973	265	13,238
Deferred implementation costs, net of current portion	8,295	(93)	8,202
Contract assets, net of current portion	—	4,541	4,541
Liabilities			
Accrued compensation	11,511	(571)	10,940
Deferred revenues, current portion	38,379	(1,803)	36,576
Deferred revenues, net of current portion	28,289	(8,174)	20,115
Stockholders' equity			
Accumulated deficit	\$(152,114)	\$ 15,842	\$(136,272)

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on the Company's condensed consolidated statement of comprehensive loss and balance sheet was as follows:

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	As Reported	Balances without new revenue standard	Effect of Change Higher/(Lower)	As Reported	Balances without new revenue standard	Effect of Change Higher/(Lower)
Income statement						
Revenues	\$58,574	\$56,940	\$ 1,634	\$113,382	\$109,483	\$ 3,899
Costs and expenses						
Cost of revenues	29,303	29,421	(118)	56,280	56,454	(174)
Sales and marketing	12,108	12,017	91	23,074	23,245	(171)
Interest and other income	755	725	30	954	900	54
Net loss	\$(8,627)	\$(10,318)	\$ 1,691	\$(14,675)	\$(18,973)	\$ 4,298
	\$(0.20)	\$(0.24)	\$ 0.04	\$(0.35)	\$(0.45)	\$ 0.10

Net loss per common share, basic and
diluted

16

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

	As of June 30, 2018		
	As	Balances	Effect of
	Reported	without	Change
		new	Higher/(Lower)
		revenue	
		standard	
Balance sheet			
Assets			
Accounts receivable, net	\$26,996	\$23,238	\$ 3,758
Contract assets, current portion	1,196	—	1,196
Deferred solution and other costs, current portion	10,402	10,313	89
Deferred implementation costs, current portion	3,066	3,154	(88)
Deferred solution and other costs, net of current portion	15,966	15,704	262
Deferred implementation costs, net of current portion	9,492	9,359	133
Contract assets, net of current portion	6,074	—	6,074
Liabilities			
Accrued compensation	7,100	7,855	(755)
Deferred revenues, current portion	33,159	36,017	(2,858)
Deferred revenues, net of current portion	19,238	24,341	(5,103)
Stockholders' equity			
Accumulated deficit	\$(151,700)	\$(171,840)	\$ (20,140)

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. In July 2018, the FASB issued ASU 2018-10, "Codification Improvements to Topic 842 (Leases)," which provides narrow amendments to clarify how to apply certain aspects of the new lease standard. In July 2018, the FASB also issued ASU 2018-11, "Targeted Improvements," which provides the option to adopt ASU No. 2016-02 retrospectively for each prior period presented or as of the adoption date with a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. These standards are effective for public entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and early application is permitted. The Company anticipates that the adoption of Topic 842 will impact its condensed consolidated balance sheets as most of its operating lease commitments will be subject to the new standard and recognized as right-of-use assets and corresponding operating lease liabilities upon the adoption of Topic 842, which will increase the total assets and total liabilities that it reports relative to such amounts prior to adoption. The Company is currently evaluating the accounting, transition, disclosure requirements, and financial statement impact of this adoption.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments," to clarify and provide specific guidance on eight cash flow classification issues that are not addressed by current GAAP and thereby reduce the current diversity in practice. The Company adopted ASU 2016-15, effective January 1, 2018, and there was no impact on the condensed consolidated financial statements as a result of the adoption.

In November 2016, the FASB issued ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash," which provides guidance on the classification of restricted cash in the statement of cash flows. The Company adopted this ASU retrospectively, effective January 1, 2018. As a result, the Company included restricted cash with cash and

cash equivalents when reconciling the beginning-of-period and end-of-period total amounts presented on the consolidated statements of cash flows, resulting in an increase in net cash of \$2.3 million for the six months ended June 30, 2018 and \$1.3 million for fiscal 2017.

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment" which simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test and requires an entity to write down the carrying value of goodwill up to the amount by which the carrying amount of a reporting unit exceeds its fair value. The standard is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years and early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of this standard to have a material impact on its condensed consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718)" to provide clarity and reduce both diversity in practice and cost and complexity when applying the guidance in Topic 718, Compensation-Stock Compensation, to a change to the terms or conditions of a share-based payment award. The Company adopted ASU 2017-09, effective January 1, 2018, and there was no impact on the condensed consolidated financial statements as a result of the adoption.

In December 2017, the SEC issued Staff Accounting Bulletin ("SAB") 118 to address the application of GAAP in situations in which a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act, or the Tax Act, which was signed into law on December 22, 2017. In March 2018, the FASB issued ASU No. 2018-05, "Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (SEC Update)," which amended ASC 740 to incorporate the requirements of SAB 118. The Company recorded the provisional tax impacts of the Tax Act in the fourth quarter of 2017. During the first half of 2018, the Company did not receive any additional information regarding these provisional calculations. As a result, the Company continues to anticipate finalizing its analysis in connection with the completion of its tax return for 2017 to be filed in 2018.

3. Business Combinations and Asset Acquisitions

In January 2017, the Company acquired the outstanding shares of a privately-owned company. In accordance with ASU 2017-01, the Company determined the set of assets acquired was not a business as substantially all of the fair value of the gross assets acquired was concentrated in a single identifiable asset, and the transaction was accounted for as an asset purchase. The Company acquired the assets for \$1.5 million in cash from existing balances which included a hold-back of \$0.2 million, which was paid in the first quarter of 2018. Consideration was allocated on a relative fair value basis and resulted in \$1.5 million in intangible assets including acquired technology and assembled workforce. Intangible assets are amortized on a straight-line basis over their estimated useful lives of three years. The acquired intangible assets are not amortizable for income tax purposes, which will result in an increase to deferred tax liabilities and a decrease of valuation allowance of \$0.3 million.

During 2015, the Company acquired all of the outstanding shares of Centrix, a privately-owned company that provides financial institutions with products that detect fraud, manage risk and simplify compliance and acquired all of the outstanding ownership interests of Social Money, a privately-owned financial services software company that offers a modern, cloud-based platform that assists financial institutions in their direct digital strategies. During 2017, the Company paid out \$7.2 million to the former Centrix shareholders based upon the achievement of certain milestone-based objectives and continued employment and \$0.2 million in retention bonuses to certain of the Social Money employees based upon their continued employment with the Company. During 2017, the Company also released the entire \$2.5 million hold-back to the former owners of Social Money upon the expiration of the hold-back period. The Company continues to accrue for payouts contingent upon future employment of acquired employees. The Company has recognized \$0.3 million and \$0.4 million under these agreements in compensation expense included in acquisition related costs in the condensed consolidated statement of comprehensive loss for the three months ended June 30, 2018 and 2017, respectively, and \$0.5 million and \$0.7 million under these agreements for the six months ended June 30, 2018 and 2017, respectively. The unpaid amounts due to the former shareholders or continuing

employees, as applicable, are recorded in accrued compensation in the condensed consolidated balance sheets as of June 30, 2018.

4. Fair Value Measurements

The carrying values of the Company's financial instruments, principally cash equivalents, investments, accounts receivable, restricted cash and accounts payable, approximated their fair values due to the short period of time to maturity or repayment.

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

Fair value is defined as the exchange price that would be received for an asset or an exit price paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The current accounting guidance for fair value measurements defines a three-level valuation hierarchy for disclosures as follows:

Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2—Inputs other than quoted prices included within Level 1 that are observable, unadjusted quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data; and

Level 3—Unobservable inputs that are supported by little or no market activity, which requires the Company to develop its own assumptions.

The categorization of a financial instrument within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following table details the fair value hierarchy of the Company's financial assets measured at fair value on a recurring basis as of June 30, 2018:

		Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash Equivalents:	Fair Value			
Money market funds	\$89,766	\$89,766	\$ —	\$ —
U.S. treasuries and agencies	10,030	10,030	—	—
	\$99,796	\$99,796	\$ —	\$ —
Investments:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government agency bonds	\$48,164	\$—	\$ 48,164	\$ —
Corporate bonds and commercial paper	48,700	—	48,700	—
Certificates of deposit	5,110	—	5,110	—
	\$101,974	\$—	\$ 101,974	\$ —

Table of Contents

Q2 HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(in thousands, except per share amounts and unless otherwise indicated)

The following table details the fair value hierarchy of the Company's financial assets measured at fair value on a recurring basis as of December 31, 2017:

	Fair Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash Equivalents:				
Money market funds	\$9,279	\$9,279	\$ —	\$ —
Investments:				
U.S. government agency bonds	\$16,194	\$—	\$ 16,194	\$ —
Corporate bonds and commercial paper	15,815	—	15,815	—
Certificates of deposit	9,676	—	9,676	—
	\$41,685	\$—	\$ 41,685	\$ —

The Company determines the fair value of its investment holdings based on pricing from our pricing vendors. The valuation techniques used to measure the fair value of financial instruments having Level 2 inputs were derived from non-binding consensus prices that are corroborated by observable market data or quoted market prices for similar instruments. Such market prices may be quoted prices in active markets for identical assets (Level 1 inputs) or pricing determined using inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs).

5. Cash, Cash Equivalents and Investments

The Company's cash, cash equivalents and investments as of June 30, 2018 and December 31, 2017 consisted primarily of cash, U.S. government agency bonds, corporate bonds, commercial paper, certificates of deposit and money market funds.

The Company classifies investments as available-for-sale at the time of purchase and reevaluates such classification as of each balance sheet date. All investments are recorded at estimated fair value. Unrealized gains and losses on available-for-sale investments are included in accumulated other comprehensive loss, a component of stockholders' equity. The Company evaluates its investments to assess whether those with unrealized loss positions are other than temporarily impaired. The Company considers impairments to be other than temporary if they are related to deterioration in credit risk or if it is likely the Company will sell the investments before the recovery of their cost basis. Realized gains and losses and declines in value judged to be other than temporary are determined based on the

specific identification method and are reported in other income (expense), net, in the condensed consolidated statements of comprehensive loss. Interest, amortization of premiums and accretion of discount on all investments classified as available-for-sale are also included as a component of other income (expense), net, in the condensed consolidated statements of comprehensive loss.

As of June 30, 2018