Q2 Holdings, Inc.
Form 10-Q
August 07, 2015
Table of Contents

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

FORM 10-Q

(Mark One),

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

For the quarterly period ended June 30, 2015.
or
o 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 ý No o
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 ý No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

o Large accelerated filer	ý Accelerated filer	o Non-accelerated filer (do not check if a smaller reporting company)	o Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 37,323,337 shares of Common Stock, $0.0001 par value per share as of July 31, 2015.

Table of Contents

TABLE OF CONTENTS

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, 2015 (unaudited)	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$69,369	$67,979
Restricted cash	713	829
Investments	49,150	20,956
Accounts receivable, net	6,987	5,007
Prepaid expenses and other current assets	2,614	2,695
Deferred solution and other costs, current portion	4,512	5,060
Deferred implementation costs, current portion	2,331	1,996
Total current assets	135,676	104,522
Property and equipment, net	18,718	18,521
Deferred solution and other costs, net of current portion	8,590	7,159
Deferred implementation costs, net of current portion	5,523	5,378
Other long-term assets	1,187	1,226
Total assets	$169,694	$136,806
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$3,527	$1,986
Accrued liabilities	6,870	9,268
Accrued compensation	4,251	3,936
Deferred revenues, current portion	17,542	17,289
Capital lease obligations, current portion	344	408
Total current liabilities	32,534	32,887
Deferred revenues, net of current portion	25,846	19,436
Capital lease obligations, net of current portion	1	167
Deferred rent, net of current portion	4,307	4,694
Other long-term liabilities	720	682
Total liabilities	63,408	57,866
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Common stock: $0.0001 par value; 150,000 shares authorized; 37,310 issued and 37,309 shares outstanding as of June 30, 2015, and 34,697 shares issued and 34,696 shares outstanding as of December 31, 2014	4	3
Preferred stock: $0.0001 par value; 5,000 shares authorized; no shares issued or outstanding as of June 30, 2015, and December 31, 2014	—	—
Treasury stock at cost; 1 share at each of June 30, 2015 and December 31, 2014	(27)	(20)
Additional paid-in capital	180,352	143,337
Accumulated other comprehensive loss	(50)	(14)
Accumulated deficit	(73,993)	(64,366)
Total stockholders' equity	106,286	78,940

Total liabilities and stockholders' equity	$169,694	$136,806

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

Table of Contents

Q2 HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(unaudited)
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues	$26,284	$19,158	$50,441	$35,992
Cost of revenues[1]	14,138	10,830	27,410	21,042
Gross profit	12,146	8,328	23,031	14,950
Operating expenses:				
Sales and marketing[1]	6,987	6,032	13,181	11,541
Research and development[1]	4,797	2,787	8,948	5,523
General and administrative[1]	5,344	4,058	10,469	7,776
Total operating expenses	17,128	12,877	32,598	24,840
Loss from operations	(4,982)	(4,549)	(9,567)	(9,890)
Other income (expense):				
Interest and other income	77	5	121	5
Interest and other expense	(65)	(124)	(137)	(331)
Total other income (expense), net	12	(119)	(16)	(326)
Loss before income taxes	(4,970)	(4,668)	(9,583)	(10,216)
Provision for income taxes	(12)	(15)	(44)	(33)
Net loss	$(4,982)	$(4,683)	$(9,627)	$(10,249)
Other comprehensive loss:				
Unrealized loss on available-for-sale investments	(45)	—	(36)	—
Comprehensive loss	$(5,027)	$(4,683)	$(9,663)	$(10,249)
Net loss per common share, basic and diluted	$(0.13)	$(0.14)	$(0.26)	$(0.42)
Weighted average common shares outstanding:				
Basic and diluted	37,232	34,068	36,437	24,143

[1] Includes stock-based compensation expenses as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Cost of revenues	$238	$147	$416	$273
Sales and marketing	344	187	636	354
Research and development	217	122	379	229
General and administrative	840	612	1,530	1,130
Total stock-based compensation expenses	$1,639	$1,068	$2,961	$1,986

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,	
	2015	2014
Cash flows from operating activities:		
Net loss	$(9,627)	$(10,249)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of deferred implementation, solution and other costs	2,117	2,030
Depreciation and amortization	2,556	2,030
Amortization of debt issuance costs	48	48
Amortization of premiums on investments	108	—
Stock-based compensation expenses	2,961	1,986
Allowance for sales credits	(7)	51
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,972)	3,545
Prepaid expenses and other current assets	90	(890)
Deferred solution and other costs	(1,806)	(1,633)
Deferred implementation costs	(1,676)	(1,836)
Other long-term assets	(50)	330
Accounts payable	1,488	(1,036)
Accrued liabilities	(174)	(3,643)
Deferred revenues	6,662	4,798
Deferred rent and other long-term liabilities	(387)	355
Net cash provided by (used in) operating activities	331	(4,114)
Cash flows from investing activities:		
Purchases of investments	(39,173)	—
Maturities of investments	10,833	—
Purchases of property and equipment	(2,321)	(2,468)
Decrease in restricted cash	116	—
Net cash used in investing activities	(30,545)	(2,468)
Cash flows from financing activities:		
Proceeds from borrowings on line of credit	—	12,500
Payments on line of credit	—	(16,710)
Payments on financing obligations	(2,205)	—
Payments on capital lease obligations	(230)	(446)
Proceeds from the issuance of common stock, net of issuance costs	32,333	86,461
Proceeds from exercise of stock options to purchase common stock	1,713	1,008
Shares acquired to settle the exercise of stock options	(7)	—
Net cash provided by financing activities	31,604	82,813
Net increase in cash and cash equivalents	1,390	76,231
Cash and cash equivalents, beginning of period	67,979	18,675
Cash and cash equivalents, end of period	$69,369	$94,906
Supplemental disclosures of cash flow information:		
Cash paid for taxes	$60	$55
Cash paid for interest	$105	$207

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., or the Company, is a leading provider of secure, cloud-based virtual banking solutions. The Company enables regional and community financial institutions, or RCFIs, to deliver a robust suite of integrated virtual banking services and more effectively engage with their retail 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, formerly known as CBG Holdings, Inc., was incorporated in Delaware in March 2005 and is a holding company that owns 100% of the outstanding capital stock of Q2 Software, Inc. On March 1, 2013 the Company was renamed Q2 Holdings, Inc.

The Company's headquarters are located in Austin, Texas.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

As used in this report, the terms "we," "us," or "our" refer to Q2 Holdings, Inc. and its wholly-owned subsidiary. 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 the Company and its wholly-owned subsidiary. 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, 2014, which are included in the Company's Annual Report on Form 10-K, filed with the SEC on February 12, 2015. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015 or for any other period.

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 revenue recognition, stock-based compensation, the useful lives of property and equipment 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.

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.

Table of Contents
Q2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share amounts and unless otherwise indicated)

Restricted Cash

Restricted cash consists of a deposit held in a checking account for leased office space.

Investments

Investments consist primarily of U.S. government agency bonds, corporate bonds, commercial paper, certificates of deposits 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, 2015 and 2014. No individual customer accounted for 10% or more of accounts receivable, net, as of June 30, 2015 or December 31, 2014.

Accounts Receivable

Accounts receivable are stated at net realizable value, including both billed and unbilled receivables to customers. Unbilled receivable balances arise primarily when the Company provides services in advance of billing for these services and also when the Company earns revenues based on the number of registered users and the number of bill-pay and certain other transactions that registered users perform on the Company's virtual banking solutions in excess of the levels included in the Company's minimum subscription fee. Generally, billing for revenues related to the number of registered users and the number of transactions processed by our registered users occurs one month in arrears. Included in the accounts receivable balances as of June 30, 2015 and December 31, 2014 were unbilled receivables of $3.4 million and $2.3 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. This allowance is recorded as a reduction against accounts receivable. As of June 30, 2015 and December 31, 2014, 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.

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 $0.2 million at each of June 30, 2015 and December 31, 2014.

Deferred Implementation Costs

The Company capitalizes certain personnel and other costs, such as employee salaries, benefits and the associated payroll taxes that are direct and 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 remaining term of the customer agreement. 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.

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. 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 remaining term of the customer agreement. The Company analyzes solution and other costs that may be capitalized to assess their recoverability and only capitalizes costs that it anticipates to be 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.

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

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. Deferred revenues that are expected to be recognized as revenues during the succeeding twelve month period are recorded in current liabilities as deferred revenues, current portion and the remaining portion is recorded in long-term liabilities as deferred revenues, net of current portion.

Revenues

All 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 substantial majority of its revenues from subscription fees for the use of its solutions hosted in the Company's data centers as well as revenues for implementation and customer support services related to the Company's solutions. A small portion of the Company's customers host the Company's solutions in their own data centers under term license and maintenance agreements, and the Company recognizes the corresponding revenues ratably over the term of those customer agreements.

Revenues are recognized net of sales credits and allowances. The Company begins to recognize revenues for a customer when all of the following criteria are satisfied:

- there is persuasive evidence of an arrangement;

- the service has been or is being provided to the customer;

- the collection of the fees is reasonably assured; and

- the amount of fees to be paid by the customer is fixed or determinable.

Determining whether and when these criteria have been met can require significant judgment and estimates. In general, revenue recognition commences when the Company's solutions are implemented and made available to the customers.

The Company's software solutions are available for use in hosted application arrangements under subscription fee agreements. Subscription fees from these applications, including related customer support, are recognized ratably over the customer agreement term beginning on the date the 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 Company's revenue recognition criteria have been met.

The Company considers subscription fees to be fixed or determinable unless the fees are subject to refund or adjustment or are not payable within the Company's standard payment terms. In determining whether collection of subscription fees is reasonably assured, the Company considers financial and other information about customers, such as a customer's current credit-worthiness and payment history over time. Historically, bad debt expenses have not been significant.

The Company enters into arrangements with multiple-deliverables that generally include multiple subscriptions and implementation services. Additional agreements with existing customers that are not in close proximity to the original arrangements are treated as separate contracts for accounting purposes.

For multiple-deliverable arrangements, arrangement consideration is allocated to deliverables based on their relative selling price. In order to treat deliverables in a multiple-deliverable arrangement as separate units of accounting, the deliverables must have standalone value upon delivery. The Company's subscription services have standalone value as such services are often sold separately. In determining whether implementation services have standalone value apart from the subscription services, the Company considers various factors including the availability of the services from other vendors. To date, the Company has concluded that the implementation services included in multiple-deliverable arrangements do not have standalone value. As a result, when implementation services are sold in a multiple-deliverable arrangement, the Company defers any arrangement fees for implementation services and recognizes such amounts ratably over the period of performance for the initial agreement term.

When multiple-deliverables included in an arrangement are separated into different units of accounting, the arrangement consideration is allocated to the identified separate units based on a relative selling price hierarchy. The selling price for a deliverable is based on its vendor-specific objective evidence of selling price, or VSOE, if available, third-party evidence of selling price, or TPE, if VSOE is not available or best estimate of selling price, or BESP, if neither VSOE nor TPE is available. The Company has not established VSOE for its subscription services due to lack of pricing consistency, the introduction of new services and other factors. The Company has determined that TPE is not a practical alternative due to differences in its service offerings compared to other parties and the availability of relevant third-party pricing information. Accordingly, the Company uses BESP to determine the relative selling price. The amount of revenue allocated to delivered items is limited by contingent revenues.

The Company determines BESP by considering its overall pricing objectives and market conditions. Significant pricing practices taken into consideration include the Company's discounting practices, the size and volume of its transactions, customer characteristics, price lists, go-to-market strategy, historical standalone sales and agreement prices. As the Company's go-to-market strategies evolve, it may modify its pricing practices in the future, which could result in changes in relative selling prices, and include both VSOE and BESP.

Subscription Fee Revenues

The Company's solutions are available as hosted solutions under subscription fee agreements without licensing perpetual rights to the software. Subscription fees from a hosted solution are recognized monthly over the customer agreement term beginning on the date the Company's solution is made available to the customer. Additional fees for monthly usage above the levels included in the standard subscription fee, which include fees for transactions processed during the period, are recognized as revenue in the month when the usage amounts are determined and reported. Any revenues related to upfront implementation services are recognized ratably over the same customer agreement term. 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.

Professional Services Revenues

When professional services are not combined with subscription services or term licenses as a single unit of accounting, these professional services revenues are recognized as the services are performed.

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 $0.3 million and $0.2 million for the three months ended June 30, 2015 and 2014, respectively, and $0.6 million and $0.3 million for the six months ended June 30, 2015 and 2014, respectively. The out-of-pocket expenses are reported in cost of revenues.

Term Licenses and Maintenance Revenues

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, which entitles the customer to technical support and upgrades and updates to the software made available on a when-and-if-available basis, are accounted for under Accounting Standards Codification 985-605, Software Revenue Recognition. The Company does not have VSOE of fair value for the maintenance and professional services so the entire arrangement consideration is recognized monthly over the term of the software license when all of the other revenue recognition criteria have been met. Revenues from term licenses and maintenance agreements were not significant in the periods presented.

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 reclassification of certain research and development expenses related to research and development personnel who perform services related to implementation and customer support. 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, with the costs amortized to cost of revenues over the useful lives of the purchased assets.

The amount of research and development expenses allocated to cost of revenues was $0.2 million and $0.4 million for the three months ended June 30, 2015 and 2014, respectively, and $0.5 million and $0.8 million for the six months ended June 30, 2015 and 2014, respectively.

The Company capitalizes certain personnel costs directly related 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 remaining term of the customer agreement. Other costs not directly recoverable from future revenues are expensed in the period incurred. The Company capitalized implementation costs in the amount of $1.1 million and $1.0 million during the three months ended June 30, 2015 and 2014, respectively, and $2.0 million and $1.8 million for the six months ended June 30, 2015 and 2014, respectively.

Software Development Costs

Software development costs include salaries and other personnel-related costs, including employee benefits, bonuses and stock-based compensation, attributed to programmers, software engineers and quality control teams working on the Company's solutions. Costs related to software development incurred between reaching technological feasibility and the point at which the software solution is ready for general release have been insignificant through June 30, 2015, and accordingly all of the Company's software development costs have been expensed as incurred as research and development.

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 $0.1 million and $0.2 million for the three months ended June 30, 2015 and 2014, respectively, and $0.1 million and $0.3 million for the six months ended June 30, 2015 and 2014, 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 investments.

Stock-Based Compensation

Stock options and restricted stock units awarded to employees, directors 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, net of the expected forfeitures. The forfeiture rate is estimated at grant date based on historical experience and adjusted in subsequent periods for differences in actual forfeitures for those estimates. 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% beginning on the one-year anniversary of the grant date.

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 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.

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 full 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.

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, 2015, the Company has not identified any material uncertain tax positions for which liabilities would be required to be recorded.

Basic and Diluted Net Loss per Common Share

The Company uses the two-class method to compute net loss per common share because the Company has previously issued securities, other than common stock, that contractually entitle the holders to participate in dividends and earnings of the Company. The two-class method requires earnings for the period to be allocated between common stock and participating securities based upon their respective rights to receive distributed and undistributed earnings. Holders of the Company's Series A, B and C preferred stock are entitled, on a pari passu basis, to receive dividends when, as and if declared by the board of directors, prior and in preference to any declaration or payment of any dividend on the common stock or junior convertible preferred stock until such time as the total dividends paid on each share of Series A, B and C preferred stock is equal to the original issue price of the shares. Holders of junior convertible preferred stock are entitled to receive a pro rata share of any dividend declared, based on the number of shares of common and preferred stock outstanding. As a result, all series of the Company's preferred stock are considered participating securities for the period of time that such securities are outstanding.

Under the two-class method, for periods with net income, basic net income per common share is computed by dividing the net income attributable to common stockholders by the weighted-average number of shares of common stock outstanding during the period. Net income attributable to common stockholders is computed by subtracting from net income the portion of current year earnings that the participating securities would have been entitled to receive pursuant to their dividend rights had all of the year's earnings been distributed. No such adjustment to earnings is made during periods with a net loss, as the holders of the participating securities have no obligation to fund losses.

Diluted net income per common share is computed under the two-class method by using the weighted-average number of shares of common stock outstanding plus, for periods with net income attributable to common stockholders, the potential dilutive effects of stock options and warrants. In addition, the Company analyzes the potential dilutive effect of the outstanding participating securities under the if-converted method when calculating diluted earnings per share, in which it is assumed that the outstanding participating securities convert into common stock at the beginning of the period. The Company reports the more dilutive of the approaches as its diluted net income per share during the period. Due to net losses for each of the three and six months ended June 30, 2015 and 2014, basic and diluted net loss per share were the same, as the effect of all potentially dilutive securities would have been anti-dilutive.

Q2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share amounts and unless otherwise indicated)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Numerators:				
Net loss attributable to common stockholders	$(4,982)	$(4,683)	$(9,627)	$(10,249)
Denominator:				
Weighted-average common shares outstanding, basic and diluted	37,232	34,068	36,437	24,143
Net loss per common share, basic and diluted	$(0.13)	$(0.14)	$(0.26)	$(0.42)

The following table sets forth the anti-dilutive common share equivalents that were excluded for the periods listed:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Stock options and restricted stock units	5,861	6,302	5,861	6,302

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), or ASU 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 will be effective for the Company beginning in its first quarter of 2018. Early adoption is permitted beginning in 2017. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company is currently evaluating the impact of adopting the new revenue standard on its consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30), or ASU 2015-03, which seeks to simplify the presentation of debt issuance costs. ASU 2015-03 will require that debt issuance costs be classified as a contra-liability against any outstanding borrowings related to such debt issuance costs, rather than as a separate asset. ASU 2015-03 will be effective for the Company beginning in its first quarter of 2016. Early adoption is permitted. The Company is currently evaluating the impact of adopting ASU 2015-03 on its consolidated financial statements.

In 2015, the FASB issued Accounting Standards Update No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40), or ASU 2015-05, related to accounting for fees paid in a cloud computing arrangement. The new standard provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the impact of adopting the new standard on its consolidated financial statements.

Subsequent Events

The Company has evaluated subsequent events through the time of filing of this Form 10-Q.

3. 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. The carrying values of the Company's debt instruments approximated their fair value based on rates currently available to the Company.

(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, 2015:

		Fair Value Measurements Using:		
Cash Equivalents:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	$21,194	$21,194	$—	$—
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. treasuries and agency bonds	$15,048	$—	$15,048	$—
Corporate bonds and commercial paper	20,153	—	20,153	—
Certificates of deposit	13,949	—	13,949	—
	$49,150	$—	$49,150	$—

14

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, 2014:

		Fair Value Measurements Using:		
Cash Equivalents:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	$17,865	$17,865	$—	$—
Certificates of deposits	1,456	—	1,456	—
	$19,321	$17,865	$1,456	$—

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. treasuries and agency bonds	$7,502	$—	$7,502	$—
Corporate bonds and commercial paper	6,192	—	6,192	—
Certificates of deposit	7,262	—	7,262	—
	$20,956	$—	$20,956	$—

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).

4. Cash, Cash Equivalents and Investments

The Company's cash, cash equivalents and investments as of June 30, 2015 and December 31, 2014 consisted primarily of cash, U.S. government agency bonds, corporate bonds, commercial paper, certificates of deposits 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, 2015 and December 31, 2014, the Company's cash was $48.2 million and $48.7 million, respectively.

Q2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share amounts and unless otherwise indicated)

A summary of the Company's cash equivalents and investments as of June 30, 2015 is as follows:

Cash Equivalents:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$21,194	$—	$—	$21,194

Investments:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agency bonds	$15,058	$—	$(10)	$15,048
Corporate bonds and commercial paper	20,193	—	(40)	20,153
Certificates of deposits	13,949	—	—	13,949
	$49,200	$—	$(50)	$49,150

A summary of the Company's cash equivalents and investments as of December 31, 2014 is as follows:

Cash Equivalents:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$17,865	$—	$—	$17,865
Certificates of deposits	1,456	—	—	1,456
	$19,321	$—	$—	$19,321

Investments:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agency bonds	$7,508	$—	$(6)	$7,502
Corporate bonds and commercial paper	6,200	—	(8)	6,192
Certificates of deposits	7,262	—	—	7,262
	$20,970	$—	$(14)	$20,956

The Company may sell its investments at any time, without significant penalty, for use in current operations or for other purposes, even if they have not yet reached maturity. As a result, the Company classifies its investments, including investments with maturities beyond twelve months, as current assets in the accompanying condensed consolidated balance sheets.

The following table summarizes the estimated fair value of the Company's investments, designated as available-for-sale and classified by the contractual maturity date of the investments as of the dates shown:

	June 30, 2015	December 31, 2014
Due within one year or less	$16,961	$9,095
Due after one year through five years	32,189	11,861
Total	$49,150	$20,956

The Company has certain available-for-sale investments in a gross unrealized loss position, all of which have been in such position for less than twelve months. The Company reviews its debt securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other than temporary decline in fair value. The Company considers factors such as the length of time and extent to which the market value has been less than the cost, the financial position and near-term prospects of the issuer and its intent to sell, or whether it is more likely than not the Company will be required to sell the investment before recovery of the investment's amortized-cost basis. If the Company determines that an other than temporary decline exists in one of these investments, the respective investment would be written down to fair value. For debt securities, the portion of the write-down related to credit loss would be recognized to other income, net in the condensed consolidated statements of comprehensive loss. Any portion not related to credit loss would be included in accumulated other comprehensive loss. Because the Company does not intend to sell any investments which have an unrealized loss position at this time, and it is not more likely than not that the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, the Company does not consider the investments with unrealized loss positions to be other than temporarily impaired as of June 30, 2015.

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

The following table shows the fair values and the gross unrealized losses of these available-for-sale investments aggregated by investment category as of June 30, 2015:

	Fair Value	Gross Unrealized Loss
U.S. government agency bonds	$15,058	$(10)
Corporate bonds and commercial paper	20,193	(40)
Total	$35,251	$(50)

The following table shows the fair values and the gross unrealized losses of these available-for-sale investments aggregated by investment category as of December 31, 2014:

	Fair Value	Gross Unrealized Loss
U.S. government agency bonds	$7,508	$(6)
Corporate bonds and commercial paper	6,200	(8)
Total	$13,708	$(14)

5. Debt

In April 2013 the Company entered into a secured credit facility agreement, or Credit Facility, with Wells Fargo Bank, National Association, or Wells Fargo, which the Company and Wells Fargo subsequently amended on March 24, 2014 and again on August 11, 2014. The Credit Facility, as amended, provides for a line of credit of up to $25.0 million, with an accordion feature, or Accordion Feature, allowing the Company to increase its maximum borrowings by up to an additional $25.0 million, subject to certain conditions and limitations, including that borrowings at any time shall be limited to 75% of the Company's trailing twelve-month recurring revenues. Access to the total borrowings available under the Credit Facility is restricted based on covenants related to the Company's minimum liquidity and adjusted EBITDA. Amounts borrowed under the Credit Facility accrue interest, at the Company's election at either: (i) the per annum rate equal to the LIBOR rate plus an applicable margin; or (ii) the current base rate plus the greater of the U.S. Federal Funds rate plus one percentage point, the one-month LIBOR plus one percentage point, or the lending financial institution's prime rate. The Company pays a monthly fee based on the total unused borrowings balance, an annual administrative fee and the initial closing fee, which is paid in three equal annual installments over the first three years of the Credit Facility. The Accordion Feature expires in October 2016, at which time maximum borrowings under the Facility are reduced to $25.0 million, and the Credit Facility matures in April 2017, at which time any outstanding borrowings and accrued interest become payable.

As of June 30, 2015, the Company had no borrowings outstanding and only a secured letter of credit of $3.0 million against the Credit Facility, leaving an available balance of approximately $21.9 million, and the interest rate applicable to the Credit Facility was 3.2%. The Credit Facility is collateralized by substantially all of the Company's assets and requires that the Company maintain certain financial covenants as provided in the Credit Facility. The Company was in compliance with all financial covenants as of June 30, 2015.

Table of Contents
Q2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share amounts and unless otherwise indicated)

6. Commitments and Contingencies
Operating and Capital Lease Commitments
The Company leases office space for its corporate headquarters in Austin, Texas under a non-cancelable operating lease that expires in April 2021 and a regional sales office in Atlanta, Georgia under a non-cancelable operating lease that expires in January 2016. Rent expense under operating leases was $0.3 million for each of the three months ended June 30, 2015 and 2014, respectively, and $0.6 million and $0.5 million for the six months ended June 30, 2015 and 2014, respectively.
The Company has entered into various capital lease arrangements to obtain property and equipment for its data center and corporate operations. These agreements expire over various terms from February 2016 through June 2016 and the leases are secured by the underlying leased property and equipment.
New Facilities Lease Amendment
On May 1, 2015, the Company entered into a First Amendment to Lease Agreement, or the Amendment, amending the Lease Agreement, dated July 18, 2014, with CREF Aspen Lake Building II, LLC, which originally provided for the lease of approximately 70,000 square feet, or the Original Premises, of office space in an office building to be located immediately adjacent to the Company's current headquarters, or the Original Lease, and as amended, or the Lease. Pursuant to the Amendment, the Company has agreed to lease an additional approximately 34,000 square feet commencing on May 1, 2016, and an additional approximately 25,000 square feet commencing January 1, 2017.
The Amendment also extends the term of the Original Lease. The Lease, as amended, provides for phased commencement dates with respect to the Original Premises, with commencement of the first phase covering 55,000 square feet anticipated to occur on October 1, 2015 (the “Initial Commencement Date”), and the remaining 15,000 square feet of the Original Premises commencing nine months thereafter. The actual commencement dates for the Original Premises are subject to timely completion of the building and premises. The term of the Lease, as amended, commences on the Initial Commencement Date and runs until April 30, 2028, with a ten year renewal option, and the rent obligations under the Lease begin with rents of $98 per month, which escalate over the course of the Lease to $311 per month in the final seven months of the Lease's term.

The rent obligations over the term assume an Initial Commencement Date of October 1, 2015, and may be subject to adjustment according to the Lease, including the Company’s right to rent abatement in certain circumstances if the premises are not timely delivered.

Future minimum payments required under capital and operating leases that have initial or remaining non-cancelable lease terms in excess of one year at June 30, 2015 were as follows:

	Capital Leases	Operating Leases
Year Ended December 31,		
2015 (from July 1 to December 31)	$188	$1,388
2016	161	3,654
2017	—	4,659
2018	—	4,750
2019	—	4,850
Thereafter	—	30,796
Total minimum lease payments	349	$50,097
Less: imputed interest	(4)	
Less: current portion	(344)	
Capital lease obligations, net of current portion	$1	

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

Contractual Commitments

The Company has non-cancelable contractual commitments related to third-party products, co-location fees and other product costs. Future minimum contractual commitments that have initial or remaining non-cancelable terms in excess of one year were as follows:

	Contractual Commitments
Year Ended December 31,	
2015 (from July 1 to December 31)	$ 5,205
2016	6,867
2017	5,917
2018	5,672
2019	4,692
Thereafter	4,092
Total commitments	$ 32,445

Legal Proceedings

From time to time, the Company may become involved in legal proceedings arising in the ordinary course of its business. The Company is not presently a party to any legal proceedings that, if determined adversely to the Company, would have a material adverse effect on the Company.

7. Stockholder's Equity

Initial Public Offering

On March 25, 2014, the Company completed its IPO of 7,761 shares of common stock at $13.00 per share. The total shares sold in the IPO included 1,511 shares sold by selling stockholders. After deducting the payment of underwriters' discounts and commissions and offering costs, the net proceeds to the Company from the sale of shares in the offering were approximately $72.6 million.

On April 2, 2014, pursuant to the terms of the Company's IPO, which occurred on March 25, 2014, the underwriters exercised their option to purchase an additional 1,164 shares to cover over-allotments. After deducting the payment of underwriters' discounts and commissions and offering costs, the Company received net proceeds from the sale of shares totaling approximately $13.7 million.

Follow-On Offering

On March 4, 2015, the Company completed its follow-on offering of 5,122 shares of common stock at $19.75 per share, and sold an additional 768 shares of common stock at $19.75 per share when the underwriters exercised their over-allotment option to purchase additional shares. The total shares sold in the follow-on offering and shares sold when the underwriters exercised their over-allotment option included 4,133 shares sold by selling stockholders. After deducting the payment of underwriters' discounts and commissions and offering costs the net proceeds to the Company from the sale of shares in the offering and the sale of shares when the underwriters exercised their over-allotment option was approximately $32.3 million.

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

Conversion of Redeemable Common and Preferred Stock

Immediately prior to the closing of the IPO, which was completed on March 25, 2014, each share of the Company's outstanding preferred, junior preferred and redeemable common stock was converted into one share of undesignated common stock. The following table presents the conversion of all classes of stock on March 25, 2014:

	Prior to Conversion	Subsequent to Conversion
Convertible preferred stock		
Series A	7,908	—
Series B	1,818	—
Series C	2,605	—
Redeemable common stock	3,829	—
Junior preferred stock	1,251	—
Undesignated common stock	—	17,412

8. Stock-Based Compensation

In March 2014, the Company's board of directors approved the 2014 Equity Incentive Plan, or 2014 Plan, under which stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares and units and other cash-based or stock-based awards may be granted to employees, consultants and directors. Shares of common stock that are issued and available for issuance under the 2014 Plan consist of authorized, but unissued or reacquired shares of common stock or any combination thereof.

A total of 1,850 shares of the Company's common stock was initially authorized and reserved for issuance under the 2014 Plan. This reserve will automatically increase on January 1 of each year subsequent to the 2014 Plan's adoption through 2024, by an amount equal to the smaller of (a) 4.5% of the number of shares of common stock issued and outstanding on the immediately preceding December 31, or (b) an amount determined by the Company's board of directors. This reserve is automatically increased to include any outstanding shares under the Company's 2007 Stock Plan, or 2007 Plan, at the time of its termination or issuable upon expiration or termination of options granted under the Company's 2007 Plan that expire or terminate without having been exercised in full. Pursuant to the terms of the 2014 Plan, 107 shares available for future issuance under the 2007 Plan were transferred to the 2014 Plan, providing a total of 1,957 shares of common stock allocated for issuance under the 2014 Plan. On January 1, 2015, 1,561 shares were added to the 2014 Plan in accordance with the annual automatic increase provision of the 2014 Plan, and 102 shares have been returned to the 2014 Plan as a result of termination of options that expired or terminated without having been exercised under the previously terminated 2007 Plan, resulting in a total of 3,620 shares available for issuance under the 2014 Plan. As of June 30, 2015, options to purchase a total of 988 shares of common stock have been granted under the 2014 Plan in the form of stock options, 257 shares have been reserved for the future vesting of restricted stock awards, 15 shares have been returned to the 2014 Plan as a result of termination of options that expired or terminated without having been exercised and restricted stock awards that terminated prior to the awards vesting, and 2,390 shares of common stock remain available for future issuance under the 2014 Plan.

In July 2007, the Company adopted the 2007 Plan under which options or stock purchase rights may be granted to employees, consultants and directors. In February 2014, the board of directors, under the authority granted to it by the 2007 Plan, increased the number of shares available to be granted under the plan by 1,400 shares, and as of June 30, 2015, a total of 9,120 shares of common stock were allocated for issuance under the plan. Upon the completion of the Company's IPO in March 2014, the board of directors terminated the 2007 Plan in connection with the IPO and pursuant to the terms of the 2014 Plan, 107 shares that were available for future issuance under the 2007 Plan at such time were transferred to the 2014 Plan. No shares remain available for future issuance of awards under the 2007 Plan. The 2007 Plan will continue to govern the terms and conditions of all outstanding equity awards granted under the

2007 Plan. Shares of common stock that are issued and were available for issuance under the 2007 Plan consist of authorized, but unissued or reacquired shares of common stock or any combination thereof.

Table of Contents
Q2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands, except per share amounts and unless otherwise indicated)

Stock Options

The following summarizes the assumptions used for estimating the fair value of stock options granted during the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Risk-free interest rate	1.5%	1.6%	1.5%	1.2 - 1.9%
Expected life (in years)	4.3	4.8	4.3 - 4.8	3.8 - 6.6
Expected volatility	46.1%	46.8%	46.1 - 46.9%	45.1 - 46.8%
Dividend yield	—	—	—	—
Weighted-average grant date fair value per share	$9.62	$6.40	$8.37	$5.42

Stock option activity during the six months ended June 30, 2015 was as follows:

	Number of Options	Weighted Average Exercise Price
Balance as of January 1, 2015	6,111	$5.90
Granted	410	20.64
Exercised	(857)	2.01
Forfeited	(58)	8.49
Balance as of June 30, 2015	5,606	$7.55

The summary of stock options outstanding as of June 30, 2015 is as follows:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)
$0.29 - $0.84	884	$0.47	3.3	884	$0.47	3.3
$1.74 - $3.10	909	2.86	6.0	804	2.83	6.0
$4.00 - $7.82	1,156	6.98	5.1	588	6.69	5.1
$8.35	1,682	8.35	5.6	98	8.35	5.6
$13.00 - $24.89	975	17.61	6.4	45	13.69	5.8
	5,606	$7.55	5.3	2,419	$3.33	4.8

The aggregate intrinsic value of stock options exercised during each of the three months ended June 30, 2015 and 2014 was $2.5 million and $0.2 million, respectively, and the aggregate intrinsic value of stock options exercised during each of the six months ended June 30, 2015 and 2014 was $15.8 million and $7.7 million, respectively. The total fair value of stock options vested during each of the three months ended June 30, 2015 and 2014 was $0.6 million and $0.4 million, respectively, and the total fair value of stock options vested during each of the six months ended June 30, 2015 and 2014 was $1.7 million and $0.8 million, respectively. As of June 30, 2015, total unrecognized stock-based compensation expense, adjusted for estimated forfeitures, related to stock options was $13.6 million, which the Company expects to recognize over the next 2.8 years.

Restricted Stock Units

The Company’s restricted stock units vest over a four-year period and upon vesting, the vested shares are issued to the recipient of the restricted stock units.

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

The summary of restricted stock unit activity during the six months ended June 30, 2015 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested as of January 1, 2015	28	$19.44
Granted	229	21.04
Vested	—	—
Forfeited	(2)	23.14
Nonvested as of June 30, 2015	255	$20.84

As of June 30, 2015, total unrecognized stock-based compensation expense, adjusted for estimated forfeitures, related to restricted stock was $4.8 million, which the Company expects to recognize over the next 3.7 years.

9. Income Taxes

In accordance with applicable accounting guidance, the income tax provision for the three and six month periods ended June 30, 2015 is based on the estimated annual effective tax rate for fiscal year 2015. The estimated effective tax rate may be subject to adjustment in subsequent quarterly periods as the estimates of pretax income for the year, along with other items that may affect the rate, change.

For the three and six month periods ended June 30, 2015, the Company's provision for income taxes reflected an effective tax rate of approximately 0.2% and 0.5%, respectively, and for each of the three and six month periods ended June 30, 2014, the Company’s provision for income taxes reflected an effective tax rate of approximately 0.3%. For the three and six months ended June 30, 2015 and 2014, the Company's effective tax rate was lower than the U.S. federal statutory rate primarily due to changes to its valuation allowance.

The Company has significant deferred tax assets related to its net operating loss carryforwards and tax credits and has provided a valuation allowance for the full amount of its deferred tax assets, as it is not more likely than not that any future benefit from deductible temporary differences, net operating loss carryforwards, and tax credit carryforwards will 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 full 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.

The Company had no unrecognized tax benefits as of June 30, 2015. The Company's tax years 2011 through 2014 remain open to examination by the major taxing jurisdictions to which the Company is subject. However, the Company is not currently under examination by any taxing jurisdiction.

10. Subsequent Events

Acquisition of Centrix Solutions, Inc.

On July 31, 2015 Q2 Software Inc., a wholly-owned subsidiary of the Company, entered into a Stock Purchase Agreement, or the Agreement, with Centrix Solutions, Inc., a Nebraska corporation, or Centrix, each of the shareholders of Centrix, or the Sellers, and the Sellers’ agent, pursuant to which the Company agreed to purchase and the Sellers agreed to sell all of the issued and outstanding capital stock of Centrix, or the Stock Purchase. The closing of the Stock Purchase coincided with the signing of the Agreement on July 31, 2015, or the Closing Date.

Pursuant to the Agreement, in exchange for the issued and outstanding capital stock of Centrix, the Company paid $20 million in cash on the Closing Date to the Sellers, subject to a customary working capital adjustment and an amount placed in escrow to secure the indemnification obligations of the Sellers. The former shareholders of Centrix also have the right to receive in the aggregate up to an additional $9 million based upon the achievement of certain milestones and the continued employment of certain shareholders.

The Agreement contains customary representations, warranties and covenants with respect to Centrix and the Sellers, on the one hand, and the Company on the other hand. The Agreement also provides for post-closing indemnification by the Sellers for breaches of representations, warranties and covenants subject to certain limitations on damages.

Amendment to Credit Facility

On July 30, 2015, the Company entered into Amendment Number Three to the Credit Facility with Wells Fargo, or the Amendment. The Amendment modifies the Credit Facility, by and among the Company, the lenders named therein, and Wells Fargo, as administrative agent, to modify a financial covenant to allow for the acquisition of Centrix Solutions, Inc. on July 31, 2015.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that are based on our management's beliefs and assumptions and on information currently available to our management. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. You can identify these statements by words such as "anticipates," "believes," "can," "continue," "could," "estimates," "expects," "intends," "may," "plans," "seeks," "should," "will," "strategy," "future," "likely," or "would" or the negative of these terms or similar expressions. These statements are not guarantees of future performance or development and involve known and unknown risks, uncertainties and other factors that are in some cases beyond our control. All of our forward-looking statements are subject to risks and uncertainties that may cause our actual results to differ materially from our expectations. Factors that may cause such differences include, but are not limited to, the risks described under "Risk Factors" in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission, or the SEC.

Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management's beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q. You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect. We hereby qualify our forward-looking statements by these cautionary statements. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our interim condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and in our other SEC filings, including the audited consolidated financial statements and the accompanying notes for the fiscal year ended December 31, 2014, which are included in our Annual Report on Form 10-K, filed with the SEC on February 12, 2015.

Table of Contents

Overview

We are a leading provider of secure, cloud-based virtual banking solutions. We enable regional and community financial institutions, or RCFIs, to deliver a robust suite of integrated virtual banking services and engage more effectively with their retail and commercial account holders who expect to bank anytime, anywhere and on any device. Our solutions are often the most frequent point of interaction between our RCFI customers and their account holders. As such, we purpose-built our solutions to deliver a compelling, consistent user experience across digital channels and drive the success of our customers by extending their local brands, enabling improved account holder retention and creating incremental sales opportunities.

The effective delivery and management of secure and advanced virtual banking solutions in the complex and heavily-regulated financial services industry requires significant resources, personnel and expertise. We provide virtual banking solutions that are designed to be highly configurable, scalable and adaptable to the specific needs of our RCFI customers. Our solutions deliver to account holders a unified virtual banking experience across online, mobile, voice and tablet channels by leveraging a common platform that integrates our solutions with each other and with our customers' other internal and third-party systems. In addition, we design our solutions and our data center infrastructure to comply with stringent security and technical regulations applicable to financial institutions and to safeguard our customers and their account holders through features such as real-time risk and fraud analytics.

We deliver our solutions to the substantial majority of our customers using a software-as-a-service, or SaaS, model under which our customers pay subscription fees for the use of our solutions. A small portion of our customers host our solutions in their own data centers under term license and maintenance agreements. Our customers have numerous account holders, and those account holders can represent one or more registered users on our solutions. We price our solutions based on the number of solutions purchased by our customers and the number of registered users utilizing our solutions. We earn additional revenues based on the number of bill-pay and certain other transactions that registered users perform on our virtual banking solutions in excess of the levels included in our standard subscription fee. As a result, our revenues grow as our customers buy more solutions from us and increase the number of registered users utilizing our solutions and as those users increase their number of transactions on our solutions.

We have achieved significant growth since our inception. During each of the past three years, our average number of registered users per installed customer has grown, and we have been able to sell additional solutions to existing customers. Our revenues per installed customer and per registered user vary period-to-period based on the length and timing of customer implementations, changes in the average number of registered users per customer, sales of additional solutions to existing customers, changes in the number of transactions on our solutions by registered users and variations among existing customers and new customers with respect to the mix of purchased solutions and related pricing.

We believe we have a significant opportunity to continue to grow our business, and we intend to invest across our organization to increase our revenues and improve our operating efficiencies. These investments will increase our costs on an absolute dollar basis, but the timing and amount of these investments will vary based on the rate at which we expect to add new customers, the implementation and support needs of our customers, our software development plans, our technology infrastructure requirements and the internal needs of our organization. Many of these investments will occur in advance of our realizing any resultant benefit which may make it difficult to determine if we are effectively allocating our resources.

If we are successful in growing our revenues by increasing the number and scope of our customer relationships, we anticipate that greater economies of scale and increased operating leverage will improve our margins over the long term. We also anticipate that increases in the number of registered users for existing customers will improve our margins. However, we do not have any control or influence over whether account holders elect to become registered users of our customers' virtual banking services.

We sell our solutions primarily through our professional sales organization. Our target market of approximately 13,000 RCFIs is well-defined as a result of applicable governmental regulations. As a result, we are able to effectively concentrate our sales and marketing efforts on these readily-identifiable financial institutions. We intend to add sales representatives for both banks and credit unions across the U.S. We also expect to increase our number of sales support and marketing personnel, as well as our investment in marketing initiatives designed to increase awareness of our solutions and generate new customer opportunities.

We seek to help our RCFI customers succeed by providing advanced virtual banking solutions that allow our customers to distinguish themselves from competing financial institutions and better engage with their account holders. We believe that we

Table of Contents

successfully compete in our market due to our deep domain expertise, reputation for innovation and the quality, breadth and integration of our solutions and common platform. We have made significant investments, and intend to increase investments, in technology innovation and software development as we enhance our solutions and platform and increase or expand the number of solutions that we offer to RCFIs and their account holders.

We believe that delivery of consistent, high-quality customer support is a significant driver of RCFI purchasing and renewal decisions. To develop and maintain a reputation for high-quality service, we seek to build deep relationships with our customers through our customer service organization, which we staff with personnel who are motivated by our common mission of using technology to help RCFIs succeed and who are knowledgeable with respect to the regulated and complex nature of the financial services industry. As we grow our business, we must continue to invest in and grow our services organization to support our customers' needs and maintain our reputation.

Recent Events

On July 31, 2015, we completed the acquisition of Centrix Solutions, Inc., or Centrix, a privately-held company that provides financial institutions with products that detect fraud, manage risk and simplify compliance, for total consideration of $20 million in cash. The former shareholders of Centrix also have the right to receive in the aggregate up to an additional $9 million based upon the achievement of certain milestones and the continued employment of certain shareholders. By acquiring Centrix, we furthered our commitment to accelerating the development and adoption of innovative secure banking platform solutions for RCFIs.

We will account for the acquisition using the purchase method of accounting. Accordingly, the financial results of the acquisition will be included in our condensed consolidated financial results from the acquisition date. See Note 10, Subsequent Events, in the Notes to the Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, for further discussion.

Key Operating Measures

In addition to the United States generally accepted accounting principals, or GAAP, measures described below in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Components of Operating Results," we monitor the following operating measures to evaluate growth trends, plan investments and measure the effectiveness of our sales and marketing efforts:

Installed Customers

We define installed customers as the number of customers from which we are currently recognizing revenues. The average size of our installed customers, measured in both registered users per installed customer and revenues per installed customer, has increased over time as our existing installed customers continue to add registered users and buy more solutions from us, and as we add larger RCFIs to our installed customer base. The rate at which we add installed customers varies based on our implementation capacity, the size and unique needs of our customers and the readiness of our customers to implement our solutions. We had 361, 334 and 299 installed customers as of December 31, 2014, 2013 and 2012, respectively.

Registered Users

We define a registered user as an individual related to an account holder of an installed customer who has registered to use one or more of our solutions and has current access to use those solutions as of the last day of the reporting period presented. We price our solutions based on the number of registered users, so as the number of registered users of our solutions increases, our revenues grow. Our average number of registered users per installed customer grows as our existing customers add more registered users and as we add larger RCFIs to our installed customer base. We anticipate that the number of registered users will grow at a faster rate than our number of installed customers. The rate at which our customers add registered users and the incremental revenues we recognize from new registered users vary significantly period-to-period based on the timing of our implementations of new customers and the timing of registration of new users. Our installed customers had approximately 4.3 million, 3.1 million and 2.4 million registered users as of December 31, 2014, 2013 and 2012, respectively. Registered users at June 30, 2015 were 5.7 million compared to 3.9 million at June 30, 2014.

Table of Contents

Revenue Retention Rate

We believe that our ability to retain our installed customers and expand their use of our products and services over time is an indicator of the stability of our revenue base and the long-term value of our customer relationships. We assess our performance in this area using a metric we refer to as our revenue retention rate. We calculate our revenue retention rate as the total revenues in a calendar year from customers who were installed customers as of December 31 of the prior year, expressed as a percentage of the total revenues during the prior year from those installed customers. Our revenue retention rate provides insight into the impact on current year revenues of the number of new customers implemented during the prior year, the timing of our implementation of those new customers in the prior year, growth in the number of registered users and changes in their usage of our solutions, sales of new products and services to our existing installed customers during the current year and customer attrition. The most significant drivers of changes in our revenue retention rate each year have historically been the number of new customers in the prior year and the timing of our implementation of those new customers. The timing of our implementation of new customers in the prior year is significant because we do not start recognizing revenues from new customers until they become installed customers. If implementations are weighted more heavily in the first or second half of the prior year, our revenue retention rate will be lower or higher, respectively. Our use of revenue retention rate has limitations as an analytical tool, and investors should not consider it in isolation. Other companies in our industry may calculate revenue retention rate differently, which reduces its usefulness as a comparative measure. Our revenue retention rate was 122%, 128% and 136% for the years ended December 31, 2014, 2013 and 2012, respectively.

Churn

We utilize churn to monitor the satisfaction of our clients and evaluate the effectiveness of our business strategies. We define churn as the amount of any monthly recurring revenue losses due to customer cancellations and downgrades, net of upgrades and additions of new solutions, during a year, divided by our monthly recurring revenue at the beginning of the year. Cancellations refer to customers that have either stopped using our services completely or remained a customer but terminated a particular service. Downgrades are a result of customers taking less of a particular service or renewing their contract for identical services at a lower price. Our annual churn has ranged from 3.5% to 5.4% over the last four years, and we had annual churn of 4.8%, 3.5% and 3.6% for the years ended December 31, 2014, 2013 and 2012, respectively. Our use of churn has limitations as an analytical tool, and investors should not consider it in isolation. Other companies in our industry may calculate churn differently, which reduces its usefulness as a comparative measure.

Adjusted EBITDA

We define adjusted EBITDA as net loss before depreciation, amortization, loss from discontinued operations, stock-based compensation, provision for income taxes, total other expense, net, unoccupied lease charges and disposal of long-lived assets. We believe that adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results for the following reasons:

- adjusted EBITDA is widely used by investors and securities analysts to measure a company's operating performance without regard to items that can vary substantially from company to company depending upon their financing, capital structures and the method by which assets were acquired;

- our management uses adjusted EBITDA in conjunction with GAAP financial measures for planning purposes, in the preparation of our annual operating budget, as a measure of our operating performance, to assess the effectiveness of our business strategies and to communicate with our board of directors concerning our financial performance;

- adjusted EBITDA provides more consistency and comparability with our past financial performance, facilitates period-to-period comparisons of our operations and also facilitates comparisons with other companies, many of which use similar non-GAAP financial measures to supplement their GAAP results; and

- our investor and analyst presentations include adjusted EBITDA as a supplemental measure of our overall operating performance.

Table of Contents

Adjusted EBITDA should not be considered as an alternative to net loss or any other measure of financial performance calculated and presented in accordance with GAAP. The use of adjusted EBITDA as an analytical tool has limitations such as:

- depreciation and amortization are non-cash charges, and the assets being depreciated or amortized will often have to be replaced in the future and adjusted EBITDA does not reflect cash requirements for such replacements;
- adjusted EBITDA may not reflect changes in, or cash requirements for, our working capital needs or contractual commitments;
- adjusted EBITDA does not reflect the potentially dilutive impact of stock-based compensation;
- adjusted EBITDA does not reflect interest or tax payments that could reduce cash available for use; and
- other companies, including companies in our industry, might calculate adjusted EBITDA or similarly titled measures differently, which reduces their usefulness as comparative measures.

Because of these and other limitations, you should consider adjusted EBITDA together with our GAAP financial measures including cash flow from operations and net loss. The following table presents a reconciliation of net loss to adjusted EBITDA for each of the periods indicated (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Reconciliation of net loss to adjusted EBITDA:				
Net loss	$(4,982)	$(4,683)	$(9,627)	$(10,249)
Depreciation and amortization	1,353	1,031	2,556	2,030
Stock-based compensation expense	1,639	1,068	2,961	1,986
Provision for income taxes	12	15	44	33
Interest (income) expense, net	(12)	119	16	326
Adjusted EBITDA	$(1,990)	$(2,450)	$(4,050)	$(5,874)

Components of Operating Results

Revenues

All of our revenue-generating activities directly relate to the sale, implementation and support of our solutions within a single operating segment. We derive the substantial majority of our revenues from subscription fees for the use of our solutions hosted in our data centers as well as revenues for implementation and customer support services related to our solutions. A small portion of our customers host our solutions in their own data centers under term license and maintenance agreements, and we recognize the corresponding revenues over the term of those customer agreements.

Subscription fees are based on the number of solutions purchased by our customers, the number of registered users and the number of bill-pay and certain other transactions those users conduct using our solutions in excess of the levels included in our standard subscription fee. Subscription fees are billed and recognized monthly over the term of our customer agreements. The initial term of our customer agreements averages over five years, although it varies by customer. We begin recognizing subscription fees on the date a solution is implemented and made available to the customer. The timing of our implementations vary period-to-period based on our implementation capacity, the number of solutions purchased by our customers, the size and unique needs of our customers and the readiness of our customers to implement our solutions. We recognize any related implementation services revenues ratably over the initial agreement term beginning on the date we commence recognizing subscription fees. Amounts that have been invoiced but not paid are recorded in accounts receivable and in revenues or deferred revenues, depending on whether our revenue recognition criteria have been met.

We consider subscription fees to be fixed or determinable unless the fees are subject to refund or adjustment or are not payable within our standard payment terms. In determining whether collection of subscription fees is reasonably assured, we consider financial and other information about customers, such as a customer's current credit-worthiness and payment history over time. Historically, our bad debt expenses have not been significant.

Table of Contents

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 our customers. This includes the costs of our implementation, customer support, data center and customer training personnel, as well as a reclassification of 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 our solutions, the amortization of deferred solution and services costs, co-location facility costs and depreciation of our data center assets, an allocation of general overhead costs and referral fees. We allocate general overhead expenses to all departments based on the number of employees in each department, which we consider to be a fair and representative means of allocation.

The amount of research and development costs reclassified to cost of revenues was $0.2 million and $0.4 million for the three months ended June 30, 2015 and 2014, respectively, and $0.5 million and $0.8 million for the six months ended June 30, 2015 and 2014, respectively.

We capitalize certain personnel costs directly related to the implementation of our solution to the extent those costs are considered to be recoverable from future revenues. We amortize the costs for a particular implementation once revenue recognition commences, and we amortize those implementation costs over the remaining term of the customer agreement. Other costs not directly recoverable from future revenues are expensed in the period incurred. We capitalized implementation costs in the amount of $1.1 million and $1.0 million for the three months ended June 30, 2015 and 2014, respectively, and $2.0 million and $1.8 million for the six months ended June 30, 2015 and 2014, respectively.

We intend to continue to increase our investments in our implementation and customer support teams and technology infrastructure to serve our customers and support our growth. We expect cost of revenues to continue to grow in absolute dollars as we grow our business but to fluctuate as a percentage of revenues based principally on the level and timing of implementation and support activities and other related costs.

Operating Expenses

Operating expenses consist of sales and marketing, research and development and general and administrative expenses. We intend to continue to hire new employees and make other investments to support our anticipated growth. As a result, we expect our operating expenses to increase in absolute dollars but to decrease as a percentage of revenues over the long term as we grow our business.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries and other personnel-related costs, including commissions, benefits, bonuses and stock-based compensation. Additional expenses relate to advertising, lead generation, promotional event programs, corporate communications, travel and allocated overhead.

Sales and marketing expenses as a percentage of total revenues will change in any given period based on several factors including the addition of newly-hired sales professionals, the number and timing of newly-installed customers and the amount of sales commissions expense amortized related to those customers. Commissions are generally capitalized and then amortized over the life of the customer agreement.

Sales and marketing expenses are also impacted by the timing of significant marketing programs such as our annual user conference which we typically hold during the second quarter. We plan to continue investing in sales and marketing by increasing our number of sales and marketing personnel and expanding our sales and marketing activities. We believe these investments will help us build brand awareness, add new customers and expand sales to our existing customers as they continue to buy more solutions from us, the number of registered users utilizing our solutions grows and those users increase the number of transactions on our solutions.

Table of Contents

Research and Development

We believe that continuing to improve and enhance our solutions is essential to maintaining our reputation for innovation and growing our customer base and revenues. Research and development expenses include salaries and personnel-related costs, including benefits, bonuses and stock-based compensation, third-party contractor expenses, software development costs, allocated overhead and other related expenses incurred in developing new solutions and enhancing existing solutions. Research and development expenses are expensed as incurred. To date, software development costs eligible for capitalization have not been significant. Accordingly, we have not capitalized any software development costs, and we do not anticipate capitalizing any such costs in the foreseeable future.

General and Administrative

General and administrative expenses consist primarily of salaries and other personnel-related costs, including benefits, bonuses and stock-based compensation, of our administrative, finance and accounting, information systems, legal and human resources employees. Additional expenses include consulting and professional fees, insurance and travel. Our general and administrative expenses have increased as a result of our operating as a public company since our initial public offering in March 2014, or the IPO. These expenses include costs to comply with Section 404 of the Sarbanes-Oxley Act and other regulations governing public companies, increased costs of directors' and officers' liability insurance, increased professional services expenses and costs associated with enhanced investor relations activities.

Total Other Expense, Net

Total other expense, net, consists primarily of interest income and expense. We earn interest income on our cash, cash equivalents and investments, and expect interest income to increase due to the increase in our cash, cash equivalents and investments as a result of our IPO and follow-on offering. Interest expense consists primarily of the interest incurred on outstanding borrowings under our credit facility with Wells Fargo Bank, National Association, or our Credit Facility, and fees and interest associated with the letter of credit issued through our Credit Facility to our landlord for the security deposit for our corporate headquarters.

Provision for Income Taxes

As a result of our current net operating loss position, income tax expenses consist primarily of state income taxes. We incurred minimal state income taxes for each of the three and six months ended June 30, 2015 and 2014.

Table of Contents

Results of Operations

Condensed Consolidated Statements of Operations Data

The following table sets forth our condensed consolidated statements of operations data for each of the periods indicated (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues	$26,284	$19,158	$50,441	$35,992
Cost of revenues(1)(2)				