

QCR HOLDINGS INC  
Form 10-Q  
August 14, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ending June 30, 2013

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-22208

**QCR HOLDINGS, INC.**

(Exact name of Registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**42-1397595**

(I.R.S. Employer Identification No.)

**3551 7<sup>th</sup> Street, Moline, Illinois 61265**

(Address of principal executive offices, including zip code)

**(309) 743-7761**

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  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  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of August 1, 2013, the Registrant had outstanding 5,807,332 shares of common stock, \$1.00 par value per share.

## QCR HOLDINGS, INC. AND SUBSIDIARIES

INDEX

|   | Page      |
|---|-----------|
|   | Number(s) |
| <u>Part I</u> FINANCIAL INFORMATION   |           |
| Item 1  |           |
| Consolidated Financial Statements (Unaudited)   |           |
| Consolidated Balance Sheets As of June 30, 2013 and December 31, 2012                                     | 2         |
| Consolidated Statements of Income For the Three Months Ended June 30, 2013 and 2012                       | 3         |
| Consolidated Statements of Income For the Six Months Ended June 30, 2013 and 2012                         | 4         |
| Consolidated Statements of Comprehensive Income For the Three and Six Months Ended June 30, 2013 and 2012 | 5         |
| Consolidated Statement of Changes in Stockholders' Equity For the Six Months Ended June 30, 2013 and 2012 | 6         |
| Consolidated Statements of Cash Flows For the Six Months Ended June 30, 2013 and 2012                     | 7         |
| Notes to the Consolidated Financial Statements  | 8-27      |
| Item 2  |           |
| Management's Discussion and Analysis of Financial Condition and Results of Operations                     | 27-54     |
| Item 3  |           |
| Quantitative and Qualitative Disclosures About Market Risk  | 54-55     |
| Item 4  |           |
| Controls and Procedures   | 56        |
| <u>Part II</u> OTHER INFORMATION  |           |
| Item 1  |           |
| Legal Proceedings   | 57        |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|            |   |    |
|------------|---|----|
| Item 1A    | Risk Factors  | 57 |
| Item 2     | Unregistered Sales of Equity Securities and Use of Proceeds | 57 |
| Item 3     | Defaults upon Senior Securities                             | 57 |
| Item 4     | Mine Safety Disclosures                                     | 57 |
| Item 5     | Other Information   | 57 |
| Item 6     | Exhibits  | 58 |
| Signatures |   | 59 |

**QCR HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS (UNAUDITED)****As of June 30, 2013 and December 31, 2012**

|   | June 30,<br>2013 | December 31,<br>2012 |
|---|------------------|----------------------|
| <b>ASSETS</b>                                       |                  |                      |
| Cash and due from banks                             | \$44,316,890     | \$61,568,446         |
| Federal funds sold                                  | 16,666,000       | 26,560,000           |
| Interest-bearing deposits at financial institutions | 34,573,775       | 22,359,490           |
| Securities held to maturity, at amortized cost      | 105,201,749      | 72,079,385           |
| Securities available for sale, at fair value        | 598,265,400      | 530,159,986          |
| Total securities                                    | 703,467,149      | 602,239,371          |
| Loans receivable held for sale                      | 2,083,075        | 4,577,233            |
| Loans/leases receivable held for investment         | 1,528,643,027    | 1,282,810,406        |
| Gross loans/leases receivable                       | 1,530,726,102    | 1,287,387,639        |
| Less allowance for estimated losses on loans/leases | (21,156,379 )    | (19,925,204 )        |
| Net loans/leases receivable                         | 1,509,569,723    | 1,267,462,435        |
| Premises and equipment, net                         | 39,064,663       | 31,262,390           |
| Goodwill  | 3,222,688        | 3,222,688            |
| Core deposit intangible                             | 3,440,076        | -                    |
| Bank-owned life insurance                           | 51,078,588       | 45,620,489           |
| Restricted investment securities                    | 16,875,975       | 15,747,850           |
| Other real estate owned, net                        | 3,858,629        | 3,954,538            |
| Other assets  | 20,637,321       | 13,732,795           |
| Total assets  | \$2,446,771,477  | \$2,093,730,492      |

**LIABILITIES AND STOCKHOLDERS' EQUITY****LIABILITIES**

## Deposits:

|                                 |               |               |
|---------------------------------|---------------|---------------|
| Noninterest-bearing             | \$493,963,650 | \$450,659,723 |
| Interest-bearing                | 1,222,816,260 | 923,454,377   |
| Total deposits                  | 1,716,779,910 | 1,374,114,100 |
| Short-term borrowings           | 157,186,204   | 171,082,961   |
| Federal Home Loan Bank advances | 209,949,500   | 202,350,000   |
| Other borrowings                | 142,644,062   | 138,239,762   |
| Junior subordinated debentures  | 40,210,175    | 36,085,000    |
| Other liabilities               | 34,555,713    | 31,424,848    |
| Total liabilities               | 2,301,325,564 | 1,953,296,671 |

**STOCKHOLDERS' EQUITY**

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|   |                 |                 |
|---|-----------------|-----------------|
| Preferred stock, \$1 par value; shares authorized 250,000 June 2013 - 54,867 shares issued and outstanding December 2012 - 54,867 shares issued and outstanding                           | 54,867          | 54,867          |
| Common stock, \$1 par value; shares authorized 20,000,000 June 2013 - 5,918,313 shares issued and 5,797,067 outstanding December 2012 - 5,039,448 shares issued and 4,918,202 outstanding | 5,918,313       | 5,039,448       |
| Additional paid-in capital  | 91,514,136      | 78,912,791      |
| Retained earnings   | 58,786,271      | 53,326,542      |
| Accumulated other comprehensive income (loss)   | (9,221,164 )    | 4,706,683       |
| Less treasury stock, June 30, 2013 and December 2012 - 121,246 common shares, at cost   | (1,606,510 )    | (1,606,510 )    |
| Total stockholders' equity  | 145,445,913     | 140,433,821     |
| Total liabilities and stockholders' equity  | \$2,446,771,477 | \$2,093,730,492 |

See Notes to Consolidated Financial Statements (Unaudited)

**QCR HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)****Three Months Ended June 30,**

|   | 2013          | 2012          |
|---|---------------|---------------|
| Interest and dividend income:                             |               |               |
| Loans/leases, including fees                              | \$ 16,369,605 | \$ 15,973,109 |
| Securities:   |               |               |
| Taxable   | 2,629,832     | 2,765,779     |
| Nontaxable  | 944,100       | 538,285       |
| Interest-bearing deposits at financial institutions       | 61,724        | 92,577        |
| Restricted investment securities                          | 131,151       | 164,778       |
| Federal funds sold  | 2,989         | -             |
| Total interest and dividend income                        | 20,139,401    | 19,534,528    |
| Interest expense:   |               |               |
| Deposits  | 1,176,855     | 1,629,517     |
| Short-term borrowings                                     | 103,435       | 77,287        |
| Federal Home Loan Bank advances                           | 1,726,622     | 1,829,120     |
| Other borrowings  | 1,162,893     | 1,224,083     |
| Junior subordinated debentures                            | 261,544       | 259,028       |
| Total interest expense                                    | 4,431,349     | 5,019,035     |
| Net interest income                                       | 15,708,052    | 14,515,493    |
| Provision for loan/lease losses                           | 1,520,137     | 1,048,469     |
| Net interest income after provision for loan/lease losses | 14,187,915    | 13,467,024    |
| Noninterest income:                                       |               |               |
| Trust department fees                                     | 1,197,181     | 852,234       |
| Investment advisory and management fees                   | 695,094       | 679,326       |
| Deposit service fees                                      | 1,054,223     | 875,073       |
| Gains on sales of residential real estate loans           | 246,621       | 271,333       |
| Gains on sales government guaranteed portions of loans    | 765,738       | 610,988       |
| Securities gains  | 16,460        | 104,600       |
| Earnings on bank-owned life insurance                     | 423,883       | 358,660       |
| Bargain purchase gain on Community National acquisition   | 1,841,385     | -             |
| Credit card issuing fees, net of processing costs         | 85,017        | 142,173       |
| Losses on other real estate owned, net                    | (83,339 )     | (389,465 )    |
| Other   | 706,493       | 562,587       |
| Total noninterest income                                  | 6,948,756     | 4,067,509     |
| Noninterest expense:                                      |               |               |
| Salaries and employee benefits                            | 9,186,233     | 8,255,639     |
| Occupancy and equipment expense                           | 1,586,841     | 1,364,912     |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |             |             |
|--|-------------|-------------|
| Professional and data processing fees  | 1,438,753   | 1,126,877   |
| FDIC and other insurance   | 627,390     | 576,215     |
| Loan/lease expense   | 251,868     | 263,166     |
| Advertising and marketing  | 412,041     | 344,100     |
| Postage and telephone  | 257,611     | 236,942     |
| Stationery and supplies  | 150,718     | 135,211     |
| Bank service charges   | 284,345     | 198,492     |
| Acquisition costs  | 432,326     | -           |
| Other-than-temporary impairment losses on securities                             | -           | 62,400      |
| Other  | 606,223     | 545,129     |
| Total noninterest expense  | 15,234,349  | 13,109,083  |
| Net income before income taxes   | 5,902,322   | 4,425,450   |
| Federal and state income tax expense   | 1,857,091   | 1,152,071   |
| Net income   | \$4,045,231 | \$3,273,379 |
| Less: Net income attributable to noncontrolling interests                        | -           | 201,223     |
| Net income attributable to QCR Holdings, Inc.                                    | \$4,045,231 | \$3,072,156 |
| Less: Preferred stock dividends  | 810,838     | 935,786     |
| Net income attributable to QCR Holdings, Inc. common stockholders                | \$3,234,393 | \$2,136,370 |
| Earnings per common share attributable to QCR Holdings, Inc. common shareholders |             |             |
| Basic  | \$0.60      | \$0.44      |
| Diluted  | \$0.59      | \$0.44      |
| Weighted average common shares outstanding                                       | 5,393,062   | 4,835,773   |
| Weighted average common and common equivalent shares outstanding                 | 5,497,275   | 4,901,853   |
| Cash dividends declared per common share   | \$0.04      | \$0.04      |

See Notes to Consolidated Financial Statements (Unaudited)



**QCR HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)****Six Months Ended June 30,**

|   | 2013         | 2012         |
|---|--------------|--------------|
| Interest and dividend income:                             |              |              |
| Loans/leases, including fees                              | \$31,458,432 | \$31,943,946 |
| Securities:   |              |              |
| Taxable   | 5,090,281    | 5,571,593    |
| Nontaxable  | 1,746,573    | 934,111      |
| Interest-bearing deposits at financial institutions       | 121,478      | 212,582      |
| Restricted investment securities                          | 256,256      | 246,100      |
| Federal funds sold  | 3,863        | -            |
| Total interest and dividend income                        | 38,676,883   | 38,908,332   |
| Interest expense:   |              |              |
| Deposits  | 2,293,646    | 3,345,257    |
| Short-term borrowings                                     | 167,702      | 142,231      |
| Federal Home Loan Bank advances                           | 3,459,434    | 3,693,441    |
| Other borrowings  | 2,353,648    | 2,481,476    |
| Junior subordinated debentures                            | 503,084      | 526,981      |
| Total interest expense                                    | 8,777,514    | 10,189,386   |
| Net interest income                                       | 29,899,369   | 28,718,946   |
| Provision for loan/lease losses                           | 2,577,919    | 1,828,915    |
| Net interest income after provision for loan/lease losses | 27,321,450   | 26,890,031   |
| Noninterest income:                                       |              |              |
| Trust department fees                                     | 2,236,851    | 1,735,966    |
| Investment advisory and management fees                   | 1,304,435    | 1,200,788    |
| Deposit service fees                                      | 1,962,046    | 1,779,479    |
| Gains on sales of residential real estate loans           | 537,772      | 562,766      |
| Gains on sales government guaranteed portions of loans    | 1,610,962    | 718,645      |
| Security gains  | 16,460       | 104,600      |
| Earnings on bank-owned life insurance                     | 862,570      | 797,062      |
| Bargain purchase gain on Community National acquisition   | 1,841,385    | -            |
| Credit card issuing fees, net of processing costs         | 134,971      | 269,188      |
| Losses on other real estate owned, net                    | (529,969 )   | (578,669 )   |
| Other   | 2,175,302    | 1,434,562    |
| Total noninterest income                                  | 12,152,785   | 8,024,387    |
| Noninterest expense:                                      |              |              |
| Salaries and employee benefits                            | 17,928,916   | 16,380,319   |
| Occupancy and equipment expense                           | 3,015,711    | 2,717,175    |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |             |             |
|--|-------------|-------------|
| Professional and data processing fees  | 2,578,814   | 2,277,067   |
| FDIC and other insurance   | 1,183,301   | 1,157,071   |
| Loan/lease expense   | 496,959     | 481,900     |
| Advertising and marketing  | 676,609     | 620,116     |
| Postage and telephone  | 476,302     | 525,182     |
| Stationery and supplies  | 261,388     | 278,177     |
| Bank service charges   | 559,840     | 398,221     |
| Acquisition costs  | 788,904     | -           |
| Other-than-temporary impairment losses on securities                             | -           | 62,400      |
| Other  | 1,226,105   | 949,535     |
| Total noninterest expense  | 29,192,849  | 25,847,163  |
| Net income before income taxes   | 10,281,386  | 9,067,255   |
| Federal and state income tax expense   | 2,971,011   | 2,391,027   |
| Net income   | \$7,310,375 | \$6,676,228 |
| Less: Net income attributable to noncontrolling interests                        | -           | 367,254     |
| Net income attributable to QCR Holdings, Inc.                                    | \$7,310,375 | \$6,308,974 |
| Less: Preferred stock dividends  | 1,621,675   | 1,874,411   |
| Net income attributable to QCR Holdings, Inc. common stockholders                | \$5,688,700 | \$4,434,563 |
| Earnings per common share attributable to QCR Holdings, Inc. common shareholders |             |             |
| Basic  | \$1.10      | \$0.92      |
| Diluted  | \$1.08      | \$0.91      |
| Weighted average common shares outstanding                                       | 5,160,327   | 4,818,090   |
| Weighted average common and common equivalent shares outstanding                 | 5,265,809   | 4,867,628   |
| Cash dividends declared per common share   | \$0.04      | \$0.04      |

See Notes to Consolidated Financial Statements (Unaudited)

**QCR HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)****Three and Six Months Ended June 30,**

|  | Three Months Ended June 30, |             |
|--|-----------------------------|-------------|
|  | 2013                        | 2012        |
| Net income   | \$4,045,231                 | \$3,273,379 |
| Other comprehensive income (loss):   |                             |             |
| Unrealized gains (losses) on securities available for sale:                  |                             |             |
| Unrealized holding gains (losses) arising during the period before tax       | (21,238,019)                | 2,114,026   |
| Less reclassification adjustment for gains included in net income before tax | 16,460                      | 104,600     |
|  | (21,254,479)                | 2,009,426   |
| Tax expense (benefit)  | (8,162,990 )                | 768,381     |
| Other comprehensive income (loss), net of tax                                | (13,091,489)                | 1,241,045   |
| Comprehensive income (loss) attributable to QCR Holdings, Inc.               | \$(9,046,258 )              | \$4,514,424 |

|  | Six Months Ended June 30, |              |
|--|---------------------------|--------------|
|  | 2013                      | 2012         |
| Net income   | \$ 7,310,375              | \$ 6,676,228 |
| Other comprehensive loss:  |                           |              |
| Unrealized losses on securities available for sale:                          |                           |              |
| Unrealized holding losses arising during the period before tax               | (22,594,571 )             | (346,545 )   |
| Less reclassification adjustment for gains included in net income before tax | 16,460                    | 104,600      |
|  | (22,611,031 )             | (451,145 )   |
| Tax benefit  | (8,683,184 )              | (174,955 )   |
|  | (13,927,847 )             | (276,190 )   |

Other comprehensive  
loss, net of tax

|   |    |            |   |    |           |
|---|----|------------|---|----|-----------|
| Comprehensive<br>income (loss)<br>attributable to QCR<br>Holdings, Inc. | \$ | (6,617,472 | ) | \$ | 6,400,038 |
|---|----|------------|---|----|-----------|

See Notes to Consolidated Financial Statements (Unaudited)

## QCR HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

Six Months Ended June 30, 2013 and 2012

|  | Preferred<br>Stock | Common<br>Stock    | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Non-<br>controlling<br>Interest | Treasury<br>Stock    | Total                |
|--|--------------------|--------------------|----------------------------------|----------------------|---|---------------------------------|----------------------|----------------------|
| <b>Balance</b>   |                    |                    |                                  |                      |   |                                 |                      |                      |
| <b>December 31, 2012</b>   | <b>\$54,867</b>    | <b>\$5,039,448</b> | <b>\$78,912,791</b>              | <b>\$53,326,542</b>  | <b>\$4,706,683</b>  | <b>\$-</b>                      | <b>\$(1,606,510)</b> | <b>\$140,433,821</b> |
| Net income   | -                  | -                  | -                                | 3,265,144            | -   | -                               | -                    | 3,265,144            |
| Other comprehensive loss, net of tax   | -                  | -                  | -                                | -                    | (836,358 )  | -                               | -                    | (836,358 )           |
| Preferred cash dividends declared  | -                  | -                  | -                                | (810,837 )           | -   | -                               | -                    | (810,837 )           |
| Proceeds from issuance of 5,884 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan | -                  | 5,884              | 63,487                           | -                    | -   | -                               | -                    | 69,371               |
| Proceeds from issuance of 19,278 shares of common stock as a result of stock options exercised                               | -                  | 19,278             | 153,550                          | -                    | -   | -                               | -                    | 172,828              |
| Exchange of 7,048 shares of common stock in connection with stock  | -                  | (7,048 )           | (111,628 )                       | -                    | -   | -                               | -                    | (118,676 )           |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|   |                 |                    |                     |                     |                    |            |                      |                      |
|---|-----------------|--------------------|---------------------|---------------------|--------------------|------------|----------------------|----------------------|
| options exercised   |                 |                    |                     |                     |                    |            |                      |                      |
| Stock compensation expense  | -               | -                  | 293,798             |                     |                    |            |                      | 293,798              |
| Tax benefit of nonqualified stock options exercised   | -               | -                  | 35,251              | -                   | -                  | -          | -                    | 35,251               |
| Restricted stock awards   | -               | 16,798             | (16,798 )           | -                   | -                  | -          | -                    | -                    |
| Exchange of 16,798 shares of common stock in connection with restricted stock vested, net                               | -               | (16,798 )          | (289,113 )          | -                   | -                  | -          | -                    | (305,911 )           |
| <b>Balance</b>  |                 |                    |                     |                     |                    |            |                      |                      |
| <b>March 31, 2013</b>   | <b>\$54,867</b> | <b>\$5,057,562</b> | <b>\$79,041,338</b> | <b>\$55,780,849</b> | <b>\$3,870,325</b> | <b>\$-</b> | <b>\$(1,606,510)</b> | <b>\$142,198,431</b> |
| Net income  | -               | -                  | -                   | 4,045,231           | -                  | -          | -                    | 4,045,231            |
| Other comprehensive loss, net of tax  | -               | -                  | -                   | -                   | (13,091,489)       | -          | -                    | (13,091,489 )        |
| Common cash dividends declared, \$0.04 per share  | -               | -                  | -                   | (228,971 )          | -                  | -          | -                    | (228,971 )           |
| Preferred cash dividends declared   | -               | -                  | -                   | (810,838 )          | -                  | -          | -                    | (810,838 )           |
| Issuance of 834,715 shares of common stock as a result of the acquisition of Community National Bancorporation, net     | -               | 834,715            | 12,181,894          | -                   | -                  | -          | -                    | 13,016,609           |
| Proceeds from issuance of 9,560 shares of common stock as a result of stock purchased under the Employee Stock Purchase | -               | 9,560              | 104,221             | -                   | -                  | -          | -                    | 113,781              |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|   |                 |                    |                     |                     |                       |            |                      |                      |
|---|-----------------|--------------------|---------------------|---------------------|-----------------------|------------|----------------------|----------------------|
| Plan  |                 |                    |                     |                     |                       |            |                      |                      |
| Proceeds from issuance of 3,769 shares of common stock as a result of stock options exercised | -               | 3,769              | 33,070              | -                   | -                     | -          | -                    | 36,839               |
| Stock compensation expense  | -               | -                  | 162,123             |                     |                       |            |                      | 162,123              |
| Tax benefit of nonqualified stock options exercised   | -               | -                  | 4,197               | -                   | -                     | -          | -                    | 4,197                |
| Restricted stock awards   | -               | 12,707             | (12,707 )           | -                   | -                     | -          | -                    | -                    |
| <b>Balance June 30, 2013</b>  | <b>\$54,867</b> | <b>\$5,918,313</b> | <b>\$91,514,136</b> | <b>\$58,786,271</b> | <b>\$(9,221,164 )</b> | <b>\$-</b> | <b>\$(1,606,510)</b> | <b>\$145,445,913</b> |

|  | Preferred Stock | Common Stock       | Additional Paid-In Capital | Retained Earnings   | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interests | Treasury Stock       | Total                |
|--|-----------------|--------------------|----------------------------|---------------------|---|--------------------------|----------------------|----------------------|
| <b>Balance December 31, 2011</b>   | <b>\$65,090</b> | <b>\$4,879,435</b> | <b>\$89,702,533</b>        | <b>\$44,585,902</b> | <b>\$4,754,714</b>                            | <b>\$2,051,538</b>       | <b>\$(1,606,510)</b> | <b>\$144,432,700</b> |
| Net income   | -               | -                  | -                          | 3,236,818           | -   | 166,031                  | -                    | 3,402,849            |
| Other comprehensive loss, net of tax   | -               | -                  | -                          | -                   | (1,517,235)                                   | -                        | -                    | (1,517,235)          |
| Preferred cash dividends declared  | -               | -                  | -                          | (938,625 )          | -   | -                        | -                    | (938,625)            |
| Proceeds from issuance of 7,767 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan | -               | 7,767              | 55,566                     | -                   | -   | -                        | -                    | 63,333               |
|  | -               | 276                | 2,374                      | -                   | -   | -                        | -                    | 2,650                |

|  |                 |                    |                     |                     |                    |                    |                      |                    |
|--|-----------------|--------------------|---------------------|---------------------|--------------------|--------------------|----------------------|--------------------|
| Proceeds from issuance of 276 shares of common stock as a result of stock options exercised  |                 |                    |                     |                     |                    |                    |                      |                    |
| Exchange of 576 shares of common stock in connection with payroll taxes for restricted stock | -               | (576 )             | (2,103 )            | -                   | -                  | -                  | -                    | (2,679)            |
| Stock compensation expense   | -               | -                  | 326,245             |                     |                    |                    |                      | 326,245            |
| Restricted stock awards  | -               | 57,770             | (57,770 )           | -                   | -                  | -                  | -                    | -                  |
| Other adjustments to noncontrolling interests  | -               | -                  | -                   | -                   | -                  | (2,066 )           | -                    | (2,066)            |
| <b>Balance March 31, 2012</b>  | <b>\$65,090</b> | <b>\$4,944,672</b> | <b>\$90,026,845</b> | <b>\$46,884,095</b> | <b>\$3,237,479</b> | <b>\$2,215,503</b> | <b>\$(1,606,510)</b> | <b>\$145,767,1</b> |
| Comprehensive income:  |                 |                    |                     |                     |                    |                    |                      |                    |
| Net income   | -               | -                  | -                   | 3,072,156           | -                  | 201,223            | -                    | 3,273,379          |
| Other comprehensive income, net of tax   | -               | -                  | -                   | -                   | 1,241,045          | -                  | -                    | 1,241,045          |
| <b>Comprehensive income</b>  |                 |                    |                     |                     |                    |                    |                      | <b>4,514,424</b>   |
| Common cash dividends declared, \$0.04 per share   | -               | -                  | -                   | (189,091 )          | -                  | -                  | -                    | (189,091)          |
| Preferred cash dividends declared  | -               | -                  | -                   | (935,786 )          | -                  | -                  | -                    | (935,786)          |
| Redemption of 10,223 shares of Series F Noncumulative Perpetual Preferred Stock              | (10,223)        | -                  | (10,212,777)        | -                   | -                  | -                  | -                    | (10,223,0          |
| Proceeds from issuance of 10,856 shares of common stock                                      | -               | 10,856             | 78,055              | -                   | -                  | -                  | -                    | 88,911             |



|   |                 |                    |                     |                     |                    |                    |                      |                    |
|---|-----------------|--------------------|---------------------|---------------------|--------------------|--------------------|----------------------|--------------------|
| as a result of<br>stock purchased<br>under the<br>Employee Stock<br>Purchase Plan<br>Proceeds from<br>issuance of<br>9,090 shares of<br>common stock  | -               | 9,090              | 79,902              | -                   | -                  | -                  | -                    | 88,992             |
| as a result of<br>stock options<br>exercised<br>Exchange of<br>611 shares of<br>common stock<br>in connection<br>with stock<br>options<br>exercised<br>Proceeds from<br>exercise of<br>warrants to<br>purchase 4,300<br>shares of<br>common stock<br>issued in<br>conjunction<br>with the Series<br>A Subordinated<br>Notes<br>Stock<br>compensation<br>expense<br>Other<br>adjustments to<br>noncontrolling<br>interests | -               | (611 )             | (7,125 )            | -                   | -                  | -                  | -                    | (7,736)            |
|   | -               | 4,300              | 38,700              | -                   | -                  | -                  | -                    | 43,000             |
|   | -               | -                  | 177,269             | -                   | -                  | -                  | -                    | 177,269            |
|   | -               | -                  | -                   | -                   | -                  | (2,065 )           | -                    | (2,065)            |
| <b>Balance June<br/>30, 2012</b>  | <b>\$54,867</b> | <b>\$4,968,307</b> | <b>\$80,180,869</b> | <b>\$48,831,374</b> | <b>\$4,478,524</b> | <b>\$2,414,661</b> | <b>\$(1,606,510)</b> | <b>\$139,322,0</b> |

See Notes to Consolidated Financial Statements (Unaudited)

**QCR HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****Six Months Ended June 30,**

|   | 2013            | 2012            |
|---|-----------------|-----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                 |                 |
| Net income  | \$7,310,375     | \$6,676,228     |
| Adjustments to reconcile net income to net cash provided by operating activities: |                 |                 |
| Depreciation  | 1,280,550       | 1,198,809       |
| Provision for loan/lease losses   | 2,577,919       | 1,828,915       |
| Stock-based compensation expense  | 455,921         | 503,514         |
| Losses on other real estate owned, net  | 529,969         | 578,669         |
| Amortization of premiums on securities, net                                       | 1,972,391       | 2,050,358       |
| Securities gains  | (16,460 )       | (104,600 )      |
| Other-than-temporary impairment losses on securities                              | -               | 62,400          |
| Loans originated for sale   | (52,272,708 )   | (51,881,417 )   |
| Proceeds on sales of loans  | 56,915,600      | 52,645,621      |
| Gains on sales of residential real estate loans, net                              | (537,772 )      | (562,766 )      |
| Gains on sales of government guaranteed portions of loans, net                    | (1,610,962 )    | (718,645 )      |
| Increase in cash value of bank-owned life insurance                               | (862,570 )      | (797,062 )      |
| Bargain purchase gain on Community National acquisition                           | (1,841,385 )    | -               |
| Decrease (increase) in other assets   | 6,556,417       | (6,150,757 )    |
| Decrease in other liabilities   | (797,225 )      | (734,316 )      |
| Net cash provided by operating activities   | \$19,660,060    | \$4,594,951     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                 |                 |
| Net decrease in federal funds sold  | 22,229,000      | 17,160,000      |
| Net increase in interest-bearing deposits at financial institutions               | (10,189,746 )   | (1,701,827 )    |
| Proceeds from sales of other real estate owned                                    | 303,766         | 814,071         |
| Activity in securities portfolio:   |                 |                 |
| Purchases   | (238,534,747)   | (311,369,517)   |
| Calls, maturities and redemptions   | 124,663,560     | 201,683,047     |
| Paydowns  | 27,762,742      | 14,403,547      |
| Sales   | 6,167,531       | 19,215,075      |
| Activity in restricted investment securities:                                     |                 |                 |
| Purchases   | (4,818,750 )    | (1,003,850 )    |
| Redemptions   | 4,950,000       | 1,033,100       |
| Net increase in loans/leases originated and held for investment                   | (51,708,379 )   | (16,077,756 )   |
| Purchase of premises and equipment  | (950,802 )      | (898,464 )      |
| Net cash received from Community National acquisition                             | 3,025,073       | -               |
| Net cash used in investing activities   | \$(117,100,752) | \$(76,742,574 ) |

(Continued)

7

---

**QCR HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) - continued****Six Months Ended June 30,**

|   | 2013            | 2012          |
|---|-----------------|---------------|
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                 |               |
| Net decrease in deposits  | 87,620,739      | 110,012,711   |
| Net decrease in short-term borrowings   | (13,896,757 )   | (28,137,412 ) |
| Activity in Federal Home Loan Bank advances:  |                 |               |
| Advances  | 119,000,000     | 14,000,000    |
| Calls and maturities  | (111,400,500)   | (15,000,000 ) |
| Proceeds from other borrowings term note  | 10,000,000      | -             |
| Advance (payment) on 364-day revolving note, net  | (5,600,000 )    | 2,000,000     |
| Repayment of Community National's other borrowings at acquisition   | (3,950,000 )    | -             |
| Payment of cash dividends on common and preferred stock   | (1,813,624 )    | (2,278,183 )  |
| Redemption of 10,223 shares of Series F Noncumulative Perpetual Preferred Stock   | -               | (10,223,000 ) |
| Proceeds from issuance of common stock, net   | 229,278         | 276,471       |
| Net cash provided by financing activities   | \$80,189,136    | \$70,650,587  |
| Net decrease in cash and due from banks   | (17,251,556 )   | (1,497,036 )  |
| Cash and due from banks, beginning  | 61,568,446      | 53,136,710    |
| Cash and due from banks, ending   | \$44,316,890    | \$51,639,674  |
| <b>Supplemental disclosure of cash flow information, cash payments for:</b>   |                 |               |
| Interest  | \$8,897,240     | \$10,343,656  |
| Income/franchise taxes  | \$1,031,120     | \$881,000     |
| <b>Supplemental schedule of noncash investing activities:</b>   |                 |               |
| Change in accumulated other comprehensive income (loss), unrealized losses on securities available for sale, net                        | \$(13,927,847 ) | \$(276,190 )  |
| Exchange of shares of common stock in connection with payroll taxes for restricted stock and in connection with stock options exercised | \$(424,587 )    | \$(10,415 )   |
| Transfers of loans to other real estate owned   | \$187,500       | \$2,143,017   |
| <b>Supplemental disclosure of cash flow information for Community National acquisition:</b>   |                 |               |
| <b>Fair value of assets acquired:</b>   |                 |               |
| Cash and due from banks *   | \$9,286,757     | \$-           |
| Federal funds sold  | 12,335,000      | -             |
| Interest-bearing deposits at financial institutions   | 2,024,539       | -             |
| Securities available for sale   | 45,853,826      | -             |
| Loans/leases receivable held for investment, net  | 195,658,486     | -             |
| Premises and equipment, net   | 8,132,021       | -             |
| Core deposit intangible   | 3,440,076       | -             |
| Bank-owned life insurance   | 4,595,529       | -             |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |               |     |
|--|---------------|-----|
| Restricted investment securities           | 1,259,375     | -   |
| Other real estate owned                    | 550,326       | -   |
| Other assets                               | 5,178,583     | -   |
| Total assets acquired                      | \$288,314,518 | \$- |
| <b>Fair value of liabilities assumed:</b>  |               |     |
| Deposits                                   | \$255,045,071 | \$- |
| Other borrowings                           | 3,950,000     | -   |
| Junior subordinated debentures             | 4,125,175     | -   |
| Other liabilities                          | 3,911,053     | -   |
| Total liabilities assumed                  | \$267,031,299 | \$- |
| Net assets acquired                        | \$21,283,219  | \$- |
| <b>Consideration paid:</b>                 |               |     |
| Cash paid *                                | \$6,261,684   | \$- |
| Issuance of 834,715 shares of common stock | 13,180,150    | -   |
| Total consideration paid                   | \$19,441,834  | \$- |
| Bargain purchase gain                      | \$1,841,385   | \$- |

\* Net cash received at closing totaled \$3,025,073

See Notes to Consolidated Financial Statements (Unaudited)

Part I

Item 1

QCR HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2013

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation: The interim unaudited consolidated financial statements contained herein should be read in conjunction with the audited consolidated financial statements and accompanying notes to the consolidated financial statements for the fiscal year ended December 31, 2012, including QCR Holdings, Inc.'s (the "Company") Form 10-K filed with the Securities and Exchange Commission on March 11, 2013. Accordingly, footnote disclosures, which would substantially duplicate the disclosures contained in the audited consolidated financial statements, have been omitted.

The financial information of the Company included herein has been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and has been prepared pursuant to the rules and regulations for reporting on Form 10-Q and Rule 10-01 of Regulation S-X. Such information reflects all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the periods presented. Any differences appearing between the numbers presented in financial statements and management's discussion and analysis are due to rounding. The results of the interim period ended June 30, 2013, are not necessarily indicative of the results expected for the year ending December 31, 2013.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries which include four commercial banks: Quad City Bank & Trust Company ("QCBT"), Cedar Rapids Bank & Trust Company ("CRBT"), Rockford Bank & Trust Company ("RB&T"), and Community National Bank ("CNB"). On May 13, 2013, the Company acquired Community National Bancorporation ("Community National") and CNB. See Note 2 for additional information on the acquisition. QCBT, CRBT, and RB&T are all state-chartered commercial banks; while CNB is a national-chartered commercial bank. The Company also engages in direct financing lease contracts through its wholly-owned equity investment by QCBT in m2 Lease Funds, LLC ("m2 Lease Funds"). All material intercompany transactions and balances have been eliminated in consolidation.

Recent accounting developments: In December 2011, the Financial Accounting Standards Board (“FASB”) issued ASU 2011-11, *Balance Sheet (Topic 210) - Disclosures about Offsetting Assets and Liabilities*. ASU 2011-11 requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet, and instruments and transactions subject to an agreement similar to a master netting arrangement. In January 2013, FASB issued ASU 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. Both ASU 2011-11 and ASU 2013-01 were effective for annual periods beginning on or after January 1, 2013, and interim periods within those annual periods. Adoption did not have a significant impact on the Company’s consolidated financial statements.

In February 2013, FASB issued ASU 2013-02, *Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income*. ASU 2013-02 supersedes and replaces the presentation requirements for reclassifications out of accumulated other comprehensive income (“AOCI”) in ASUs 2011-05 and 2011-12, which were adopted by the Company during the current year. The amendments require an entity to provide information about the amounts reclassified out of AOCI by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For other amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required. Adoption did not have a significant impact on the Company’s consolidated financial statements.

In July 2013, FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Management is in the process of evaluating the impact of ASU 2013-11 on the Company’s consolidated financial statements.

Reclassifications: Certain amounts in the prior year financial statements have been reclassified, with no effect on net income or stockholders’ equity, to conform with the current period presentation.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 2 – ACQUISITION OF COMMUNITY NATIONAL BANCORPORATION AND COMMUNITY NATIONAL BANK

On May 13, 2013, the Company acquired 100% of Community National's outstanding common stock for aggregate consideration totaling \$19,441,834, which consisted of 834,715 shares of QCR Holdings common stock valued at \$13,180,150 and cash of \$6,261,684. Community National was the bank holding company providing bank and bank related services through its wholly-owned bank subsidiary, CNB. CNB is a commercial bank headquartered in Waterloo, Iowa and serves Waterloo, Cedar Falls, and Mason City, Iowa and Austin, Minnesota. As a de novo bank, CNB commenced its operations in 1997. The Company has operated CNB as a separate banking charter since the acquisition.

The Company accounted for the business combination under the acquisition method of accounting in accordance with Accounting Standards Codification (“ASC”) 805, “Business Combinations” (“ASC 805”). The Company recognized the full fair value of the assets acquired and liabilities assumed at the acquisition date, net of applicable income tax effects. The excess of fair value of net assets over the carrying value is recorded as bargain purchase gain which is included in noninterest income on the statement of income. The market value adjustments are accreted or amortized on a level yield basis over the expected term. Additionally, the Company recorded a core deposit intangible totaling \$3,440,076 which is the portion of the acquisition purchase price which represents the value assigned to the existing deposit base. The core deposit intangible has a finite life and is amortized by the straight-line method over the estimated useful life of the deposits.

The Company's acquired loans were recorded at fair value at the acquisition date and no separate valuation allowance was established. The initial fair value was determined with the assistance of a valuation specialist that discounted expected cash flows at appropriate rates. The discount rates were based on market rates for new originations of comparable loans and did not include a factor for credit losses as that was included in the estimated cash flows. ASC Topic 310-30, “Loans and Debt Securities Acquired with Deteriorated Credit Quality”, applies to loans acquired in a transfer with evidence of deterioration of credit quality for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable. If both conditions exist, the Company determines whether to account for each loan individually or whether such loans will be assembled into pools based on common risk characteristics such as credit score, loan type, and origination date. Based on this evaluation, the Company determined that the loans acquired from the Community National acquisition subject to ASC Topic 310-30 would be accounted for individually. At the acquisition date, the historical cost and fair value of these loans totaled \$3,033,022



and \$2,207,891, respectively.

The Company considered expected prepayments and estimated the total expected cash flows, which includes undiscounted expected principal and interest. The excess of that amount over the fair value of the loan is referred to as accretable yield. Accretable yield is recognized as interest income on a constant yield basis over the expected life of the loan. The excess of the contractual cash flows over expected cash flows is referred to as nonaccretable difference and is not accreted into income. Over the life of the loan, the Company continues to estimate expected cash flows. Subsequent decreases in expected cash flows are recognized as impairments in the current period through the allowance for loan losses. Subsequent increases in cash flows to be collected are first used to reverse any existing valuation allowance and any remaining increase is recognized prospectively through an adjustment of the loan's yield over its remaining life. At the acquisition date, accretable yield totaled \$4,128,315 and nonaccretable yield totaled \$397,894.

The Company assumed junior subordinated debentures with principal outstanding of \$6,702,000 and fair value of \$4,125,175 after a discount of \$2,576,825. The initial fair value was determined with the assistance of a valuation specialist that discounted expected cash flows at appropriate rates. The discount will be accreted as interest expense on a level yield basis over the expected remaining term of the junior subordinated debentures.

Results of the operations of the acquired business are included in the income statement from the effective date of the acquisition.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

The fair values of the assets acquired and liabilities assumed including the consideration paid and resulting bargain purchase gain is as follows:

|   | As of         |
|---|---------------|
|   | May 13, 2013  |
| <b>ASSETS</b>                                       |               |
| Cash and due from banks                             | \$9,286,757   |
| Federal funds sold                                  | 12,335,000    |
| Interest-bearing deposits at financial institutions | 2,024,539     |
| Securities available for sale                       | 45,853,826    |
| Loans/leases receivable, net                        | 195,658,486   |
| Premises and equipment                              | 8,132,021     |
| Core deposit intangible                             | 3,440,076     |
| Bank-owned life insurance                           | 4,595,529     |
| Restricted investment securities                    | 1,259,375     |
| Other real estate owned                             | 550,326       |
| Other assets  | 5,178,583     |
| Total assets acquired                               | \$288,314,518 |
| <b>LIABILITIES</b>                                  |               |
| Deposits  | \$255,045,071 |
| Other borrowings                                    | 3,950,000     |
| Junior subordinated debentures                      | 4,125,175     |
| Other liabilities                                   | 3,911,053     |
| Total liabilities assumed                           | \$267,031,299 |
| Net assets acquired                                 | \$21,283,219  |
| <b>CONSIDERATION PAID:</b>                          |               |
| Cash  | \$6,261,684   |
| Issuance of 834,715 shares of common stock          | 13,180,150    |
| Total consideration paid                            | \$19,441,834  |
| Bargain purchase gain                               | \$1,841,385   |

In order to fund the cash portion of the consideration and pay off the \$3,950,000 of Community National term debt at acquisition, the Company borrowed \$4,400,000 on its 364-day revolving credit note. The outstanding balance on the 364-day revolving credit note totaled \$10,000,000 until maturity at June 26, 2013. Upon maturity, the credit facility was restructured whereby the \$10,000,000 of outstanding debt was restructured into a secured 3-year term note with principal due quarterly and interest due monthly where the interest is calculated at the effective LIBOR rate plus 3.00% per annum (3.30% at June 30, 2013). Additionally, as part of the restructure, the Company maintained a secured 364-day revolving credit note with availability of \$10,000,000 where the interest is calculated at the effective LIBOR rate plus 2.50% per annum. At June 30, 2013, the Company had not borrowed on this revolving credit note and had the full amount available.

The current note agreement contains certain covenants that place restrictions on additional debt and stipulate minimum capital and various asset quality and operating ratios.

The Company recorded a bargain purchase gain on the acquisition totaling \$1,841,385 as the market value of the net assets acquired from Community National exceeded the total consideration paid. The consideration paid approximated a slight premium to the book value of Community National's net assets at acquisition. The net impact of the market value adjustments resulted in a net increase to Community National's net assets. The more significant market value adjustments were the core deposit intangible (\$3,440,076) and the discount on the trust preferred securities (\$2,576,825), as previously discussed.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Unaudited combined pro forma operating results for the three and six months ended June 30, 2013 and 2012, giving effect to the Community National acquisition as if it had occurred as of January 1, 2012, are as follows:

|  | Three months ended |              | Six months ended |              |
|--|--------------------|--------------|------------------|--------------|
|  | June 30,           |              | June 30,         |              |
|  | 2013               | 2012         | 2013             | 2012         |
| Interest income  | \$21,275,698       | \$22,056,089 | \$42,364,836     | \$43,963,029 |
| Noninterest income   | \$5,511,338        | \$4,885,073  | \$11,339,794     | \$9,472,182  |
| Net income   | \$1,945,117        | \$3,610,172  | \$5,476,700      | \$7,153,770  |
| Net income attributable to QCR Holdings, Inc. common stockholders                | \$1,134,279        | \$2,473,163  | \$3,855,025      | \$4,912,105  |
| Earnings per common share attributable to QCR Holdings, Inc. common stockholders |                    |              |                  |              |
| Basic  | \$0.21             | \$0.46       | \$0.71           | \$0.91       |
| Diluted  | \$0.21             | \$0.45       | \$0.70           | \$0.89       |

The pro forma results exclude the impact of the bargain purchase gain of \$1,841,385. Additionally, the pro forma results do not purport to be indicative of the results of operations that actually would have resulted had the acquisition occurred on January 1, 2012 or of future results of operations of the consolidated entities.

On June 4, 2013, CNB signed a definitive agreement to sell certain assets and liabilities of the two Mason City branches of CNB. CNB will sell deposits of approximately \$62 million and loans of approximately \$26 million. The proposed transaction, which is subject to regulatory approval and customary closing conditions, is expected to be completed in the fourth quarter of 2013.

On July 8, 2013, CNB signed a definitive agreement to sell certain assets and liabilities of the two Austin, Minnesota branches of CNB. CNB will sell deposits of approximately \$37 million and loans of approximately \$31 million. The proposed transaction, which is subject to regulatory approval and customary closing conditions, is expected to be completed in the fourth quarter of 2013.

Based on the premiums the Company expects to receive at the closing of these two transactions, net of the core deposit intangible associated with the Austin and Mason City branches totaling approximately \$1.4 million, the Company anticipates recognizing a pre-tax gain of approximately \$1.5 million in the fourth quarter of 2013. The gain is a premium on the deposits; therefore, it is dependent upon the amount of deposits sold at closing.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 3 – INVESTMENT SECURITIES

The amortized cost and fair value of investment securities as of June 30, 2013 and December 31, 2012 are summarized as follows:

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>(Losses) | Fair<br>Value  |
|--|-------------------|------------------------------|---------------------------------|----------------|
| <b>June 30, 2013:</b>                              |                   |                              |                                 |                |
| Securities held to maturity:                       |                   |                              |                                 |                |
| Municipal securities                               | \$ 104,551,749    | \$ 152,017                   | \$(5,853,172 )                  | \$ 98,850,594  |
| Other securities                                   | 650,000           | -                            | -                               | 650,000        |
|  | \$ 105,201,749    | \$ 152,017                   | \$(5,853,172 )                  | \$ 99,500,594  |
| Securities available for sale:                     |                   |                              |                                 |                |
| U.S. govt. sponsored agency securities             | \$ 395,513,928    | \$ 238,359                   | \$(14,836,396)                  | \$ 380,915,891 |
| Residential mortgage-backed and related securities | 179,822,160       | 1,807,687                    | (3,084,293 )                    | 178,545,554    |
| Municipal securities                               | 36,478,946        | 1,102,715                    | (752,811 )                      | 36,828,850     |
| Trust preferred securities                         | 86,200            | 130,000                      | -                               | 216,200        |
| Other securities                                   | 1,362,730         | 396,393                      | (218 )                          | 1,758,905      |
|  | \$ 613,263,964    | \$ 3,675,154                 | \$(18,673,718)                  | \$ 598,265,400 |
| <b>December 31, 2012:</b>                          |                   |                              |                                 |                |
| Securities held to maturity:                       |                   |                              |                                 |                |
| Municipal securities                               | \$ 71,429,385     | \$ 997,969                   | \$(71,648 )                     | \$ 72,355,706  |
| Other securities                                   | 650,000           | -                            | -                               | 650,000        |
|  | \$ 72,079,385     | \$ 997,969                   | \$(71,648 )                     | \$ 73,005,706  |
| Securities available for sale:                     |                   |                              |                                 |                |
| U.S. govt. sponsored agency securities             | \$ 336,570,995    | \$ 2,198,655                 | \$(160,279 )                    | \$ 338,609,371 |
| Residential mortgage-backed and related securities | 160,035,196       | 3,736,821                    | (170,914 )                      | 163,601,103    |
| Municipal securities                               | 24,508,015        | 1,696,555                    | (18,834 )                       | 26,185,736     |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|                            |               |             |              |               |
|----------------------------|---------------|-------------|--------------|---------------|
| Trust preferred securities | 86,200        | 53,200      | -            | 139,400       |
| Other securities           | 1,347,113     | 300,732     | (23,469 )    | 1,624,376     |
|                            | \$522,547,519 | \$7,985,963 | \$(373,496 ) | \$530,159,986 |

The Company's held to maturity municipal securities consist largely of private issues of municipal debt. The municipalities are located within the Midwest with a portion in or adjacent to the communities of QCBT and CRBT. The municipal debt investments are underwritten using specific guidelines with ongoing monitoring.

The Company's residential mortgage-backed and related securities portfolio consists entirely of government sponsored or government guaranteed securities. The Company has not invested in commercial mortgage-backed securities or pooled trust preferred securities.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of June 30, 2013 and December 31, 2012, are summarized as follows:

|  | Less than 12 Months |                 | 12 Months or More |             | Total         |                 |
|--|---------------------|-----------------|-------------------|-------------|---------------|-----------------|
|  | Fair                | Gross           | Fair              | Gross       | Fair          | Gross           |
|  | Value               | Unrealized      | Value             | Unrealized  | Value         | Unrealized      |
|  |                     | Losses          |                   | Losses      |               | Losses          |
| <b>June 30, 2013:</b>                              |                     |                 |                   |             |               |                 |
| Securities held to maturity:                       |                     |                 |                   |             |               |                 |
| Municipal securities                               | \$88,263,477        | \$(5,853,172 )  | \$-               | \$-         | \$88,263,477  | \$(5,853,172 )  |
| Securities available for sale:                     |                     |                 |                   |             |               |                 |
| U.S. govt. sponsored agency securities             | \$351,380,421       | \$(14,836,396 ) | \$-               | \$-         | \$351,380,421 | \$(14,836,396 ) |
| Residential mortgage-backed and related securities | 102,856,893         | (3,054,077 )    | 2,065,109         | (30,216 )   | 104,922,002   | (3,084,293 )    |
| Municipal securities                               | 14,212,014          | (752,811 )      | -                 | -           | 14,212,014    | (752,811 )      |
| Other securities                                   | -                   | -               | 241,345           | (218 )      | 241,345       | (218 )          |
|  | \$468,449,328       | \$(18,643,284 ) | \$2,306,454       | \$(30,434 ) | \$470,755,782 | \$(18,673,718 ) |
| <b>December 31, 2012:</b>                          |                     |                 |                   |             |               |                 |
| Securities held to maturity:                       |                     |                 |                   |             |               |                 |
| Municipal securities                               | \$4,282,352         | \$(71,648 )     | \$-               | \$-         | \$4,282,352   | \$(71,648 )     |
| Securities available for sale:                     |                     |                 |                   |             |               |                 |
| U.S. govt. sponsored agency securities             | \$55,621,718        | \$(160,279 )    | \$-               | \$-         | \$55,621,718  | \$(160,279 )    |
| Residential mortgage-backed and related securities | 29,324,928          | (170,914 )      | -                 | -           | 29,324,928    | (170,914 )      |
| Municipal securities                               | 1,039,625           | (18,834 )       | -                 | -           | 1,039,625     | (18,834 )       |
| Other securities                                   | -                   | -               | 217,500           | (23,469 )   | 217,500       | (23,469 )       |
|  | \$85,986,271        | \$(350,027 )    | \$217,500         | \$(23,469 ) | \$86,203,771  | \$(373,496 )    |



At June 30, 2013, the investment portfolio included 533 securities. Of this number, 350 securities had current unrealized losses with aggregate depreciation of less than 5% from the total amortized cost basis. Of these 350, only three had unrealized losses for twelve months or more and the amount of the unrealized losses was only \$30,434. All of the debt securities in unrealized loss positions are considered acceptable credit risks. Based upon an evaluation of the available evidence, including the recent changes in market rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these debt securities are temporary. In addition, the Company does not intend to sell these securities and it is not more-likely-than-not that the Company will be required to sell these debt securities before their anticipated recovery. At June 30, 2013 and December 31, 2012, equity securities represented less than 1% of the total portfolio.

The Company did not recognize other-than-temporary impairment on any debt securities for the three and six months ended June 30, 2013 and 2012.

The Company did not recognize other-than-temporary impairment on any equity securities for the three and six months ended June 30, 2013. During the second quarter of 2012, the Company's evaluation determined that one privately held equity security experienced a decline in fair value that was other-than-temporary. As a result, the Company wrote down the value of this security and recognized a loss in the amount of \$62,400. The Company did not recognize other-than-temporary impairment on any equity securities during the first quarter of 2012.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

All sales of securities for the three and six months ended June 30, 2013 and 2012, respectively, were from securities identified as available-for-sale. Information on proceeds received, as well as pre-tax gross gains from sales on those securities is as follows:

|  | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | June 30,<br>2013   | June 30,<br>2012 | June 30,<br>2013 | June 30,<br>2012 |
| Proceeds from sales of securities            | \$6,167,531        | \$19,215,075     | \$6,167,531      | \$19,215,075     |
| Pre-tax gross gains from sales of securities | 16,460             | 104,600          | 16,460           | 104,600          |

The amortized cost and fair value of securities as of June 30, 2013 by contractual maturity are shown below. Expected maturities of residential mortgage-backed and related securities may differ from contractual maturities because the residential mortgages underlying the residential mortgage-backed and related securities may be called or prepaid without any penalties. Therefore, these securities are not included in the maturity categories in the following table. "Other securities" are excluded from the maturity categories as there is no fixed maturity date for those securities.

|  | Amortized<br>Cost | Fair Value    |
|--|-------------------|---------------|
| Securities held to maturity:                       |                   |               |
| Due in one year or less                            | \$1,785,269       | \$1,784,577   |
| Due after one year through five years              | 10,214,545        | 10,126,030    |
| Due after one year through five years              | 93,201,935        | 87,589,987    |
|  | \$105,201,749     | \$99,500,594  |
| Securities available for sale:                     |                   |               |
| Due in one year or less                            | \$5,334,543       | \$5,329,272   |
| Due after one year through five years              | 33,501,636        | 33,339,485    |
| Due after five years                               | 393,242,895       | 379,292,184   |
|  | \$432,079,074     | \$417,960,941 |
| Residential mortgage-backed and related securities | 179,822,160       | 178,545,554   |
| Other securities                                   | 1,362,730         | 1,758,905     |

\$613,263,964 \$598,265,400

Portions of the U.S. government sponsored agency securities and municipal securities contain call options, at the discretion of the issuer, to terminate the security at predetermined dates prior to the stated maturity, summarized as follows:

|  | Amortized<br>Cost | Fair Value    |
|--|-------------------|---------------|
| Securities held to maturity:           |                   |               |
| Municipal securities                   | \$69,862,451      | \$65,051,896  |
| Securities available for sale:         |                   |               |
| U.S. govt. sponsored agency securities | 355,831,837       | 342,070,506   |
| Municipal securities                   | 22,786,922        | 22,750,101    |
|  | \$378,618,759     | \$364,820,607 |

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 4 – LOANS/LEASES RECEIVABLE

The composition of the loan/lease portfolio as of June 30, 2013 and December 31, 2012 is presented as follows:

|   | As of June 30,<br>2013 | As of<br>December 31,<br>2012 |
|---|------------------------|-------------------------------|
| Commercial and industrial loans                           | \$470,416,356          | \$394,244,252                 |
| Commercial real estate loans                              |                        |                               |
| Owner-occupied commercial real estate                     | 266,927,092            | 204,911,308                   |
| Commercial construction, land development, and other land | 48,013,677             | 44,962,381                    |
| Other non owner-occupied commercial real estate           | 409,065,105            | 344,105,550                   |
|   | 724,005,874            | 593,979,239                   |
| Direct financing leases *                                 | 114,754,757            | 103,685,656                   |
| Residential real estate loans **                          | 143,093,342            | 115,581,573                   |
| Installment and other consumer loans                      | 74,568,755             | 76,720,514                    |
|   | 1,526,839,084          | 1,284,211,234                 |
| Plus deferred loan/lease origination costs, net of fees   | 3,887,018              | 3,176,405                     |
|   | 1,530,726,102          | 1,287,387,639                 |
| Less allowance for estimated losses on loans/leases       | (21,156,379 )          | (19,925,204 )                 |
|   | \$1,509,569,723        | \$1,267,462,435               |
| <br>  |                        |                               |
| * Direct financing leases:                                |                        |                               |
| Net minimum lease payments to be received                 | \$129,915,909          | \$117,719,380                 |
| Estimated unguaranteed residual values of leased assets   | 1,344,853              | 1,095,848                     |
| Unearned lease/residual income                            | (16,506,005 )          | (15,129,572 )                 |
|   | 114,754,757            | 103,685,656                   |
| Plus deferred lease origination costs, net of fees        | 4,318,828              | 3,907,140                     |
|   | 119,073,585            | 107,592,796                   |
| Less allowance for estimated losses on leases             | (2,187,605 )           | (1,990,395 )                  |

\$116,885,980    \$105,602,401

Management performs an evaluation of the estimated unguaranteed residual values of leased assets on an annual basis, at a minimum. The evaluation consists of discussions with reputable and current vendors and management's expertise and understanding of the current states of particular industries to determine informal valuations of the equipment. As necessary and where available, management will utilize valuations by independent appraisers. The large majority of leases with residual values contain a lease options rider which requires the lessee to pay the residual value directly, finance the payment of the residual value, or extend the lease term to pay the residual value. In these cases, the residual value is protected and the risk of loss is minimal. There were no losses related to residual values for the three and six months ended June 30, 2013 and 2012.

\*\*Includes residential real estate loans held for sale totaling \$2,083,075 and \$4,577,233 as of June 30, 2013, and December 31, 2012, respectively.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

The aging of the loan/lease portfolio by classes of loans/leases as of June 30, 2013 and December 31, 2012 is presented as follows:

| Classes of Loans/Leases                                   | As of June 30, 2013 |                     |                     |                                   |                         | Total           |
|---|---------------------|---------------------|---------------------|-----------------------------------|-------------------------|-----------------|
|   | Current             | 30-59 Days Past Due | 60-89 Days Past Due | Accruing Past Due 90 Days or More | Nonaccrual Loans/Leases |                 |
| Commercial and Industrial                                 | \$465,430,639       | \$1,349,678         | \$262,201           | \$ -                              | \$3,373,838             | \$470,416,356   |
| Commercial Real Estate Owner-Occupied                     | 259,065,675         | 193,040             | 77,828              | -                                 | 7,590,549               | 266,927,092     |
| Commercial Construction, Land Development, and Other Land | 46,609,905          | -                   | 270,796             | -                                 | 1,132,976               | 48,013,677      |
| Other Non Owner-Occupied Commercial Real Estate           | 392,880,893         | 1,851,491           | 1,695,414           | -                                 | 12,637,307              | 409,065,105     |
| Direct Financing Leases                                   | 112,797,068         | 998,918             | 258,197             | -                                 | 700,574                 | 114,754,757     |
| Residential Real Estate                                   | 141,298,113         | 369,329             | 149,816             | -                                 | 1,276,084               | 143,093,342     |
| Installment and Other Consumer                            | 73,194,203          | 283,495             | 16,932              | 3,248                             | 1,070,877               | 74,568,755      |
|   | \$1,491,276,496     | \$5,045,951         | \$2,731,184         | \$3,248                           | \$27,782,205            | \$1,526,839,084 |
| As a percentage of total loan/lease portfolio             | 97.67               | % 0.33              | % 0.18              | % 0.00                            | % 1.82                  | % 100.00        |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| Classes of Loans/Leases                                   | As of December 31, 2012 |                     |                     |                                   |                         |                 |
|---|-------------------------|---------------------|---------------------|-----------------------------------|-------------------------|-----------------|
|   | Current                 | 30-59 Days Past Due | 60-89 Days Past Due | Accruing Past Due 90 Days or More | Nonaccrual Loans/Leases | Total           |
| Commercial and Industrial                                 | \$388,825,307           | \$3,724,506         | \$9,940             | \$120,000                         | \$1,564,499             | \$394,244,252   |
| Commercial Real Estate                                    |                         |                     |                     |                                   |                         |                 |
| Owner-Occupied Commercial Real Estate                     | 204,141,070             | 142,993             | -                   | -                                 | 627,245                 | 204,911,308     |
| Commercial Construction, Land Development, and Other Land | 42,180,819              | -                   | -                   | -                                 | 2,781,562               | 44,962,381      |
| Other Non Owner-Occupied Commercial Real Estate           | 332,644,532             | 86,986              | 1,111,856           | -                                 | 10,262,176              | 344,105,550     |
| Direct Financing Leases                                   | 101,635,084             | 877,210             | 174,560             | -                                 | 998,802                 | 103,685,656     |
| Residential Real Estate                                   | 111,993,859             | 2,254,730           | 283,466             | -                                 | 1,049,518               | 115,581,573     |
| Installment and Other Consumer                            | 75,711,203              | 301,025             | 20,112              | 39,481                            | 648,693                 | 76,720,514      |
|   | \$1,257,131,874         | \$7,387,450         | \$1,599,934         | \$159,481                         | \$17,932,495            | \$1,284,211,234 |
| As a percentage of total loan/lease portfolio             | 97.89                   | % 0.58              | % 0.12              | % 0.01                            | % 1.40                  | % 100.00        |

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Nonperforming loans/leases by classes of loans/leases as of June 30, 2013 and December 31, 2012 is presented as follows:

| Classes of Loans/Leases                                   | As of June 30, 2013               |                           |   |                                  |        | Percentage of Total Nonperforming Loans/Leases |
|---|-----------------------------------|---------------------------|---|----------------------------------|--------|--|
|   | Accruing Past Due 90 Days or More | Nonaccrual Loans/Leases * | Troubled Debt Restructurings - Accruing | Total Nonperforming Loans/Leases |        |  |
| Commercial and Industrial Commercial Real Estate          | \$-                               | \$ 3,373,838              | \$ 893,875                              | \$ 4,267,713                     | 14.24  | %  |
| Owner-Occupied Commercial Real Estate                     | -                                 | 7,590,549                 | 47,958                                  | 7,638,507                        | 25.49  | %  |
| Commercial Construction, Land Development, and Other Land | -                                 | 1,132,976                 | 300,000                                 | 1,432,976                        | 4.78   | %  |
| Other Non Owner-Occupied Commercial Real Estate           | -                                 | 12,637,307                | 269,327                                 | 12,906,634                       | 43.08  | %  |
| Direct Financing Leases                                   | -                                 | 700,574                   | -                                       | 700,574                          | 2.34   | %  |
| Residential Real Estate                                   | -                                 | 1,276,084                 | 296,436                                 | 1,572,520                        | 5.25   | %  |
| Installment and Other Consumer                            | 3,248                             | 1,070,877                 | 370,000                                 | 1,444,125                        | 4.82   | %  |
|   | \$3,248                           | \$ 27,782,205             | \$ 2,177,596                            | \$ 29,963,049                    | 100.00 | %  |

\*Nonaccrual loans/leases includes \$7,740,416 of troubled debt restructurings, including \$145,914 in commercial and industrial loans, \$6,934,208 in commercial real estate loans, \$379,769 in residential real estate loans, and \$280,525 in installment loans.

| Classes of Loans/Leases | As of December 31, 2012           |                            |   |                                  |  | Percentage of Total Nonperforming Loans/Leases |
|-------------------------|-----------------------------------|----------------------------|---|----------------------------------|--|--|
|                         | Accruing Past Due 90 Days or More | Nonaccrual Loans/Leases ** | Troubled Debt Restructurings - Accruing | Total Nonperforming Loans/Leases |  |  |



Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |            |               |              |               |        |   |
|--|------------|---------------|--------------|---------------|--------|---|
| Commercial and Industrial<br>Commercial Real Estate          | \$ 120,000 | \$ 1,564,499  | \$ 184,084   | \$ 1,868,583  | 7.36   | % |
| Owner-Occupied Commercial Real<br>Estate                     | -          | 627,245       | -            | 627,245       | 2.47   | % |
| Commercial Construction, Land<br>Development, and Other Land | -          | 2,781,562     | 1,016,023    | 3,797,585     | 14.96  | % |
| Other Non Owner-Occupied Commercial<br>Real Estate           | -          | 10,262,176    | 5,820,765    | 16,082,941    | 63.34  | % |
| Direct Financing Leases                                      | -          | 998,802       | -            | 998,802       | 3.93   | % |
| Residential Real Estate                                      | -          | 1,049,518     | 167,739      | 1,217,257     | 4.79   | % |
| Installment and Other Consumer                               | 39,481     | 648,693       | 110,982      | 799,156       | 3.15   | % |
|  | \$ 159,481 | \$ 17,932,495 | \$ 7,299,593 | \$ 25,391,569 | 100.00 | % |

\*\*Nonaccrual loans/leases includes \$5,658,781 of troubled debt restructurings, including \$99,804 in commercial and industrial loans, \$5,173,589 in commercial real estate loans, \$64,722 in residential real estate loans, and \$320,666 in installment loans.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Changes in the allowance for estimated losses on loans/leases by portfolio segment for the three and six months ended June 30, 2013 and 2012, respectively, are presented as follows:

## Three Months Ended June 30, 2013

|  | Commercial<br>and<br>Industrial | Commercial<br>Real Estate | Direct<br>Financing<br>Leases | Residential<br>Real Estate | Installment<br>and Other<br>Consumer | Total        |
|--|---------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|--------------|
| Balance, beginning                                   | \$4,466,264                     | \$12,188,953              | \$2,296,523                   | \$966,336                  | \$851,386                            | \$20,769,462 |
| Provisions charged to expense                        | 348,298                         | 672,077                   | 340,137                       | 195,774                    | (36,149 )                            | 1,520,137    |
| Loans/leases charged off                             | (38,685 )                       | (820,725 )                | (449,622 )                    | -                          | (23,875 )                            | (1,332,907 ) |
| Recoveries on loans/leases<br>previously charged off | 14,951                          | 150,192                   | 567                           | 3,231                      | 30,746                               | 199,687      |
| Balance, ending                                      | \$4,790,828                     | \$12,190,497              | \$2,187,605                   | \$1,165,341                | \$822,108                            | \$21,156,379 |

## Three Months Ended June 30, 2012

|  | Commercial<br>and<br>Industrial | Commercial<br>Real Estate | Direct<br>Financing<br>Leases | Residential<br>Real<br>Estate | Installment<br>and Other<br>Consumer | Total        |
|--|---------------------------------|---------------------------|-------------------------------|-------------------------------|--------------------------------------|--------------|
| Balance, beginning                                   | \$4,585,467                     | \$10,855,442              | \$1,366,528                   | \$963,157                     | \$1,236,050                          | \$19,006,644 |
| Provisions charged to expense                        | (683,718 )                      | 1,275,510                 | 258,469                       | 23,557                        | 174,651                              | 1,048,469    |
| Loans/leases charged off                             | (79,334 )                       | (1,427,987 )              | (27,543 )                     | -                             | (199,935 )                           | (1,734,799 ) |
| Recoveries on loans/leases<br>previously charged off | 358,377                         | 7,026                     | 13,545                        | -                             | 25,273                               | 404,221      |
| Balance, ending                                      | \$4,180,792                     | \$10,709,991              | \$1,610,999                   | \$986,714                     | \$1,236,039                          | \$18,724,535 |

## Six Months Ended June 30, 2013

|  | Commercial<br>and<br>Industrial | Commercial<br>Real Estate | Direct<br>Financing<br>Leases | Residential<br>Real Estate | Installment<br>and Other<br>Consumer | Total |
|--|---------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|-------|
|--|---------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|-------|

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|   |             |              |             |             |             |              |
|---|-------------|--------------|-------------|-------------|-------------|--------------|
| Balance, beginning                                | \$4,531,545 | \$11,069,502 | \$1,990,395 | \$1,070,328 | \$1,263,434 | \$19,925,204 |
| Provisions charged to expense                     | 260,491     | 1,786,371    | 718,760     | 204,673     | (392,376 )  | 2,577,919    |
| Loans/leases charged off                          | (38,900 )   | (820,725 )   | (522,671 )  | (112,891 )  | (140,487 )  | (1,635,674 ) |
| Recoveries on loans/leases previously charged off | 37,692      | 155,349      | 1,121       | 3,231       | 91,537      | 288,930      |
| Balance, ending                                   | \$4,790,828 | \$12,190,497 | \$2,187,605 | \$1,165,341 | \$822,108   | \$21,156,379 |

Six Months Ended June 30, 2012

|   | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total        |
|---|---------------------------|------------------------|-------------------------|-------------------------|--------------------------------|--------------|
| Balance, beginning                                | \$4,878,006               | \$10,596,958           | \$1,339,496             | \$704,946               | \$1,269,856                    | \$18,789,262 |
| Provisions charged to expense                     | (774,618 )                | 1,533,374              | 573,915                 | 286,525                 | 209,719                        | 1,828,915    |
| Loans/leases charged off                          | (455,742 )                | (1,427,987 )           | (343,264 )              | (4,757 )                | (327,801 )                     | (2,559,551 ) |
| Recoveries on loans/leases previously charged off | 533,146                   | 7,646                  | 40,852                  | -                       | 84,265                         | 665,909      |
| Balance, ending                                   | \$4,180,792               | \$10,709,991           | \$1,610,999             | \$986,714               | \$1,236,039                    | \$18,724,535 |

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

The allowance for estimated losses on loans/leases by impairment evaluation and by portfolio segment as of June 30, 2013 and December 31, 2012 is presented as follows:

|   | As of June 30, 2013          |                           |                               |                            |                                      |                 |   |
|---|------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|-----------------|---|
|   | Commercial<br>and Industrial | Commercial<br>Real Estate | Direct<br>Financing<br>Leases | Residential<br>Real Estate | Installment<br>and Other<br>Consumer | Total           |   |
| Allowance<br>for<br>loans/leases<br>individually<br>evaluated for<br>impairment | \$1,039,328                  | \$4,303,557               | \$116,077                     | \$90,235                   | \$35,927                             | \$5,585,124     |   |
| Allowance<br>for<br>loans/leases<br>collectively<br>evaluated for<br>impairment | 3,751,500                    | 7,886,940                 | 2,071,528                     | 1,075,106                  | 786,181                              | 15,571,255      |   |
|   | \$4,790,828                  | \$12,190,497              | \$2,187,605                   | \$1,165,341                | \$822,108                            | \$21,156,379    |   |
| Loans/leases<br>individually<br>evaluated for<br>impairment                     | \$2,907,420                  | \$18,873,036              | \$700,574                     | \$1,572,520                | \$1,440,877                          | \$25,494,427    |   |
| Loans/leases<br>collectively<br>evaluated for<br>impairment                     | 467,508,936                  | 705,132,838               | 114,054,183                   | 141,520,822                | 73,127,878                           | 1,501,344,657   |   |
|   | \$470,416,356                | \$724,005,874             | \$114,754,757                 | \$143,093,342              | \$74,568,755                         | \$1,526,839,084 |   |
| Allowance as<br>a percentage  | 35.75                        | % 22.80                   | % 16.57                       | % 5.74                     | % 2.49                               | % 21.91         | % |

|   |      |   |      |   |      |   |      |   |      |   |      |   |
|---|------|---|------|---|------|---|------|---|------|---|------|---|
| of<br>loans/leases<br>individually<br>evaluated for<br>impairment<br>Allowance as<br>a percentage<br>of | 0.80 | % | 1.12 | % | 1.82 | % | 0.76 | % | 1.08 | % | 1.04 | % |
| loans/leases<br>collectively<br>evaluated for<br>impairment   | 1.02 | % | 1.68 | % | 1.91 | % | 0.81 | % | 1.10 | % | 1.38 | % |

|   | As of December 31, 2012         |                           |                               |                            |                                      |                 |      |   |       |   |       |   |
|---|---------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|-----------------|------|---|-------|---|-------|---|
|   | Commercial<br>and<br>Industrial | Commercial<br>Real Estate | Direct<br>Financing<br>Leases | Residential<br>Real Estate | Installment<br>and Other<br>Consumer | Total           |      |   |       |   |       |   |
| Allowance<br>for<br>loans/leases<br>individually<br>evaluated for<br>impairment | \$280,170                       | \$4,005,042               | \$125,000                     | \$105,565                  | \$71,992                             | \$4,587,769     |      |   |       |   |       |   |
| Allowance<br>for<br>loans/leases<br>collectively<br>evaluated for<br>impairment | 4,251,375                       | 7,064,460                 | 1,865,395                     | 964,763                    | 1,191,442                            | 15,337,435      |      |   |       |   |       |   |
|   | \$4,531,545                     | \$11,069,502              | \$1,990,395                   | \$1,070,328                | \$1,263,434                          | \$19,925,204    |      |   |       |   |       |   |
| Loans/leases<br>individually<br>evaluated for<br>impairment                     | \$1,006,952                     | \$20,383,846              | \$998,802                     | \$1,217,256                | \$687,355                            | \$24,294,211    |      |   |       |   |       |   |
| Loans/leases<br>collectively<br>evaluated for<br>impairment                     | 393,237,300                     | 573,595,393               | 102,686,854                   | 114,364,317                | 76,033,159                           | 1,259,917,023   |      |   |       |   |       |   |
|   | \$394,244,252                   | \$593,979,239             | \$103,685,656                 | \$115,581,573              | \$76,720,514                         | \$1,284,211,234 |      |   |       |   |       |   |
| Allowance as<br>a percentage<br>of<br>loans/leases<br>individually              | 27.82                           | %                         | 19.65                         | %                          | 12.51                                | %               | 8.67 | % | 10.47 | % | 18.88 | % |

|  |      |   |      |   |      |   |      |   |      |   |      |   |
|--|------|---|------|---|------|---|------|---|------|---|------|---|
| evaluated for<br>impairment<br>Allowance as<br>a percentage<br>of<br>loans/leases<br>collectively<br>evaluated for<br>impairment | 1.08 | % | 1.23 | % | 1.82 | % | 0.84 | % | 1.57 | % | 1.22 | % |
|  | 1.15 | % | 1.86 | % | 1.92 | % | 0.93 | % | 1.65 | % | 1.55 | % |

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Information for impaired loans/leases is presented in the tables below. The recorded investment represents customer balances net of any partial charge-offs recognized on the loan/lease. The unpaid principal balance represents the recorded balance outstanding on the loan/lease prior to any partial charge-offs.

Loans/leases, by classes of financing receivable, considered to be impaired as of and for the six months ended June 30, 2013 is presented as follows:

| Classes of Loans/Leases   | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Interest Income Recognized for Cash Payments Received |
|---|---------------------|--------------------------|-------------------|-----------------------------|----------------------------|---|
| <b>Impaired Loans/Leases with No Specific Allowance Recorded:</b> |                     |                          |                   |                             |                            |   |
| Commercial and Industrial Commercial Real Estate                  | \$678,239           | \$1,149,252              | \$-               | \$690,717                   | \$ 3,861                   | \$ 3,861  |
| Owner-Occupied Commercial Real Estate                             | 3,554,904           | 4,934,815                | -                 | 1,318,703                   | -                          | -   |
| Commercial Construction, Land Development, and Other Land         | 300,000             | 300,000                  | -                 | 331,250                     | -                          | -   |
| Other Non Owner-Occupied Commercial Real Estate                   | 224,719             | 224,719                  | -                 | 1,782,488                   | 40,773                     | 40,773  |
| Direct Financing Leases   | 542,497             | 542,497                  | -                 | 845,413                     | -                          | -   |
| Residential Real Estate   | 1,271,905           | 1,538,919                | -                 | 934,120                     | -                          | -   |
| Installment and Other Consumer                                    | 1,019,980           | 1,032,521                | -                 | 792,024                     | 5,112                      | 5,112   |
|   | \$7,592,244         | \$9,722,723              | \$-               | \$6,694,715                 | \$ 49,746                  | \$ 49,746   |
| <b>Impaired Loans/Leases with Specific Allowance Recorded:</b>    |                     |                          |                   |                             |                            |   |
| Commercial and Industrial Commercial Real Estate                  | \$2,229,181         | \$2,238,999              | \$1,039,328       | \$722,935                   | \$ 15,307                  | \$ 15,307   |
|   | 980,236             | 980,236                  | 400,000           | 326,908                     | -                          | -   |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|   |               |               |              |               |           |           |
|---|---------------|---------------|--------------|---------------|-----------|-----------|
| Owner-Occupied Commercial Real Estate                     |               |               |              |               |           |           |
| Commercial Construction, Land Development, and Other Land | 3,652,434     | 3,652,434     | 1,428,466    | 3,626,128     | 5,419     | 5,419     |
| Other Non Owner-Occupied Commercial Real Estate           | 10,160,743    | 10,413,703    | 2,475,091    | 10,088,904    | 4,501     | 4,501     |
| Direct Financing Leases                                   | 158,077       | 158,077       | 116,077      | 124,691       | -         | -         |
| Residential Real Estate                                   | 300,615       | 300,615       | 90,235       | 305,587       | -         | -         |
| Installment and Other Consumer                            | 420,897       | 420,897       | 35,927       | 289,628       | -         | -         |
|   | \$ 17,902,183 | \$ 18,164,961 | \$ 5,585,124 | \$ 15,484,781 | \$ 25,199 | \$ 25,199 |
| <br>  |               |               |              |               |           |           |
| Total Impaired Loans/Leases:                              |               |               |              |               |           |           |
| Commercial and Industrial Commercial Real Estate          | \$ 2,907,420  | \$ 3,388,251  | \$ 1,039,328 | \$ 1,413,652  | \$ 19,168 | \$ 19,168 |
| Owner-Occupied Commercial Real Estate                     | 4,535,140     | 5,915,051     | 400,000      | 1,645,611     | -         | -         |
| Commercial Construction, Land Development, and Other Land | 3,952,434     | 3,952,434     | 1,428,466    | 3,957,378     | 5,419     | 5,419     |
| Other Non Owner-Occupied Commercial Real Estate           | 10,385,462    | 10,638,422    | 2,475,091    | 11,871,392    | 45,274    | 45,274    |
| Direct Financing Leases                                   | 700,574       | 700,574       | 116,077      | 970,104       | -         | -         |
| Residential Real Estate                                   | 1,572,520     | 1,839,534     | 90,235       | 1,239,707     | -         | -         |
| Installment and Other Consumer                            | 1,440,877     | 1,453,418     | 35,927       | 1,081,652     | 5,112     | 5,112     |
|   | \$ 25,494,427 | \$ 27,887,684 | \$ 5,585,124 | \$ 22,179,496 | \$ 74,973 | \$ 74,973 |

Impaired loans/leases for which no allowance has been provided have adequate collateral, based on management's current estimates.



## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Loans/leases, by classes of financing receivable, considered to be impaired as of and for the three months ended June 30, 2013 and 2012, respectively, is presented as follows:

| Classes of Loans/Leases   | Three Months Ended June 30, 2013 |                            |   | Three Months Ended June 30, 2012 |                            |   |
|---|----------------------------------|----------------------------|---|----------------------------------|----------------------------|---|
|   | Average Recorded Investment      | Interest Income Recognized | Interest Income Recognized for Cash Payments Received | Average Recorded Investment      | Interest Income Recognized | Interest Income Recognized for Cash Payments Received |
| <b>Impaired Loans/Leases with No Specific Allowance Recorded:</b> |                                  |                            |   |                                  |                            |   |
| Commercial and Industrial Commercial Real Estate                  | \$ 613,506                       | \$ 1,937                   | \$ 1,937  | \$ 870,085                       | \$ -                       | \$ -  |
| Owner-Occupied Commercial Real Estate                             | 3,107,106                        | -                          | -   | 668,313                          | -                          | -   |
| Commercial Construction, Land Development, and Other Land         | 325,000                          | -                          | -   | 4,773,032                        | 1,683                      | 1,683   |
| Other Non Owner-Occupied Commercial Real Estate                   | 353,972                          | 657                        | 657   | 6,997,797                        | -                          | -   |
| Direct Financing Leases   | 822,718                          | -                          | -   | 585,845                          | -                          | -   |
| Residential Real Estate   | 1,057,657                        | -                          | -   | 734,485                          | 1,673                      | 1,673   |
| Installment and Other Consumer                                    | 915,478                          | 2,686                      | 2,686   | 974,591                          | 101                        | 101   |
|   | \$ 7,195,437                     | \$ 5,280                   | \$ 5,280  | \$ 15,604,148                    | \$ 3,457                   | \$ 3,457  |
| <b>Impaired Loans/Leases with Specific Allowance Recorded:</b>    |                                  |                            |   |                                  |                            |   |
| Commercial and Industrial Commercial Real Estate                  | \$ 1,229,737                     | \$ 15,307                  | \$ 15,307   | \$ 314,872                       | \$ 1,971                   | \$ 1,971  |
| Owner-Occupied Commercial Real Estate                             | 653,815                          | -                          | -   | 66,660                           | -                          | -   |
| Commercial Construction, Land Development, and Other Land         | 3,656,226                        | 2,716                      | 2,716   | 2,348,194                        | -                          | -   |
| Other Non Owner-Occupied Commercial Real Estate                   | 10,143,708                       | -                          | -   | 8,354,604                        | 83,113                     | 83,113  |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|   |               |           |           |               |           |           |
|---|---------------|-----------|-----------|---------------|-----------|-----------|
| Direct Financing Leases                                   | 133,038       | -         | -         | 118,275       | -         | -         |
| Residential Real Estate                                   | 302,334       | -         | -         | 462,406       | -         | -         |
| Installment and Other Consumer                            | 430,427       | -         | -         | 1,998         | -         | -         |
|   | \$ 16,549,285 | \$ 18,023 | \$ 18,023 | \$ 11,667,009 | \$ 85,084 | \$ 85,084 |
| Total Impaired Loans/Leases:                              |               |           |           |               |           |           |
| Commercial and Industrial                                 | \$ 1,843,243  | \$ 17,244 | \$ 17,244 | \$ 1,184,957  | \$ 1,971  | \$ 1,971  |
| Commercial Real Estate                                    |               |           |           |               |           |           |
| Owner-Occupied Commercial Real Estate                     | 3,760,921     | -         | -         | 734,973       | -         | -         |
| Commercial Construction, Land Development, and Other Land | 3,981,226     | 2,716     | 2,716     | 7,121,226     | 1,683     | 1,683     |
| Other Non Owner-Occupied Commercial Real Estate           | 10,497,680    | 657       | 657       | 15,352,401    | 83,113    | 83,113    |
| Direct Financing Leases                                   | 955,756       | -         | -         | 704,120       | -         | -         |
| Residential Real Estate                                   | 1,359,991     | -         | -         | 1,196,891     | 1,673     | 1,673     |
| Installment and Other Consumer                            | 1,345,905     | 2,686     | 2,686     | 976,589       | 101       | 101       |
|   | \$ 23,744,722 | \$ 23,303 | \$ 23,303 | \$ 27,271,157 | \$ 88,541 | \$ 88,541 |

Impaired loans/leases for which no allowance has been provided have adequate collateral, based on management's current estimates.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Loans/leases, by classes of financing receivable, considered to be impaired as of December 31, 2012 is presented as follows:

| Classes of Loans/Leases                                    | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|--|---------------------|--------------------------|-------------------|
| Impaired Loans/Leases with No Specific Allowance Recorded: |                     |                          |                   |
| Commercial and Industrial Commercial Real Estate           | \$438,355           | \$1,203,710              | \$-               |
| Owner-Occupied Commercial Real Estate                      | 503,321             | 503,321                  | -                 |
| Commercial Construction, Land Development, and Other Land  | 678,523             | 678,523                  | -                 |
| Other Non Owner-Occupied Commercial Real Estate            | 495,702             | 495,702                  | -                 |
| Direct Financing Leases                                    | 777,645             | 777,645                  | -                 |
| Residential Real Estate                                    | 944,211             | 1,127,242                | -                 |
| Installment and Other Consumer                             | 534,368             | 534,368                  | -                 |
|  | \$4,372,125         | \$5,320,511              | \$-               |
| Impaired Loans/Leases with Specific Allowance Recorded:    |                     |                          |                   |
| Commercial and Industrial Commercial Real Estate           | \$568,597           | \$590,849                | \$280,170         |
| Owner-Occupied Commercial Real Estate                      | -                   | -                        | -                 |
| Commercial Construction, Land Development, and Other Land  | 3,967,583           | 3,967,583                | 1,105,795         |
| Other Non Owner-Occupied Commercial Real Estate            | 14,738,717          | 14,991,676               | 2,899,247         |
| Direct Financing Leases                                    | 221,157             | 221,157                  | 125,000           |
| Residential Real Estate                                    | 273,045             | 273,045                  | 105,565           |
| Installment and Other Consumer                             | 152,987             | 152,987                  | 71,992            |
|  | \$19,922,086        | \$20,197,297             | \$4,587,769       |
| Total Impaired Loans/Leases:                               |                     |                          |                   |
| Commercial and Industrial Commercial Real Estate           | \$1,006,952         | \$1,794,559              | \$280,170         |
| Owner-Occupied Commercial Real Estate                      | 503,321             | 503,321                  | -                 |
| Commercial Construction, Land Development, and Other Land  | 4,646,106           | 4,646,106                | 1,105,795         |
| Other Non Owner-Occupied Commercial Real Estate            | 15,234,419          | 15,487,378               | 2,899,247         |
| Direct Financing Leases                                    | 998,802             | 998,802                  | 125,000           |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|                                |              |              |             |
|--------------------------------|--------------|--------------|-------------|
| Residential Real Estate        | 1,217,256    | 1,400,287    | 105,565     |
| Installment and Other Consumer | 687,355      | 687,355      | 71,992      |
|                                | \$24,294,211 | \$25,517,808 | \$4,587,769 |

Impaired loans/leases for which no allowance has been provided have adequate collateral, based on management's current estimates.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

For commercial and industrial and commercial real estate loans, the Company's credit quality indicator is internally assigned risk ratings. Each commercial loan is assigned a risk rating upon origination. The risk rating is reviewed every 15 months, at a minimum, and on an as needed basis depending on the specific circumstances of the loan.

For direct financing leases, residential real estate loans, and installment and other consumer loans, the Company's credit quality indicator is performance determined by delinquency status. Delinquency status is updated daily by the Company's loan system.

For each class of financing receivable, the following presents the recorded investment by credit quality indicator as of June 30, 2013 and December 31, 2012:

| Internally Assigned Risk Rating | As of June 30, 2013       |                                       |   |                              | Total            |
|---------------------------------|---------------------------|---------------------------------------|---|------------------------------|------------------|
|                                 | Commercial and Industrial | Owner-Occupied Commercial Real Estate | Commercial Real Estate<br>Non Owner-Occupied<br>Construction,<br>Land Development,<br>and Other<br>Land | Other Commercial Real Estate |                  |
| Pass (Ratings 1 through 5)      | \$ 444,731,963            | \$ 254,134,556                        | \$ 34,521,499   | \$ 374,410,742               | \$ 1,107,798,760 |
| Special Mention (Rating 6)      | 10,507,646                | 3,349,849                             | 6,843,887   | 8,026,958                    | 28,728,340       |
| Substandard (Rating 7)          | 15,176,747                | 9,442,687                             | 6,648,291   | 26,627,405                   | 57,895,130       |
| Doubtful (Rating 8)             | -                         | -                                     | -   | -                            | -                |
|                                 | \$ 470,416,356            | \$ 266,927,092                        | \$ 48,013,677   | \$ 409,065,105               | \$ 1,194,422,230 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| Delinquency Status * | As of June 30, 2013     |                         |                                |                |
|----------------------|-------------------------|-------------------------|--------------------------------|----------------|
|                      | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total          |
| Performing           | \$ 114,054,183          | \$ 141,520,822          | \$ 73,124,630                  | \$ 328,699,635 |
| Nonperforming        | 700,574                 | 1,572,520               | 1,444,125                      | 3,717,219      |
|                      | \$ 114,754,757          | \$ 143,093,342          | \$ 74,568,755                  | \$ 332,416,854 |

| Internally Assigned Risk Rating | As of December 31, 2012   |                        |  |                              |               |
|---------------------------------|---------------------------|------------------------|--|------------------------------|---------------|
|                                 | Commercial and Industrial | Commercial Real Estate | Commercial Real Estate<br>Non Owner-Occupied<br>Construction, Land Development, and Other Land | Other Commercial Real Estate | Total         |
| Pass (Ratings 1 through 5)      | \$371,856,380             | \$195,567,523          | \$38,125,793   | \$312,370,393                | \$917,920,089 |
| Special Mention (Rating 6)      | 8,008,866                 | 5,488,602              | 1,238,152  | 7,319,902                    | 22,055,522    |
| Substandard (Rating 7)          | 14,379,006                | 3,855,183              | 5,598,436  | 24,415,255                   | 48,247,880    |
| Doubtful (Rating 8)             | -                         | -                      | -  | -                            | -             |
|                                 | \$394,244,252             | \$204,911,308          | \$44,962,381   | \$344,105,550                | \$988,223,491 |

| Delinquency Status * | As of December 31, 2012 |                         |                                |               |
|----------------------|-------------------------|-------------------------|--------------------------------|---------------|
|                      | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total         |
| Performing           | \$102,686,854           | \$114,364,316           | \$75,921,358                   | \$292,972,528 |
| Nonperforming        | 998,802                 | 1,217,257               | 799,156                        | 3,015,215     |
|                      | \$103,685,656           | \$115,581,573           | \$76,720,514                   | \$295,987,743 |

\*Performing = loans/leases accruing and less than 90 days past due. Nonperforming = loans/leases on nonaccrual, accruing loans/leases that are greater than or equal to 90 days past due, and accruing troubled debt restructurings.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

As of June 30, 2013 and December 31, 2012, troubled debt restructurings totaled \$9,918,012 and \$12,958,374, respectively.

For each class of financing receivable, the following presents the number and recorded investment of troubled debt restructurings, by type of concession, that were restructured during the three and six months ended June 30, 2013 and 2012. The difference between the pre-modification recorded investment and the post-modification recorded investment would be any partial charge-offs at the time of the restructuring.

| Classes of Loans/Leases                                   | For the three months ended June 30, 2013 |                                      |                                       | For the three months ended June 30, 2012 |                                      |                                       |                    |
|---|--|--------------------------------------|---------------------------------------|--|--------------------------------------|---------------------------------------|--------------------|
|   | Number of Loans / Leases                 | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Number of Loans / Leases                 | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Specific Allowance |
| CONCESSION - Significant payment delay                    |  |                                      |                                       |  |                                      |                                       |                    |
| Residential Real Estate                                   | 1  | \$ 91,581                            | \$ 91,581                             | -  | \$ -                                 | \$ -                                  | \$ -               |
| Installment and Other Consumer                            | 1  | 370,000                              | 370,000                               | -  | -                                    | -                                     | -                  |
|   | 2  | \$ 461,581                           | \$ 461,581                            | -  | \$ -                                 | \$ -                                  | \$ -               |
| CONCESSION - Interest rate adjusted below market          |  |                                      |                                       |  |                                      |                                       |                    |
| Commercial Construction, Land Development, and Other Land | 1  | \$ 337,500                           | \$ 337,500                            | -  | \$ -                                 | \$ -                                  | \$ -               |
| Residential Real Estate                                   | 1  | 160,627                              | 160,627                               | -  | -                                    | -                                     | -                  |
|   | 2  | \$ 498,127                           | \$ 498,127                            | -  | \$ -                                 | \$ -                                  | \$ -               |
| <b>TOTAL</b>  | <b>4</b>                                 | <b>\$ 959,708</b>                    | <b>\$ 959,708</b>                     | <b>-</b>                                 | <b>\$ -</b>                          | <b>\$ -</b>                           | <b>\$ -</b>        |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| Classes of Loans/Leases                                   | For the six months ended June 30, 2013 |                                      |                                       | For the six months ended June 30, 2012 |                        |                                      |                                       |                    |
|---|--|--------------------------------------|---------------------------------------|--|------------------------|--------------------------------------|---------------------------------------|--------------------|
|   | Number of Loans/Leases                 | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Specific Allowance                     | Number of Loans/Leases | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Specific Allowance |
| <b>CONCESSION -</b>                                       |  |                                      |                                       |  |                        |                                      |                                       |                    |
| Extension of maturity                                     |  |                                      |                                       |  |                        |                                      |                                       |                    |
| Commercial and Industrial                                 | 3                                      | \$ 809,494                           | \$ 809,494                            | \$ 188,700                             | -                      | \$ -                                 | \$ -                                  | \$ -               |
|   | 3                                      | \$ 809,494                           | \$ 809,494                            | \$ 188,700                             | -                      | \$ -                                 | \$ -                                  | \$ -               |
| <b>CONCESSION -</b>                                       |  |                                      |                                       |  |                        |                                      |                                       |                    |
| Significant payment delay                                 |  |                                      |                                       |  |                        |                                      |                                       |                    |
| Owner-Occupied Commercial Real Estate                     | 1                                      | \$ 47,958                            | \$ 47,958                             | \$ -                                   | -                      | \$ -                                 | \$ -                                  | \$ -               |
| Residential Real Estate                                   | 1                                      | 91,581                               | 91,581                                | -                                      | -                      | -                                    | -                                     | -                  |
| Installment and Other Consumer                            | 1                                      | 370,000                              | 370,000                               | -                                      | -                      | -                                    | -                                     | -                  |
| Commercial Construction, Land Development, and Other Land | -                                      | -                                    | -                                     | -                                      | 2                      | 200,000                              | 200,000                               | 144,000            |
|   | 3                                      | \$ 509,539                           | \$ 509,539                            | \$ -                                   | 2                      | \$ 200,000                           | \$ 200,000                            | \$ 144,000         |
| <b>CONCESSION -</b>                                       |  |                                      |                                       |  |                        |                                      |                                       |                    |
| Interest rate adjusted below market                       |  |                                      |                                       |  |                        |                                      |                                       |                    |
| Commercial Construction, Land Development, and Other Land | 1                                      | \$ 337,500                           | \$ 337,500                            | \$ -                                   | 1                      | \$ 337,500                           | \$ 337,500                            | \$ -               |
| Residential Real Estate                                   | 1                                      | 160,627                              | 160,627                               | -                                      | 1                      | 167,739                              | 167,739                               | -                  |
| Installment and Other Consumer                            | -                                      | -                                    | -                                     | -                                      | 1                      | 16,043                               | 16,043                                | -                  |
|   | 2                                      | \$ 498,127                           | \$ 498,127                            | \$ -                                   | 3                      | \$ 521,282                           | \$ 521,282                            | \$ -               |
| <b>TOTAL</b>  | <b>8</b>                               | <b>\$ 1,817,160</b>                  | <b>\$ 1,817,160</b>                   | <b>\$ 188,700</b>                      | <b>5</b>               | <b>\$ 721,282</b>                    | <b>\$ 721,282</b>                     | <b>\$ 144,000</b>  |

Of the troubled debt restructurings reported above, three with post-modification recorded investments totaling \$178,007 were on nonaccrual as of June 30, 2013, and two with post-modification recorded investments totaling \$200,000 were on nonaccrual as of June 30, 2012.

For the three and six months ended June 30, 2013 and 2012, none of the Company's troubled debt restructurings had redefaulted within 12 months subsequent to restructure where default is defined as delinquency of 90 days or more and/or placement on nonaccrual status.





## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 5 – JUNIOR SUBORDINATED DEBENTURES

As part of the acquisition of Community National, the Company assumed two junior subordinated debentures detailed as follows:

The first debenture assumed was issued in September 2004 in the amount of \$3,093,000, and provides that interest is payable quarterly with the interest rate adjusted to equal three-month LIBOR plus 2.17% (2.45% at June 30, 2013). Principal is due September 20, 2034, but is callable at any time. The second debenture assumed was issued in March 2007 in the amount of \$3,609,000, and provides that interest is payable quarterly with the interest rate adjusted to equal three-month LIBOR plus 1.75% (2.03% at June 30, 2013). Principal is due March 15, 2037, but is callable at any time.

Junior subordinated debentures are summarized as of June 30, 2013 and December 31, 2012 as follows:

|  | 2013         | 2012         |
|--|--------------|--------------|
| Note Payable to QCR Holdings Capital Trust II  | \$12,372,000 | \$12,372,000 |
| Note Payable to QCR Holdings Capital Trust III | 8,248,000    | 8,248,000    |
| Note Payable to QCR Holdings Capital Trust IV  | 5,155,000    | 5,155,000    |
| Note Payable to QCR Holdings Capital Trust V   | 10,310,000   | 10,310,000   |
| Note Payable to Community National Trust II    | 3,093,000    | -            |
| Note Payable to Community National Trust III   | 3,609,000    | -            |
| Market Value Discount per ASC 805              | (2,576,825 ) | -            |
|  | \$40,210,175 | \$36,085,000 |

The fair value of Community National's junior subordinated debentures totaled \$4,125,175 at the acquisition date which resulted in a discount of \$2,576,825. The discount will be accreted as interest expense on a level yield basis over the expected remaining term of the junior subordinated debentures.

A schedule of the Company's non-consolidated subsidiaries formed for the issuance of trust preferred securities including the amounts outstanding as of June 30, 2013 and December 31, 2012, is as follows:

| Name                                   | Date Issued    | Amount Issued | Interest Rate            | Interest Rate as of 6/30/2013 | Interest Rate as of 12/31/2012 |
|--|----------------|---------------|--------------------------|-------------------------------|--------------------------------|
| QCR Holdings Statutory Trust II        | February 2004  | \$12,372,000  | 2.85% over 3-month LIBOR | 3.13 %                        | 3.21 %                         |
| QCR Holdings Statutory Trust III       | February 2004  | 8,248,000     | 2.85% over 3-month LIBOR | 3.13 %                        | 3.21 %                         |
| QCR Holdings Statutory Trust IV        | May 2005       | 5,155,000     | 1.80% over 3-month LIBOR | 2.08 %                        | 2.14 %                         |
| QCR Holdings Statutory Trust V         | February 2006  | 10,310,000    | 1.55% over 3-month LIBOR | 1.83 %                        | 1.89 %                         |
| Community National Statutory Trust II  | September 2004 | 3,093,000     | 2.17% over 3-month LIBOR | 2.45 %                        | N/A                            |
| Community National Statutory Trust III | March 2007     | 3,609,000     | 1.75% over 3-month LIBOR | 2.03 %                        | N/A                            |
|  |                | \$42,787,000  | Weighted Average Rate    | 2.55 %                        | 2.68 %                         |

Securities issued by all of the trusts listed above mature 30 years from the date of issuance, but all are currently callable at par at any time.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 6 - EARNINGS PER SHARE

The following information was used in the computation of earnings per share on a basic and diluted basis:

|   | Three months ended |             | Six months ended |             |
|---|--------------------|-------------|------------------|-------------|
|   | June 30,           |             | June 30,         |             |
|   | 2013               | 2012        | 2013             | 2012        |
| Net income  | \$4,045,231        | \$3,273,379 | \$7,310,375      | \$6,676,228 |
| Less: Net income attributable to noncontrolling interests   | -                  | 201,223     | -                | 367,254     |
| Net income attributable to QCR Holdings, Inc.   | \$4,045,231        | \$3,072,156 | \$7,310,375      | \$6,308,974 |
| Less: Preferred stock dividends   | 810,838            | 935,786     | 1,621,675        | 1,874,411   |
| Net income attributable to QCR Holdings, Inc. common stockholders   | \$3,234,393        | \$2,136,370 | \$5,688,700      | \$4,434,563 |
| Earnings per common share attributable to QCR Holdings, Inc. common stockholders                                  |                    |             |                  |             |
| Basic   | \$0.60             | \$0.44      | \$1.10           | \$0.92      |
| Diluted   | \$0.59             | \$0.44      | \$1.08           | \$0.91      |
| Weighted average common shares outstanding  | 5,393,062          | 4,835,773   | 5,160,327        | 4,818,090   |
| Weighted average common shares issuable upon exercise of stock options and under the employee stock purchase plan | 104,213            | 66,080      | 105,482          | 49,538      |
| Weighted average common and common equivalent shares outstanding  | 5,497,275          | 4,901,853   | 5,265,809        | 4,867,628   |

NOTE 7 – BUSINESS SEGMENT INFORMATION

Selected financial and descriptive information is required to be disclosed for reportable operating segments, applying a “management perspective” as the basis for identifying reportable segments. The management perspective is determined by the view that management takes of the segments within the Company when making operating decisions, allocating resources, and measuring performance. The segments of the Company have been defined by the structure of the Company’s internal organization, focusing on the financial information that the Company’s operating decision-makers routinely use to make decisions about operating matters.

The Company’s primary segment, Commercial Banking, is geographically divided by markets into the secondary segments which are the four subsidiary banks wholly-owned by the Company: QCBT, CRBT, RB&T, and CNB (which was acquired on May 13, 2013). Each of these secondary segments offers similar products and services, but is managed separately due to different pricing, product demand, and consumer markets. Each offers commercial, consumer, and mortgage loans and deposit services.

The Company’s Wealth Management segment represents the trust and asset management and investment management and advisory services offered at the Company’s four subsidiary banks in aggregate. This segment generates income primarily from fees charged based on assets under administration for corporate and personal trusts, custodial services, and investments managed. No assets of the subsidiary banks have been allocated to the Wealth Management segment.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

The Company's All Other segment includes the operations of all other consolidated subsidiaries and/or defined operating segments that fall below the segment reporting thresholds. This segment includes the corporate operations of the parent company.

Selected financial information on the Company's business segments is presented as follows for the three and six months ended June 30, 2013 and 2012.

|   | <b>Commercial Banking</b> |                              |                          | Community<br>National<br>Bank | <b>Wealth<br/>Management</b> | <b>All Other</b> | <b>Intercompany<br/>Eliminations</b> | <b>Corporate<br/>Eliminations</b> |
|---|---------------------------|------------------------------|--------------------------|-------------------------------|------------------------------|------------------|--------------------------------------|-----------------------------------|
|   | Quad City<br>Bank & Trust | Cedar Rapids<br>Bank & Trust | Rockford<br>Bank & Trust |                               |                              |                  |                                      |                                   |
| <b>Three<br/>Months<br/>Ended<br/>June 30,<br/>2013</b> |                           |                              |                          |                               |                              |                  |                                      |                                   |
| Total revenue   | \$ 11,810,586             | \$ 6,468,480                 | \$ 3,649,811             | \$ 1,672,243                  | \$ 1,728,074                 | \$ 6,439,309     | \$(4,680,346)                        | \$ 2,877,037                      |
| Net interest income                                     | \$ 8,485,092              | \$ 3,951,787                 | \$ 2,434,391             | \$ 1,225,612                  | \$ -                         | \$(388,830)      | \$ -                                 | \$ 1,061,260                      |
| Net income attributable to QCR Holdings, Inc.           | \$ 1,951,271              | \$ 1,624,472                 | \$ 719,480               | \$ 239,902                    | \$ 232,035                   | \$ 4,045,231     | \$(4,767,160)                        | \$ 4,483,460                      |
| Total assets  | \$ 1,226,928,751          | \$ 619,443,210               | \$ 333,996,843           | \$ 277,425,832                | \$ -                         | \$ 211,484,709   | \$(222,507,868)                      | \$ 2,036,620,467                  |
| Provision for loan/lease losses                         | \$ 1,020,123              | \$ 100,000                   | \$ 400,000               | \$ 14                         | \$ -                         | \$ -             | \$ -                                 | \$ 1,520,123                      |
| Goodwill  | \$ 3,222,688              | \$ -                         | \$ -                     | \$ -                          | \$ -                         | \$ -             | \$ -                                 | \$ 3,222,688                      |
| Core deposit  | \$ -                      | \$ -                         | \$ -                     | \$ 3,440,076                  | \$ -                         | \$ -             | \$ -                                 | \$ 3,440,076                      |

intangible

**Three  
Months  
Ended  
June 30,  
2012**

|   |                  |                |                |     |              |                |                 |       |
|---|------------------|----------------|----------------|-----|--------------|----------------|-----------------|-------|
| Total revenue                                 | \$ 11,936,569    | \$ 6,536,887   | \$ 3,648,057   | \$- | \$ 1,531,560 | \$ 4,379,005   | \$(4,430,041)   | ) \$2 |
| Net interest income                           | \$ 8,532,585     | \$ 3,896,184   | \$ 2,458,333   | \$- | \$-          | \$(371,609)    | ) \$-           | \$    |
| Net income attributable to QCR Holdings, Inc. | \$ 2,327,046     | \$ 1,413,869   | \$ 402,494     | \$- | \$ 156,523   | \$ 3,110,821   | \$(4,338,597)   | ) \$3 |
| Total assets                                  | \$ 1,157,927,167 | \$ 581,059,340 | \$ 301,189,716 | \$- | \$-          | \$ 194,399,498 | \$(191,149,975) | ) \$2 |
| Provision for loan/lease losses               | \$ 392,469       | \$ 225,000     | \$ 431,000     | \$- | \$-          | \$-            | \$-             | ) \$  |
| Goodwill                                      | \$ 3,222,688     | \$-            | \$-            | \$- | \$-          | \$-            | \$-             | ) \$3 |

**Six Months  
Ended  
June 30,  
2013**

|   |                  |                |                |                |              |                |                 |       |
|---|------------------|----------------|----------------|----------------|--------------|----------------|-----------------|-------|
| Total revenue                                 | \$ 23,866,247    | \$ 13,396,831  | \$ 6,833,870   | \$ 1,672,243   | \$ 3,377,085 | \$ 11,171,879  | \$(9,488,487)   | ) \$3 |
| Net interest income                           | \$ 16,876,630    | \$ 7,796,669   | \$ 4,739,468   | \$ 1,225,612   | \$-          | \$(739,010)    | ) \$-           | \$2   |
| Net income attributable to QCR Holdings, Inc. | \$ 4,448,296     | \$ 3,345,283   | \$ 815,722     | \$ 239,902     | \$ 445,042   | \$ 7,310,375   | \$(9,294,245)   | ) \$7 |
| Total assets                                  | \$ 1,226,928,751 | \$ 619,443,210 | \$ 333,996,843 | \$ 277,425,832 | \$-          | \$ 211,484,709 | \$(222,507,868) | ) \$2 |
| Provision for loan/lease losses               | \$ 1,377,905     | \$ 400,000     | \$ 800,000     | \$ 14          | \$-          | \$-            | \$-             | ) \$2 |
| Goodwill                                      | \$ 3,222,688     | \$-            | \$-            | \$-            | \$-          | \$-            | \$-             | ) \$3 |
| Core deposit intangible                       | \$-              | \$-            | \$-            | \$ 3,440,076   | \$-          | \$-            | \$-             | ) \$3 |

**Six Months  
Ended  
June 30,  
2012**

|  |               |               |              |     |              |              |               |       |
|--|---------------|---------------|--------------|-----|--------------|--------------|---------------|-------|
|  | \$ 24,201,602 | \$ 13,123,036 | \$ 6,768,852 | \$- | \$ 2,936,754 | \$ 8,990,997 | \$(9,088,522) | ) \$4 |
|--|---------------|---------------|--------------|-----|--------------|--------------|---------------|-------|

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|   |                  |                |                |      |            |                |                  |        |      |
|---|------------------|----------------|----------------|------|------------|----------------|------------------|--------|------|
| Total revenue                                 |                  |                |                |      |            |                |                  |        |      |
| Net interest income                           | \$ 16,921,627    | \$ 7,664,183   | \$ 4,891,039   | \$ - | \$ -       | \$ (757,903    | ) \$ -           |        | \$ - |
| Net income attributable to QCR Holdings, Inc. | \$ 5,016,730     | \$ 2,681,135   | \$ 795,969     | \$ - | \$ 316,406 | \$ 6,407,185   | \$ (8,908,451    | ) \$ - | \$ - |
| Total assets                                  | \$ 1,157,927,167 | \$ 581,059,340 | \$ 301,189,716 | \$ - | \$ -       | \$ 194,399,498 | \$ (191,149,975) |        | \$ - |
| Provision for loan/lease losses               | \$ 787,915       | \$ 575,000     | \$ 466,000     | \$ - | \$ -       | \$ -           | \$ -             |        | \$ - |
| Goodwill                                      | \$ 3,222,688     | \$ -           | \$ -           | \$ - | \$ -       | \$ -           | \$ -             |        | \$ - |

28

---



Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 8 – FAIR VALUE

Accounting guidance on fair value measurement uses a hierarchy intended to maximize the use of observable inputs and minimize the use of unobservable inputs. This hierarchy includes three levels and is based upon the valuation techniques used to measure assets and liabilities. The three levels are as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in markets;
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Assets measured at fair value on a recurring basis comprise the following at June 30, 2013 and December 31, 2012:

|  |                   |  |                                   |                               |
|--|-------------------|--|-----------------------------------|-------------------------------|
|  | <b>Fair Value</b> | <b>Fair Value Measurements at Reporting Date Using Quoted Prices</b> | <b>Significant</b>                | <b>Significant</b>            |
|  |                   | in Active Markets for Identical Assets                               | Other Observable Inputs (Level 2) | Unobservable Inputs (Level 3) |
|  |                   | (Level 1)  |                                   |                               |

June 30, 2013:

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Securities available for sale:

|  |               |           |               |    |   |
|--|---------------|-----------|---------------|----|---|
| U.S. govt. sponsored agency securities             | \$380,915,891 | \$-       | \$380,915,891 | \$ | - |
| Residential mortgage-backed and related securities | 178,545,554   | -         | 178,545,554   |    | - |
| Municipal securities                               | 36,828,850    | -         | 36,828,850    |    | - |
| Trust preferred securities                         | 216,200       | -         | 216,200       |    | - |
| Other securities                                   | 1,758,905     | 264,869   | 1,494,036     |    | - |
|  | \$598,265,400 | \$264,869 | \$598,000,531 | \$ | - |

December 31, 2012:

Securities available for sale:

|  |               |           |               |    |   |
|--|---------------|-----------|---------------|----|---|
| U.S. govt. sponsored agency securities             | \$338,609,371 | \$-       | \$338,609,371 | \$ | - |
| Residential mortgage-backed and related securities | 163,601,103   | -         | 163,601,103   |    | - |
| Municipal securities                               | 26,185,736    | -         | 26,185,736    |    | - |
| Trust preferred securities                         | 139,400       | -         | 139,400       |    | - |
| Other securities                                   | 1,624,376     | 234,453   | 1,389,923     |    | - |
|  | \$530,159,986 | \$234,453 | \$529,925,533 | \$ | - |

There were no transfers of assets or liabilities between Levels 1, 2, and 3 of the fair value hierarchy for the three and six months ended June 30, 2013 and 2012.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

A small portion of the securities available for sale portfolio consists of common stock issued by various unrelated bank holding companies. The fair values used by the Company are obtained from an independent pricing service and represent quoted market prices for the identical securities (Level 1 inputs).

The remainder of the securities available for sale portfolio consists of securities whereby the Company obtains fair values from an independent pricing service. The fair values are determined by pricing models that consider observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market makers and live trading systems (Level 2 inputs).

Certain financial assets are measured at fair value on a non-recurring basis; that is, the assets are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

Assets measured at fair value on a non-recurring basis comprise the following at June 30, 2013 and December 31, 2012:

|                           | Fair Value    | Fair Value Measurements at Reporting Date Using |         |               |
|---------------------------|---------------|---|---------|---------------|
|                           |               | Level 1   | Level 2 | Level 3       |
| <u>June 30, 2013:</u>     |               |   |         |               |
| Impaired loans/leases     | \$ 16,005,797 | \$-   | \$ -    | \$ 16,005,797 |
| Other real estate owned   | 4,167,319     | -   | -       | 4,167,319     |
|                           | \$ 20,173,116 | \$-   | \$ -    | \$ 20,173,116 |
| <u>December 31, 2012:</u> |               |   |         |               |
| Impaired loans/leases     | \$ 18,054,234 | \$-   | \$ -    | \$ 18,054,234 |
| Other real estate owned   | 4,270,901     | -   | -       | 4,270,901     |
|                           | \$ 22,325,135 | \$-   | \$ -    | \$ 22,325,135 |

Impaired loans/leases are evaluated and valued at the time the loan/lease is identified as impaired, at the lower of cost or fair value, and are classified as Level 3 in the fair value hierarchy. Fair value is measured based on the value of the collateral securing these loans/leases. Collateral may be real estate and/or business assets, including equipment, inventory and/or accounts receivable, and is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business.

Other real estate owned in the table above consists of property acquired through foreclosures and settlements of loans. Property acquired is carried at the estimated fair value of the property, less disposal costs, and is classified as a Level 3 in the fair value hierarchy. The estimated fair value of the property is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values are discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the property.

For the impaired loans/leases and other real estate owned, the Company records carrying value at fair value less disposal or selling costs. The amounts reported in the tables above are fair values before the adjustment for disposal or selling costs.

There have been no changes in valuation techniques used for any assets measured at fair value during the three and six months ended June 30, 2013 and 2012.

## Part I

## Item 1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

The following table presents the carrying values and estimated fair values of financial assets and liabilities carried on the Company's consolidated balance sheets, including those financial assets and liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis:

|   | Fair Value Hierarchy Level | As of June 30, 2013 |                      | As of December 31, 2012 |                      |
|---|----------------------------|---------------------|----------------------|-------------------------|----------------------|
|   |                            | Carrying Value      | Estimated Fair Value | Carrying Value          | Estimated Fair Value |
| Cash and due from banks                             | Level 1                    | \$44,316,890        | \$44,316,890         | \$61,568,446            | \$61,568,446         |
| Federal funds sold                                  | Level 2                    | 16,666,000          | 16,666,000           | 26,560,000              | 26,560,000           |
| Interest-bearing deposits at financial institutions | Level 2                    | 34,573,775          | 34,573,775           | 22,359,490              | 22,359,490           |
| Investment securities:                              |                            |                     |                      |                         |                      |
| Held to maturity                                    | Level 3                    | 105,201,749         | 99,500,594           | 72,079,385              | 73,005,706           |
| Available for sale                                  | See Previous Table         | 598,265,400         | 598,265,400          | 530,159,986             | 530,159,986          |
| Loans/leases receivable, net                        | Level 3                    | 14,820,182          | 16,005,797           | 16,716,883              | 18,054,234           |
| Loans/leases receivable, net                        | Level 2                    | 1,494,749,541       | 1,496,225,203        | 1,250,745,552           | 1,262,090,766        |
| Deposits:   |                            |                     |                      |                         |                      |
| Nonmaturity deposits                                | Level 2                    | 1,204,708,666       | 1,204,708,666        | 1,039,572,326           | 1,039,572,326        |
| Time deposits                                       | Level 2                    | 512,071,244         | 517,791,000          | 334,541,774             | 337,343,000          |
| Short-term borrowings                               | Level 2                    | 157,186,204         | 157,186,204          | 171,082,961             | 171,082,961          |
| Federal Home Loan Bank advances                     | Level 2                    | 209,949,500         | 221,501,000          | 202,350,000             | 220,815,000          |
| Other borrowings                                    | Level 2                    | 142,644,062         | 154,228,000          | 138,239,762             | 154,101,000          |
| Junior subordinated debentures                      | Level 2                    | 40,210,175          | 27,856,246           | 36,085,000              | 18,786,000           |

The methodologies for estimating the fair value of financial assets and liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. For certain financial assets and liabilities, carrying value approximates fair value due to the nature of the financial instrument. These instruments include: cash and due from banks, federal funds sold, interest-bearing deposits at financial institutions, non-maturity deposits, and short-term borrowings. The Company used the following methods and assumptions in estimating the fair value of the following instruments:

Securities held to maturity: The fair values are estimated using pricing models that consider certain observable market data, however, as most of the securities have limited or no trading activity and are not rated, the fair value is partially dependent upon unobservable inputs.

Loans/leases receivable: The fair values for all types of loans/leases are estimated using discounted cash flow analyses, using interest rates currently being offered for loans/leases with similar terms to borrowers with similar credit quality. The fair value of loans held for sale is based on quoted market prices of similar loans sold in the secondary market.

Deposits: The fair values disclosed for demand deposits equal their carrying amounts, which represent the amount payable on demand. Fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregate expected monthly maturities on time deposits.

FHLB advances and junior subordinated debentures: The fair value of these instruments is estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Other borrowings: The fair value for the wholesale repurchase agreements and fixed rate other borrowings is estimated using rates currently available for debt with similar terms and remaining maturities. The fair value for variable rate other borrowings is equal to its carrying value.

Commitments to extend credit: The fair value of these commitments is not material.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

QCR Holdings, Inc. is the parent company of QCBT, CRBT, RB&T, and as the result of the May 13, 2013 acquisition, CNB. See Note 2 to the Consolidated Financial Statements for additional information regarding the Company's acquisition of CNB.

QCBT and CRBT are Iowa-chartered commercial banks, and RB&T is an Illinois-chartered commercial bank. CNB is a national-chartered commercial bank headquartered in Iowa. All are members of the Federal Reserve System with depository accounts insured to the maximum amount permitted by law by the Federal Deposit Insurance Corporation ("FDIC").

QCBT commenced operations in 1994 and provides full-service commercial and consumer banking, and trust and asset management services, to the Quad City area and adjacent communities through its five offices that are located in Bettendorf and Davenport, Iowa and Moline, Illinois. QCBT also provides leasing services through its wholly-owned subsidiary, m2 Lease Funds, located in Brookfield, Wisconsin. In addition, QCBT owns 100% of Quad City Investment Advisors, LLC, which is an investment management and advisory company.

CRBT commenced operations in 2001 and provides full-service commercial and consumer banking, and trust and asset management services, to Cedar Rapids, Iowa and adjacent communities through its main office located on First Avenue in downtown Cedar Rapids, Iowa and its branch facility located on Council Street in northern Cedar Rapids. Previously, CRBT had provided residential real estate mortgage lending services through its 50%-owned joint venture, Cedar Rapids Mortgage Company. During the first quarter of 2013, CRBT and the partner mutually terminated the joint venture. CRBT continues to provide residential real estate mortgage lending services through its consumer banking division.

RB&T commenced operations in January 2005 and provides full-service commercial and consumer banking, and trust and asset management services, to Rockford, Illinois and adjacent communities through its main office located on Guilford Road at Alpine Road in Rockford and its branch facility in downtown Rockford.

CNB commenced operations in 1997 and provides full-service commercial and consumer banking, and trust and asset management services, to Cedar Falls, Mason City, and Waterloo, Iowa and Austin, Minnesota. CNB has a total of eight branch facilities with four in the Waterloo/Cedar Falls area which is where CNB is headquartered, two in Mason City, and two in Austin. Recently, CNB signed separate definite agreements to sell certain assets and liabilities of the two Mason City branches and the two Austin branches. The proposed transactions, which are subject to regulatory approval and customary closing conditions, are expected to be completed in the fourth quarter of 2013. See Note 2 to the Consolidated Financial Statements for additional information regarding the Company's sales of the Mason City and Austin branches.



## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

OVERVIEW

The Company recognized net income and net income attributable to QCR Holdings, Inc. of \$4.0 million for the quarter ended June 30, 2013. After preferred stock dividends of \$811 thousand, the Company reported net income attributable to common stockholders of \$3.2 million, or diluted earnings per common share of \$0.59. By comparison, for the second quarter of 2012, the Company recognized net income of \$3.3 million and net income attributable to QCR holdings, Inc. of \$3.1 million, which excludes the net income attributable to noncontrolling interests of \$201 thousand. After preferred stock dividends of \$936 thousand, the Company reported net income attributable to common stockholders of \$2.1 million, or diluted earnings per common share of \$0.44. For the first half of 2013, the Company recognized net income and net income attributable to QCR Holdings, Inc. of \$7.3 million, or diluted earnings per share of \$1.08 after preferred stock dividends of \$1.6 million. This is an increase of \$1.0 million, or 16%, over the same period of 2012.

Following is a table that represents the various net income measurements for the Company.

|   | For the three months<br>ended |                  | For the six months<br>ended |                  |
|---|-------------------------------|------------------|-----------------------------|------------------|
|   | June 30,<br>2013              | June 30,<br>2012 | June 30,<br>2013            | June 30,<br>2012 |
| Net income  | \$4,045,231                   | \$3,273,379      | \$7,310,375                 | \$6,676,228      |
| Less: Net income attributable to noncontrolling interests         | -                             | 201,223          | -                           | 367,254          |
| Net income attributable to QCR Holdings, Inc.                     | \$4,045,231                   | \$3,072,156      | \$7,310,375                 | \$6,308,974      |
| Less: Preferred stock dividends                                   | 810,838                       | 935,786          | 1,621,675                   | 1,874,411        |
| Net income attributable to QCR Holdings, Inc. common stockholders | \$3,234,393                   | \$2,136,370      | \$5,688,700                 | \$4,434,563      |
| Diluted earnings per common share                                 | \$0.59                        | \$0.44           | \$1.08                      | \$0.91           |

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Weighted average common and common equivalent shares outstanding | 5,497,275 | 4,901,853 | 5,265,809 | 4,867,628 |
|--|-----------|-----------|-----------|-----------|

Following is a table that represents the major income and expense categories for the Company.

|                                 | For the three months ended |                   |                  | For the six months ended |                  |
|---------------------------------|----------------------------|-------------------|------------------|--------------------------|------------------|
|                                 | June 30,<br>2013           | March 31,<br>2013 | June 30,<br>2012 | June 30,<br>2013         | June 30,<br>2012 |
| Net interest income             | \$15,708,052               | \$14,191,317      | \$14,515,493     | \$29,899,369             | \$28,718,946     |
| Provision for loan/lease losses | (1,520,137 )               | (1,057,782 )      | (1,048,469 )     | (2,577,919 )             | (1,828,915 )     |
| Noninterest income              | 6,948,756                  | 5,204,029         | 4,067,509        | 12,152,785               | 8,024,387        |
| Noninterest expense             | (15,234,349)               | (13,958,500)      | (13,109,083)     | (29,192,849)             | (25,847,163)     |
| Federal and state income tax    | (1,857,091 )               | (1,113,920 )      | (1,152,071 )     | (2,971,011 )             | (2,391,027 )     |
| Net income                      | \$4,045,231                | \$3,265,144       | \$3,273,379      | \$7,310,375              | \$6,676,228      |

With the acquisition of Community National and CNB on May 13, 2013, the Company's quarterly results include a partial quarter of CNB's earnings. Specifically, CNB recognized net income of \$240 thousand.

In comparing quarter-over-quarter, following are some noteworthy fluctuations:

Net interest income grew \$1.5 million, or 11%, propelled by the addition of CNB for the partial quarter as well as organic growth in earning assets.

Provision for loan/lease losses ("provision") increased \$462 thousand as specific reserves were established for certain commercial credits at the Company's largest bank.

Noninterest income increased \$1.7 million, or 34%, which consisted primarily of a bargain purchase gain (\$1.8 million) that was recorded on the Community National acquisition.

The Company incurred \$1.3 million more in noninterest expenses as a result of the acquisition of CNB's existing cost structure, as well as additional acquisition related expenses.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

NET INTEREST INCOME

Net interest income, on a tax equivalent basis, increased \$1.4 million, or 9%, to \$16.4 million for the quarter ended June 30, 2013, from \$15.0 million for the same period of 2012. The increase in net interest income was driven by the addition of CNB for a partial quarter (\$1.2 million at a net interest margin of approximately 3.72%). Exclusive of CNB, the Company was successful in growing net interest income. This was the result of organic loan/lease growth and continued reductions in the cost of deposits as well as growth in noninterest bearing deposits more than offsetting the impact of declining yields on loans.

A comparison of yields, spread and margin from the second quarter of 2013 to the second quarter of 2012 is as follows (on a tax equivalent basis):

- The average yield on interest-earning assets decreased 48 basis points.
- The average cost of interest-bearing liabilities decreased 32 basis points.
- The net interest spread declined 16 basis points from 2.88% to 2.72%.
- The net interest margin declined 22 basis points from 3.21% to 2.99%.

Net interest income, on a tax equivalent basis, increased \$1.6 million, or 5%, to \$31.1 million for the first half of 2013, from \$29.5 million for the same period of 2012. The increase in net interest income was driven primarily by the addition of CNB for a partial quarter (\$1.2 million at a net interest margin of approximately 3.72%). As with the quarterly comparison, the Company expanded net interest income excluding CNB through organic earning asset growth and declining cost of funds more than offsetting the continued declining yields on loans.

A comparison of yields, spread and margin from the first half of 2013 to the same period of 2012 is as follows (on a tax equivalent basis):

The average yield on interest-earning assets decreased 41 basis points.  
The average cost of interest-bearing liabilities decreased 28 basis points.  
The net interest spread declined 13 basis points from 2.84% to 2.71%.  
The net interest margin declined 16 basis points from 3.16% to 3.00%.

The Company's management closely monitors and manages net interest margin. From a profitability standpoint, an important challenge for the Company's subsidiary banks and leasing company is the improvement of their net interest margins. Management continually addresses this issue with pricing and other balance sheet management strategies. As an example, during the first quarter of 2013, QCBT modified \$50.0 million of fixed rate wholesale structured repurchase agreements ("structured repos") with a weighted average interest rate of 3.21% and a weighted average maturity of February 2016 into new fixed rate structured repos with a weighted average interest rate of 2.65% and a weighted average maturity of May 2020. This modification serves to reduce interest expense and improve net interest margin, and minimizes the exposure to rising rates through duration extension of fixed rate liabilities.

Over the past several years, the Company's management has emphasized improving its funding mix by reducing its reliance on long-term wholesale funding, which tends to be at a higher cost than deposits. In addition, with deposit growth continuing to outpace loan growth, the Company's management has focused on growing and diversifying its securities portfolio.

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

The Company's average balances, interest income/expense, and rates earned/paid on major balance sheet categories, as well as the components of change in net interest income, are presented in the following tables:

|  | For the three months ended June 30,<br>2013 |                               |                                | 2012               |                               |                                |
|--|---|-------------------------------|--------------------------------|--------------------|-------------------------------|--------------------------------|
|  | Average<br>Balance                          | Interest<br>Earned<br>or Paid | Average<br>Yield<br>or<br>Cost | Average<br>Balance | Interest<br>Earned<br>or Paid | Average<br>Yield<br>or<br>Cost |
|  | (dollars in thousands)                      |                               |                                |                    |                               |                                |
| <b>ASSETS</b>  |   |                               |                                |                    |                               |                                |
| Interest earning assets:                               |   |                               |                                |                    |                               |                                |
| Federal funds sold                                     | \$8,410                                     | \$3                           | 0.14 %                         | \$-                | \$-                           | 0.00 %                         |
| Interest-bearing deposits at financial institutions    | 35,158                                      | 62                            | 0.71 %                         | 36,478             | 92                            | 1.01 %                         |
| Investment securities (1)                              | 714,808                                     | 4,040                         | 2.27 %                         | 615,089            | 3,569                         | 2.33 %                         |
| Restricted investment securities                       | 16,531                                      | 131                           | 3.18 %                         | 15,282             | 165                           | 4.34 %                         |
| Gross loans/leases receivable (1) (2) (3)              | 1,418,389                                   | 16,530                        | 4.67 %                         | 1,211,595          | 16,165                        | 5.37 %                         |
| Total interest earning assets                          | \$2,193,296                                 | 20,766                        | 3.80 %                         | \$1,878,444        | 19,991                        | 4.28 %                         |
| Noninterest-earning assets:                            |   |                               |                                |                    |                               |                                |
| Cash and due from banks                                | \$41,791                                    |                               |                                | \$39,896           |                               |                                |
| Premises and equipment                                 | 35,698                                      |                               |                                | 31,529             |                               |                                |
| Less allowance for estimated losses on loans/leases... | (22,192 )                                   |                               |                                | (19,183 )          |                               |                                |
| Other  | 74,743                                      |                               |                                | 74,938             |                               |                                |
| Total assets   | \$2,323,336                                 |                               |                                | \$2,005,624        |                               |                                |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>            |   |                               |                                |                    |                               |                                |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |             |          |      |   |             |          |      |   |
|--|-------------|----------|------|---|-------------|----------|------|---|
| Interest-bearing liabilities:  |             |          |      |   |             |          |      |   |
| Interest-bearing deposits  | \$632,932   | 398      | 0.25 | % | \$532,718   | 722      | 0.55 | % |
| Time deposits  | 416,085     | 779      | 0.75 | % | 354,285     | 908      | 1.03 | % |
| Short-term borrowings  | 195,202     | 103      | 0.21 | % | 179,979     | 77       | 0.17 | % |
| Federal Home Loan Bank advances  | 216,725     | 1,727    | 3.20 | % | 205,162     | 1,829    | 3.59 | % |
| Junior subordinated debentures   | 41,398      | 261      | 2.53 | % | 36,085      | 259      | 2.89 | % |
| Other borrowings   | 140,091     | 1,163    | 3.33 | % | 136,648     | 1,224    | 3.60 | % |
| <br>   |             |          |      |   |             |          |      |   |
| Total interest-bearing liabilities   | \$1,642,433 | 4,431    | 1.08 | % | \$1,444,877 | 5,019    | 1.40 | % |
| <br>   |             |          |      |   |             |          |      |   |
| Noninterest-bearing demand deposits  | \$502,078   |          |      |   | \$391,475   |          |      |   |
| Other noninterest-bearing liabilities  | 32,154      |          |      |   | 25,331      |          |      |   |
| Total liabilities  | \$2,176,665 |          |      |   | \$1,861,683 |          |      |   |
| <br>   |             |          |      |   |             |          |      |   |
| Stockholders' equity   | 146,671     |          |      |   | 143,941     |          |      |   |
| <br>   |             |          |      |   |             |          |      |   |
| Total liabilities and stockholders' equity                                       | \$2,323,336 |          |      |   | \$2,005,624 |          |      |   |
| <br>   |             |          |      |   |             |          |      |   |
| Net interest income  |             | \$16,335 |      |   |             | \$14,972 |      |   |
| <br>   |             |          |      |   |             |          |      |   |
| Net interest spread  |             |          | 2.72 | % |             |          | 2.88 | % |
| <br>   |             |          |      |   |             |          |      |   |
| Net interest margin  |             |          | 2.99 | % |             |          | 3.21 | % |
| <br>   |             |          |      |   |             |          |      |   |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 133.54      | %        |      |   | 130.01      | %        |      |   |

(1) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 34% tax rate.

(2) Loan/lease fees are not material and are included in interest income from loans/leases receivable in accordance with accounting and regulatory guidance.

(3) Non-accrual loans/leases are included in the average balance for gross loans/leases receivable in accordance with accounting and regulatory guidance.

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

**Analysis of Changes of Interest Income/Interest Expense****For the three months ended June 30, 2013**

|   | <b>Inc./Decomponents<br/>from of Change (1)</b> |             |               |
|---|---|-------------|---------------|
|   | <b>Prior<br/>Period</b>                         | <b>Rate</b> | <b>Volume</b> |
|   | <b>2013 vs. 2012</b>                            |             |               |
|   | (dollars in thousands)                          |             |               |
| <b>INTEREST INCOME</b>                              |   |             |               |
| Federal funds sold                                  | \$3   | \$-         | \$3           |
| Interest-bearing deposits at financial institutions | (30 )   | (27 )       | (3 )          |
| Investment securities (2)                           | 471   | (628 )      | 1,099         |
| Restricted investment securities                    | (34 )   | (109 )      | 75            |
| Gross loans/leases receivable (3) (4) (5)           | 365   | (9,392 )    | 9,757         |
| Total change in interest income                     | \$775   | \$(10,156)  | \$10,931      |
| <b>INTEREST EXPENSE</b>                             |   |             |               |
| Interest-bearing deposits                           | \$(324 )  | \$(1,049 )  | \$725         |
| Time deposits                                       | (129 )  | (854 )      | 725           |
| Short-term borrowings                               | 26  | 19          | 7             |
| Federal Home Loan Bank advances                     | (102 )  | (613 )      | 511           |
| Junior subordinated debentures                      | 2   | (139 )      | 141           |
| Other borrowings                                    | (61 )   | (232 )      | 171           |
| Total change in interest expense                    | \$(588 )  | \$(2,868 )  | \$2,280       |
| Total change in net interest income                 | \$1,363   | \$(7,288 )  | \$8,651       |

The column "Inc./(Dec.) from Prior Period" is segmented into the changes attributable to variations in volume and (1) the changes attributable to changes in interest rates. The variations attributable to simultaneous volume and rate changes have been proportionately allocated to rate and volume.

(2) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 34% tax rate.

(3) Loan/lease fees are not material and are included in interest income from loans/leases receivable in accordance with accounting and regulatory guidance.

(4) Non-accrual loans/leases are included in the average balance for gross loans/leases receivable in accordance with accounting and regulatory guidance.



## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

|  | <b>For the six months ended June 30,</b> |          |         |             |          |         |
|--|--|----------|---------|-------------|----------|---------|
|  | <b>2013</b>                              |          |         | <b>2012</b> |          |         |
|  | Average                                  | Interest | Average | Average     | Interest | Average |
|  | Balance                                  | Earned   | Yield   | Balance     | Earned   | Yield   |
|  |  | or Paid  | or      |             | or Paid  | or      |
|  |  |          | Cost    |             |          | Cost    |
|  | (dollars in thousands)                   |          |         |             |          |         |
| <b>ASSETS</b>  |  |          |         |             |          |         |
| Interest earning assets:                               |  |          |         |             |          |         |
| Federal funds sold                                     | \$5,379                                  | \$4      | 0.15 %  | \$-         | \$-      | 0.00 %  |
| Interest-bearing deposits at financial institutions    | 36,496                                   | 122      | 0.67 %  | 60,423      | 213      | 0.71 %  |
| Investment securities (1)                              | 681,723                                  | 7,697    | 2.28 %  | 595,810     | 6,959    | 2.35 %  |
| Restricted investment securities                       | 15,973                                   | 256      | 3.23 %  | 15,281      | 246      | 3.24 %  |
| Gross loans/leases receivable (1) (2) (3)              | 1,348,715                                | 31,782   | 4.75 %  | 1,204,820   | 32,297   | 5.39 %  |
| Total interest earning assets                          | 2,088,286                                | 39,861   | 3.85 %  | \$1,876,334 | 39,715   | 4.26 %  |
| Noninterest-earning assets:                            |  |          |         |             |          |         |
| Cash and due from banks                                | \$40,849                                 |          |         | \$40,459    |          |         |
| Premises and equipment                                 | 33,450                                   |          |         | 31,600      |          |         |
| Less allowance for estimated losses on loans/leases... | (21,208 )                                |          |         | (19,047 )   |          |         |
| Other  | 75,297                                   |          |         | 75,837      |          |         |
| Total assets   | \$2,216,674                              |          |         | \$2,005,183 |          |         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>            |  |          |         |             |          |         |
| Interest-bearing liabilities:                          |  |          |         |             |          |         |
| Interest-bearing deposits                              | \$597,918                                | 807      | 0.27 %  | \$536,976   | 1,465    | 0.55 %  |
| Time deposits  | 374,890                                  | 1,487    | 0.80 %  | 350,043     | 1,880    | 1.08 %  |
| Short-term borrowings                                  | 185,454                                  | 167      | 0.18 %  | 179,480     | 142      | 0.16 %  |
| Federal Home Loan Bank advances                        | 209,672                                  | 3,460    | 3.33 %  | 205,650     | 3,693    | 3.61 %  |
| Junior subordinated debentures                         | 38,742                                   | 502      | 2.61 %  | 36,085      | 527      | 2.94 %  |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |           |           |      |   |              |           |      |   |
|--|-----------|-----------|------|---|--------------|-----------|------|---|
| Other borrowings (4)   | 139,151   | 2,354     | 3.41 | % | 136,273      | 2,482     | 3.66 | % |
| Total interest-bearing liabilities   | 1,545,826 | 8,777     | 1.14 | % | \$ 1,444,507 | 10,189    | 1.42 | % |
| Noninterest-bearing demand deposits  | 494,671   |           |      |   | \$ 390,748   |           |      |   |
| Other noninterest-bearing liabilities  | 32,250    |           |      |   | 26,046       |           |      |   |
| Total liabilities  | 2,072,747 |           |      |   | \$ 1,861,301 |           |      |   |
| Stockholders' equity   | 143,927   |           |      |   | 143,882      |           |      |   |
| Total liabilities and stockholders' equity                                       | 2,216,674 |           |      |   | \$ 2,005,183 |           |      |   |
| Net interest income  |           | \$ 31,084 |      |   |              | \$ 29,526 |      |   |
| Net interest spread  |           |           | 2.71 | % |              |           | 2.84 | % |
| Net interest margin  |           |           | 3.00 | % |              |           | 3.16 | % |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 135.09    | %         |      |   | 129.89       | %         |      |   |

- (1) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 34% tax rate.
- (2) Loan/lease fees are not material and are included in interest income from loans/leases receivable in accordance with accounting and regulatory guidance.
- (3) Non-accrual loans/leases are included in the average balance for gross loans/leases receivable in accordance with accounting and regulatory guidance.

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

**Analysis of Changes of Interest Income/Interest Expense****For the six months ended June 30, 2013**

|   | <b>Inc./Dec. Components<br/>from of Change (1)</b> |             |               |
|---|--|-------------|---------------|
|   | <b>Prior<br/>Period<br/>2013 vs. 2012</b>          | <b>Rate</b> | <b>Volume</b> |
|   | <b>(dollars<br/>in<br/>thousands)</b>              |             |               |
| <b>INTEREST INCOME</b>                              |  |             |               |
| Federal funds sold                                  | \$4  | \$-         | \$4           |
| Interest-bearing deposits at financial institutions | (91 )  | (10 )       | (81 )         |
| Investment securities (2)                           | 738  | (578 )      | 1,316         |
| Restricted investment securities                    | 10   | (1 )        | 11            |
| Gross loans/leases receivable (3) (4) (5)           | (515 )   | (7,983)     | 7,468         |
| Total change in interest income                     | \$146  | \$(8,572)   | \$8,718       |
| <b>INTEREST EXPENSE</b>                             |  |             |               |
| Interest-bearing deposits                           | \$(658 )   | \$(1,083)   | \$425         |
| Time deposits                                       | (393 )   | (730 )      | 337           |
| Short-term borrowings                               | 25   | 20          | 5             |
| Federal Home Loan Bank advances                     | (233 )   | (419 )      | 186           |
| Junior subordinated debentures                      | (25 )  | (109 )      | 84            |
| Other borrowings (5)                                | (128 )   | (259 )      | 131           |
| Total change in interest expense                    | \$(1,412)  | \$(2,580)   | \$1,168       |
| Total change in net interest income                 | \$1,558  | \$(5,992)   | \$7,550       |

- The column "Inc./(Dec.) from Prior Period" is segmented into the changes attributable to variations in volume and
- (1) the changes attributable to changes in interest rates. The variations attributable to simultaneous volume and rate changes have been proportionately allocated to rate and volume.
  - (2) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 34% tax rate.
  - (3) Loan/lease fees are not material and are included in interest income from loans/leases receivable in accordance with accounting and regulatory guidance.
  - (4) Non-accrual loans/leases are included in the average balance for gross loans/leases receivable in accordance with accounting and regulatory guidance.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

CRITICAL ACCOUNTING POLICIES

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained within these statements is, to a significant extent, financial information that is based on approximate measures of the financial effects of transactions and events that have already occurred.

Based on its consideration of accounting policies that involve the most complex and subjective decisions and assessments, management has identified its most critical accounting policy to be that related to the allowance for estimated losses on loans/leases ("allowance"). The Company's allowance methodology incorporates a variety of risk considerations, both quantitative and qualitative, in establishing an allowance that management believes is appropriate at each reporting date. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, changes in nonperforming loans/leases, and other factors. Quantitative factors also incorporate known information about individual loans/leases, including borrowers' sensitivity to interest rate movements. Qualitative factors include the general economic environment in the Company's markets, including economic conditions throughout the Midwest, and in particular, the state of certain industries. Size and complexity of individual credits in relation to loan/lease structure, existing loan/lease policies and pace of portfolio growth are other qualitative factors that are considered in the methodology. Management may report a materially different amount for the provision in the statement of income to change the allowance if its assessment of the above factors were different. This discussion and analysis should be read in conjunction with the Company's financial statements and the accompanying notes presented elsewhere herein, as well as the portion in the section entitled "Financial Condition" of this Management's Discussion and Analysis that discusses the allowance. Although management believes the level of the allowance as of June 30, 2013 is adequate to absorb losses inherent in the loan/lease portfolio, a decline in local economic conditions, or other factors, could result in increasing losses that cannot be reasonably predicted at this time.

The Company's assessment of other-than-temporary impairment of its available-for-sale securities portfolio is another critical accounting policy as a result of the level of judgment required by management. Available-for-sale securities are evaluated to determine whether declines in fair value below their cost are other-than-temporary. In estimating other-than-temporary impairment losses, management considers a number of factors including, but not limited to, (1) the length of time and extent to which the fair value has been less than amortized cost, (2) the financial condition and

near-term prospects of the issuer, (3) the current market conditions, and (4) the intent of the Company to not sell the security prior to recovery and whether it is not more-likely-than-not that the Company will be required to sell the security prior to recovery. The discussion regarding the Company's assessment of other-than-temporary impairment should be read in conjunction with the Company's financial statements and the accompanying notes presented elsewhere herein.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

RESULTS OF OPERATIONS

INTEREST INCOME

Interest income grew \$604 thousand, or 3%, comparing the second quarter of 2013 to the same period of 2012. For the first half of 2013, interest income declined \$231 thousand, or 1%, compared to the same period of 2012. Excluding CNB's interest income for the partial quarter which totaled \$1.3 million, the trend in declining interest income continued as the effect of declines in loan and securities yields, caused primarily by the continuing low interest rate environment, more than offset the growth in loans and securities. The Company continues to focus on diversifying its securities portfolio, including increasing its portfolio of agency-sponsored mortgage-backed securities as well as municipal securities. Of the latter, all are located in the Midwest with strong underwriting conducted before investment.

The Company intends to continue to grow quality loans and leases as well as to diversify the securities portfolio to maximize yield while minimizing credit and interest rate risk.

INTEREST EXPENSE

Interest expense for the second quarter of 2013 declined \$588 thousand, or 12%, from the second quarter of 2012. For the first half of 2013, the Company's interest expense fell \$1.4 million, or 14%, compared to the first half of 2012. CNB's interest expense for the partial second quarter of 2013 totaled \$115 thousand which is exclusively cost of deposits as CNB has no borrowings. The Company has been successful in maintaining pricing discipline on deposits and decreasing the cost of borrowings, which has contributed to the decline in interest expense. Management has placed a strong focus on reducing the reliance on long-term wholesale funding as it tends to be higher cost than deposits. In recent years, the majority of maturing wholesale funds have not been replaced, or, to a lesser extent, have

been replaced at significantly reduced cost. Additionally, over the recent years, the Company has been successful in modifying a portion of its wholesale funding portfolio which serves to reduce interest expense through extending maturities while minimizing the exposure to rising rates.

Management continues to consider strategies to accelerate the reduction of the reliance on wholesale funding and continue the shift in mix to a funding base consisting of a higher percentage of core deposits, including noninterest-bearing deposits.



Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

PROVISION FOR LOAN/LEASE LOSSES

The provision is established based on a number of factors, including the Company's historical loss experience, delinquencies and charge-off trends, the local and national economy and risk associated with the loans/leases in the portfolio as described in more detail in the "Critical Accounting Policies" section.

Provision totaled \$1.5 million for the second quarter of 2013, which is up \$462 thousand from the prior quarter, and an increase of \$472 thousand from the second quarter of 2012. For the first half of 2013, the Company's provision totaled \$2.6 million which is an increase of \$749 thousand, or 41%, from the same period of 2012. The increased provision in the second quarter of 2013 was the result of specific reserves established on certain, isolated commercial credits at the Company's largest subsidiary bank. With the provision of \$1.5 million more than offsetting the net charge-offs totaling \$1.1 million (only 8 basis points of average loans/leases during the current quarter), the Company's allowance grew to \$21.2 million at June 30, 2013. In accordance with generally accepted accounting principles for acquisition accounting, CNB's loans are recorded at fair value; therefore, there is no allowance associated with CNB's loans at June 30, 2013. As a result, the Company's allowance to total loans/leases fell to 1.38% from 1.61% at March 31, 2013, and from 1.54% at June 30, 2012. Had CNB's loans remained at their historical carrying value with the related allowance as of the acquisition, the allowance to total loans/leases would be approximately 1.60%. Further, the Company's allowance to total nonperforming loans/leases was 71% at June 30, 2013 which is down from 105% at March 31, 2013 and up from 69% at June 30, 2012. Similarly, adjusting for CNB's loans at their historical carrying value with the related allowance as of the acquisition, the resulting ratio of allowance to nonperforming loans/leases would increase to approximately 82%.

A more detailed discussion of the Company's allowance can be found in the "Financial Condition" section of this report.

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

## NONINTEREST INCOME

The following tables set forth the various categories of noninterest income for the three and six months ended June 30, 2013 and 2012.

|   | Three Months Ended |               | \$ Change   | % Change |   |
|---|--------------------|---------------|-------------|----------|---|
|   | June 30, 2013      | June 30, 2012 |             |          |   |
| Trust department fees                                     | \$1,197,181        | \$852,234     | \$344,947   | 40.5     | % |
| Investment advisory and management fees                   | 695,094            | 679,326       | 15,768      | 2.3      |   |
| Deposit service fees                                      | 1,054,223          | 875,073       | 179,150     | 20.5     |   |
| Gains on sales of residential real estate loans           | 246,621            | 271,333       | (24,712)    | (9.1)    | ) |
| Gains on sales of government guaranteed portions of loans | 765,738            | 610,988       | 154,750     | 25.3     |   |
| Earnings on bank-owned life insurance                     | 423,883            | 358,660       | 65,223      | 18.2     |   |
| Credit card fees, net of processing costs                 | 85,017             | 142,173       | (57,156)    | (40.2)   | ) |
| Subtotal  | \$4,467,757        | \$3,789,787   | \$677,970   | 17.9     |   |
| Losses on other real estate owned, net                    | (83,339)           | (389,465)     | 306,126     | (78.6)   | ) |
| Securities gains  | 16,460             | 104,600       | (88,140)    | (84.3)   | ) |
| Bargain purchase gain on Community National acquisition   | 1,841,385          | -             | 1,841,385   | 100.0    |   |
| Other   | 706,493            | 562,587       | 143,906     | 25.6     |   |
| Total noninterest income                                  | \$6,948,756        | \$4,067,509   | \$2,881,247 | 70.8     | % |

|                       | Six Months Ended |               | \$ Change | % Change |   |
|-----------------------|------------------|---------------|-----------|----------|---|
|                       | June 30, 2013    | June 30, 2012 |           |          |   |
| Trust department fees | \$2,236,851      | \$1,735,966   | \$500,885 | 28.9     | % |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|   |              |             |             |         |
|---|--------------|-------------|-------------|---------|
| Investment advisory and management fees                   | 1,304,435    | 1,200,788   | 103,647     | 8.6     |
| Deposit service fees                                      | 1,962,046    | 1,779,479   | 182,567     | 10.3    |
| Gains on sales of residential real estate loans           | 537,772      | 562,766     | (24,993 )   | (4.4 )  |
| Gains on sales of government guaranteed portions of loans | 1,610,962    | 718,645     | 892,316     | 124.2   |
| Earnings on bank-owned life insurance                     | 862,570      | 797,062     | 65,508      | 8.2     |
| Credit card fees, net of processing costs                 | 134,971      | 269,188     | (134,217 )  | (49.9 ) |
| Subtotal  | \$8,649,607  | \$7,063,894 | \$1,585,713 | 22.4    |
| Losses on other real estate owned, net                    | (529,969 )   | (578,669 )  | 48,700      | (8.4 )  |
| Securities gains  | 16,460       | 104,600     | (88,140 )   | (84.3 ) |
| Bargain purchase gain on Community National acquisition   | 1,841,385    | -           | 1,841,385   | 100.0   |
| Other   | 2,175,302    | 1,434,562   | 740,740     | 51.6    |
| Total noninterest income                                  | \$12,152,785 | \$8,024,387 | \$4,128,398 | 51.4 %  |

Trust department fees continue to be a significant contributor to noninterest income. Trust department fees grew 40% from the second quarter of 2012 to the second quarter of 2013. For the first half of 2013, trust department fees are up 29% compared to the same period of 2012. CNB recognized \$164 thousand of trust department fees for the partial second quarter. The majority of the trust department fees are determined based on the value of the investments within the managed trusts. As markets have strengthened with the national economy's continued recovery from recession, the Company's fee income has experienced similar growth. Additionally, the Company has been successful in expanding its customer base, which has helped to drive the recent increases in fee income.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

In recent years, the Company has placed a stronger emphasis on growing its investment advisory and management services. Part of this initiative has been to restructure the Company's Wealth Management Division to allow for more efficient delivery of products and services through selective additions of talent as well as the leverage of and collaboration among existing resources (including the aforementioned trust department). Fee income for investment advisory and management services grew 2% comparing the second quarter of 2013 to the same period of 2012, and grew 9% in the first half of 2013 over the first half of 2012. CNB does not currently provide investment advisory and management services; however, the Company expects to leverage its existing infrastructure to efficiently offer these services in the communities served by CNB. Similar to trust department fees, these fees are largely determined based on the value of the investments managed. Continued expansion of the customer base has helped drive the recent increases in fee income.

As management focuses on growing fee income, expanding market share in trust and investment advisory services across all of the Company's markets will continue to be a primary strategic focus.

Deposit service fees have generally expanded over the past several years. This expansion continued into the second quarter of 2013 with increases of 20% quarter-over-quarter and 10% year-over-year. CNB's deposit service fees for the partial second quarter were \$125 thousand. Excluding CNB, the Company organically grew deposit service fees in the second quarter. The Company continues its emphasis on shifting the mix of deposits from brokered and retail time deposits to non-maturity demand deposits. With this shift in mix, the Company has increased the number of demand deposit accounts, which tend to be lower in interest cost and higher in service fees. The Company plans to continue this shift in mix and to further focus on growing deposit service fees.

Gains on sales of residential real estate loans fell 9% comparing second quarter of 2013 to second quarter of 2012, and were down 4% year-over-year. With the sustained historically low interest rate environment, refinancing activity has slowed as most of the Company's existing and prospective customers have already executed a refinancing.

As one of its core strategies, the Company continues to leverage its small business lending expertise by taking advantage of programs offered by the Small Business Administration (“SBA”) and the United States Department of Agriculture (“USDA”). The Company’s portfolio of government guaranteed loans has grown as a direct result of the Company’s strong expertise in SBA and USDA lending. In some cases, it is more beneficial for the Company to sell the government guaranteed portions of the loans on the secondary market for a premium rather than retain the loans in the Company’s portfolio. Sales activity for government guaranteed portions of loans tends to fluctuate depending on the demand for small business loans that fit the criteria for the government guarantee. Further, some of the transactions can be large and, as the gain is determined as a percentage of the guaranteed amount, the resulting gain on sale can be large. Lastly, a strategy for improved pricing is packaging loans together for sale. From time to time, the Company may execute on this strategy, which may delay the gains on sales of some loans to achieve better pricing. Despite the fluctuation, the Company will continue to focus on growing small business lending and selling the government guaranteed portion as it continues to be beneficial.

During the first quarter of 2013, the Company wrote down one existing individual other real estate owned (“OREO”) property by \$463 thousand as a result of a further decline in appraised value. Management continues to proactively manage its OREO portfolio in an effort to sell the properties timely at minimal loss.

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

In accordance with acquisition accounting rules, the Company recognized a bargain purchase gain of \$1.8 million in recording the acquisition of Community National. The Company adjusted the acquired assets and assumed liabilities to fair value as determined by an independent valuation specialist. The gain resulted primarily from the recording of a core deposit intangible based on the value of the acquired deposit portfolio, and the recognition of a discount on the trust preferred securities that were previously issued by Community National and were assumed by the Company in the transaction. Net of other more modest valuation adjustments, and the resulting deferred income tax liabilities, the \$1.8 million bargain purchase gain was included noninterest income. See Note 2 to the Consolidated Financial Statements for additional information regarding the Company's acquisition of Community National.

The following table sets forth the various categories of other noninterest income for the three and six months ended June 30, 2013 and 2012.

|   | Three Months Ended |                  |              |             |
|---|--------------------|------------------|--------------|-------------|
|   | June 30,<br>2013   | June 30,<br>2012 | \$<br>Change | %<br>Change |
| Debit card fees                                 | \$257,200          | \$251,800        | \$5,400      | 2.1 %       |
| Fees on interest rate swaps on commercial loans | -                  | -                | -            | -           |
| Miscellaneous                                   | 449,293            | 310,787          | 138,506      | 44.6        |
| Other noninterest income                        | \$706,493          | \$562,587        | \$143,906    | 25.6 %      |

  

|   | Six Months Ended |                  |           |             |
|---|------------------|------------------|-----------|-------------|
|   | June 30,<br>2013 | June 30,<br>2012 | \$ Change | %<br>Change |
| Gain on sale of credit card portfolio           | \$495,405        | \$-              | \$495,405 | 100.0 %     |
| Gain on sale of credit card issuing operations  | 355,268          | -                | 355,268   | 100.0       |
| Debit card fees                                 | 487,100          | 489,600          | (2,500 )  | (0.5 )      |
| Fees on interest rate swaps on commercial loans | 6,720            | 206,640          | (199,920) | (96.7 )     |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|                          |             |             |           |      |   |
|--------------------------|-------------|-------------|-----------|------|---|
| Miscellaneous            | 830,809     | 738,322     | 92,487    | 12.5 |   |
| Other noninterest income | \$2,175,302 | \$1,434,562 | \$740,740 | 51.6 | % |

During the first quarter of 2013, QCBT sold its credit card loan portfolio for a pre-tax gain on sale of \$495 thousand. In addition, QCBT sold its credit card issuing operations to the same purchaser for a pre-tax gain on sale of \$355 thousand. The latter was the primary reason for the decline in the credit card fees, net of processing costs, during the first half of 2013.

In recent years as a result of the sustained historically low interest rate environment, CRBT has introduced the execution of interest rate swaps on select commercial loans. The interest rate swaps allow the commercial borrowers to pay a fixed interest rate while CRBT receives a variable interest rate as well as an upfront fee dependent upon the pricing. Management believes that these swaps help position CRBT more favorably for rising rate environments. Management will continue to review opportunities to execute these swaps at all four of its subsidiary banks as the circumstances are appropriate for the borrower and the Company.

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

## NONINTEREST EXPENSE

The following tables set forth the various categories of noninterest expense for the three and six months ended June 30, 2013 and 2012.

|  | Three Months Ended |               | \$ Change   | % Change |   |
|--|--------------------|---------------|-------------|----------|---|
|  | June 30, 2013      | June 30, 2012 |             |          |   |
| Salaries and employee benefits                       | \$9,186,233        | \$8,255,639   | \$930,594   | 11.3     | % |
| Occupancy and equipment expense                      | 1,586,841          | 1,364,912     | 221,929     | 16.3     |   |
| Professional and data processing fees                | 1,438,753          | 1,126,877     | 311,876     | 27.7     |   |
| FDIC and other insurance                             | 627,390            | 576,215       | 51,175      | 8.9      |   |
| Loan/lease expense                                   | 251,868            | 263,166       | (11,298)    | (4.3)    | ) |
| Advertising and marketing                            | 412,041            | 344,100       | 67,941      | 19.7     |   |
| Postage and telephone                                | 257,611            | 236,942       | 20,669      | 8.7      |   |
| Stationery and supplies                              | 150,718            | 135,211       | 15,507      | 11.5     |   |
| Bank service charges                                 | 284,345            | 198,492       | 85,853      | 43.3     |   |
| Subtotal   | \$14,195,800       | \$12,501,554  | \$1,694,246 | 13.6     |   |
| Acquisition costs                                    | 432,326            | -             | 432,326     | 100.0    |   |
| Other-than-temporary impairment losses on securities | -                  | 62,400        | (62,400)    | (100.0)  | ) |
| Other  | 606,223            | 545,129       | 61,094      | 11.2     |   |
| Total noninterest expense                            | \$15,234,349       | \$13,109,083  | \$2,125,266 | 16.2     | % |
|  | Six Months Ended   |               |             |          |   |
|  | June 30, 2013      | June 30, 2012 | \$ Change   | % Change |   |
| Salaries and employee benefits                       | \$17,928,916       | \$16,380,319  | \$1,548,597 | 9.5      | % |
| Occupancy and equipment expense                      | 3,015,711          | 2,717,175     | 298,536     | 11.0     |   |



Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |              |              |             |          |
|--|--------------|--------------|-------------|----------|
| Professional and data processing fees                | 2,578,814    | 2,277,067    | 301,747     | 13.3     |
| FDIC and other insurance                             | 1,183,301    | 1,157,071    | 26,230      | 2.3      |
| Loan/lease expense                                   | 496,959      | 481,900      | 15,059      | 3.1      |
| Advertising and marketing                            | 676,609      | 620,116      | 56,493      | 9.1      |
| Postage and telephone                                | 476,302      | 525,182      | (48,880 )   | (9.3 )   |
| Stationery and supplies                              | 261,388      | 278,177      | (16,789 )   | (6.0 )   |
| Bank service charges                                 | 559,840      | 398,221      | 161,619     | 40.6     |
| Subtotal   | \$27,177,840 | \$24,835,228 | \$2,342,612 | 9.4      |
| Acquisition costs                                    | 788,904      | -            | 788,904     | 100.0    |
| Other-than-temporary impairment losses on securities | -            | 62,400       | (62,400 )   | (100.0 ) |
| Other  | 1,226,105    | 949,535      | 276,570     | 29.1     |
| Total noninterest expense                            | \$29,192,849 | \$25,847,163 | \$3,345,686 | 12.9 %   |

Management places a strong emphasis on overall cost containment and is committed to improving the Company's general efficiency. The addition of CNB's cost structure for the partial second quarter impacts the Company's noninterest expenses. Management fully intends to continue to execute the integration plan for CNB over the next few quarters and increase efficiency and realize cost savings.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Salaries and employee benefits, which is the largest component of noninterest expense, increased from the second quarter of 2012 to the second quarter of 2013 by 11%, and increased from the first half of 2012 to the first half of 2013 by 10%. This increase is largely the result of:

Addition of CNB's cost structure for a partial quarter. Specifically, CNB incurred salaries and benefits cost of \$691 thousand for the partial second quarter.

Customary annual salary and benefits increases for the majority of the Company's employee base in 2013.

Continued increases in health insurance-related employee benefits for the majority of the Company's employee base. Targeted talent additions in early 2012. Specifically, the Company added four business development officers (three in the Wealth Management Division and one in the Correspondent Banking Division) in an effort to continue to grow market share.

Occupancy and equipment expense increased from the prior year with the purchases of additional technology for enhanced customer service and for improved fraud detection and prevention systems. In addition, the largest branch of RB&T was renovated to allow for existing and future expansion. Lastly, CNB's occupancy and equipment expense totaled \$131 thousand for the partial second quarter.

Professional and data processing fees increased from prior year primarily due to the addition of CNB's cost structure. CNB incurred \$163 thousand of professional and data processing fees for the partial second quarter. The remaining increase was the result of one-time expenses.

FDIC and other insurance expense has generally fallen over the past several years since the FDIC modified its assessment calculation to more closely align with bank performance and risk. CNB incurred \$39 thousand of FDIC and other insurance expense for the partial second quarter. Excluding CNB, the expense was relatively flat from quarter-to-quarter and year-over-year.

Bank service charges, which include costs incurred to provide services to QCBT's correspondent banking customer portfolio, have increased over the past several quarters. The increase is due, in large part, to the success QCBT has had in growing its correspondent banking customer portfolio over the recent years.

With the acquisition of Community National on May 13, 2013, the Company incurred acquisition costs totaling \$432 thousand for the second quarter of 2013, and \$789 thousand for the first half of 2013. In accordance with generally accepted accounting principles, the Company expensed these costs as incurred. With the conversion of CNB's systems set to occur over the second half of 2013, management expects to incur further acquisition related costs.

In conjunction with the sales of QCBT's credit card loan portfolio and issuing operations in the first quarter of 2013, the Company incurred pre-tax expenses related to those transactions totaling \$257 thousand (\$143 thousand in other noninterest expenses and \$114 thousand of professional fees).

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

## INCOME TAXES

The provision for income taxes totaled \$1.9 million, or an effective tax rate of 31%, for the second quarter of 2013 compared to \$1.2 million, or an effective tax rate of 26%, for the same quarter in 2012. For the first half of 2013, provision for income taxes totaled \$3.0 million, or an effective tax rate of 29%, compared to \$2.4 million, or an effective tax rate of 26%, for the first half of 2012. The increases in effective tax rate are the result of the following:

The acquisition costs incurred are capitalized for tax purposes; therefore, the Company's taxable income is not reduced for these costs; and

CNB's effective tax rate for the partial second quarter was 38%. CNB has a smaller proportion of tax exempt income from securities and loans as compared to the Company's legacy banks.

FINANCIAL CONDITION

Following is a table that represents the major categories of the Company's balance sheet.

|   | As of<br>June 30, 2013 |      | December 31,<br>2012 |      | June 30, 2012 |      |
|---|------------------------|------|----------------------|------|---------------|------|
|   | Amount                 | %    | Amount               | %    | Amount        | %    |
| Cash, federal funds sold, and interest-bearing deposits | \$95,557               | 4 %  | \$110,488            | 5 %  | \$83,717      | 4 %  |
| Securities  | 703,467                | 29 % | 602,239              | 29 % | 638,838       | 31 % |
| Net loans/leases  | 1,509,570              | 62 % | 1,267,462            | 61 % | 1,194,579     | 58 % |

*(dollars in thousands)*

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |             |       |             |       |             |       |
|--|-------------|-------|-------------|-------|-------------|-------|
| Other assets                               | 138,177     | 5 %   | 113,541     | 5 %   | 126,292     | 7 %   |
| Total assets                               | \$2,446,771 | 100 % | \$2,093,730 | 100 % | \$2,043,426 | 100 % |
| Total deposits                             | \$1,716,780 | 70 %  | \$1,374,114 | 66 %  | \$1,315,470 | 64 %  |
| Total borrowings                           | 549,990     | 22 %  | 547,758     | 26 %  | 563,470     | 28 %  |
| Other liabilities                          | 34,555      | 1 %   | 31,424      | 1 %   | 25,164      | 1 %   |
| Total stockholders' equity                 | 145,446     | 6 %   | 140,434     | 7 %   | 139,322     | 7 %   |
| Total liabilities and stockholders' equity | \$2,446,771 | 100 % | \$2,093,730 | 100 % | \$2,043,426 | 100 % |

During the second quarter of 2013, the Company's total assets grew \$302.8 million, or 14%, to a total of \$2.45 billion. Excluding the impact of the CNB acquisition, the Company grew total assets organically by \$25.4 million, or 1%. Loans/leases grew \$238.5 million, or 19%, with \$190.7 million attributed to CNB and \$47.8 million, or 4%, of organic growth. Most of the organic loan/lease growth was funded with deposits (organic growth of \$50.7 million, or 4%) and proceeds from calls, maturities, or sales of securities (decline of the existing portfolio by \$33.5 million, or 5%).

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

The composition of the Company's securities portfolio is managed to meet liquidity needs while prioritizing the impact on asset-liability position and maximizing return. With the strong growth in deposits more than offsetting the pace of loan growth over the past several years, the Company has grown and diversified its securities portfolio, including increasing the portfolio of agency-sponsored mortgage-backed securities as well as more than tripling the portfolio of municipal securities. Of the latter, the large majority are located in the Midwest with some in or near the Company's existing markets and require a thorough underwriting process before investment. As the portfolio has grown over recent years, management has elevated its focus on maximizing return while minimizing credit and interest rate risk. Additionally, management will continue to diversify the portfolio with further growth strictly dictated by the pace of growth in deposits and loans. Ideally, management expects to fund future loan growth partially with cash flow from the securities portfolio (calls and maturities of government sponsored agencies and/or paydowns on residential mortgage-backed securities).

Following is a breakdown of the Company's securities portfolio by type, the percentage of unrealized gains (losses) to amortized cost on the total portfolio, and the portfolio duration:

|  | As of                         |       | December 31, |       | June 30, 2012 |       |
|--|-------------------------------|-------|--------------|-------|---------------|-------|
|  | June 30, 2013                 |       | 2012         |       | June 30, 2012 |       |
|  | Amount                        | %     | Amount       | %     | Amount        | %     |
|  | <i>(dollars in thousands)</i> |       |              |       |               |       |
| U.S. govt. sponsored agency securities                 | \$380,916                     | 54 %  | \$338,609    | 57 %  | \$389,600     | 61 %  |
| Residential mortgage-backed and related securities     | 178,546                       | 25 %  | 163,601      | 27 %  | 165,827       | 26 %  |
| Municipal securities                                   | 141,381                       | 21 %  | 97,615       | 16 %  | 81,072        | 13 %  |
| Other securities                                       | 2,624                         | 0 %   | 2,414        | 0 %   | 2,339         | 0 %   |
|  | \$703,467                     | 100 % | \$602,239    | 100 % | \$638,838     | 100 % |
| As a % of Total Assets                                 | 28.75                         | %     | 28.76        | %     | 31.26         | %     |
| Net Unrealized Gains/(Losses) as a % of Amortized Cost | -2.88                         | %     | 1.44         | %     | 1.15          | %     |

|                     |     |     |     |
|---------------------|-----|-----|-----|
| Duration (in years) | 4.1 | 2.8 | 2.7 |
|---------------------|-----|-----|-----|

With the increase in long-term interest rates during the second quarter of 2013, the Company's securities portfolio shifted from a net unrealized gain position to a net unrealized loss position. Management expected this shift to occur with the increase in long-term interest rates. Management performs an evaluation of the portfolio quarterly to understand the current market value as well as projections of market value in a variety of rising and falling interest rate scenarios. In addition, management has evaluated those securities with an unrealized loss position to determine whether the loss is derived from credit deterioration or the movement in interest rates. The evaluation determined that there were no securities with other-than-temporary impairment. See the "Critical Accounting Policies" section for further discussion on this evaluation.

The Company has not invested in commercial mortgage-backed securities or pooled trust preferred securities.

See Note 3 to the Consolidated Financial Statements for additional information regarding the Company's investment securities.

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Total loans/leases grew \$238.5 million, or 19%, during the second quarter of 2013, with \$190.7 million attributed to CNB with the remainder consisting of organic growth (\$47.8 million, or 4%). Over the past several quarters, the Company has been successful in shifting the mix of its commercial loan portfolio by adding more commercial and industrial loans, owner-occupied commercial real estate loans, and leases and fewer non owner-occupied commercial real estate and construction loans. The addition of CNB's portfolio helped maintain this shift in mix as CNB's portfolio mix is similar to the three legacy banks. The mix of the loan/lease types within the Company's loan/lease portfolio is presented in the following table.

|   | As of                         |       | December 31, |       | June 30, 2012 |       |
|---|-------------------------------|-------|--------------|-------|---------------|-------|
|   | June 30, 2013                 |       | 2012         |       | June 30, 2012 |       |
|   | Amount                        | %     | Amount       | %     | Amount        | %     |
|   | <i>(dollars in thousands)</i> |       |              |       |               |       |
| Commercial and industrial loans                         | \$470,416                     | 31 %  | \$394,244    | 31 %  | \$350,780     | 29 %  |
| Commercial real estate loans                            | 724,006                       | 47 %  | 593,979      | 46 %  | 576,287       | 48 %  |
| Direct financing leases                                 | 114,755                       | 8 %   | 103,686      | 8 %   | 98,568        | 8 %   |
| Residential real estate loans                           | 143,093                       | 9 %   | 115,582      | 9 %   | 107,450       | 9 %   |
| Installment and other consumer loans                    | 74,569                        | 5 %   | 76,720       | 6 %   | 77,417        | 6 %   |
| Total loans/leases                                      | \$1,526,839                   | 100 % | \$1,284,211  | 100 % | \$1,210,502   | 100 % |
| Plus deferred loan/lease origination costs, net of fees | 3,887                         |       | 3,176        |       | 2,802         |       |
| Less allowance for estimated losses on loans/leases     | (21,156 )                     |       | (19,925 )    |       | (18,725 )     |       |
| Net loans/leases  | \$1,509,570                   |       | \$1,267,462  |       | \$1,194,579   |       |

Regarding the Company's levels of qualified small business lending as defined by the U.S. Department of the Treasury ("Treasury") as part of the Company's participation in the Small Business Lending Fund ("SBLF"), see the discussion later in this section of the Management's Discussion and Analysis.



Following is the mix of CNB's loan portfolio as of June 30, 2013 (dollars in thousands):

|                                      | June 30, 2013 |       |
|--------------------------------------|---------------|-------|
|                                      | Amount        | %     |
| Commercial and industrial loans      | \$58,624      | 31 %  |
| Commercial real estate loans         | 102,820       | 54 %  |
| Direct financing leases              | -             | 0 %   |
| Residential real estate loans        | 20,977        | 11 %  |
| Installment and other consumer loans | 8,306         | 4 %   |
| Total loans/leases                   | \$190,727     | 100 % |

As commercial real estate loans are the largest portfolio segment, management places a strong emphasis on monitoring the composition of the Company's commercial real estate loan portfolio. Management tracks the level of owner-occupied commercial real estate loans versus non owner-occupied loans. Owner-occupied loans are generally considered to have less risk. As of June 30, 2013 and December 31, 2012, approximately 37% and 34%, respectively, of the commercial real estate loan portfolio was owner-occupied. CNB's portfolio of owner-occupied commercial real estate loans was 44% of total commercial real estate loans as of June 30, 2013. Additionally, CNB only had \$3.4 million of commercial construction, land development, and other land loans.

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Following is a listing of significant industries within the Company's commercial real estate loan portfolio as of June 30, 2013 and December 31, 2012:

|                                     | As of June 30,<br>2013        |       | As of<br>December 31,<br>2012 |       |
|-------------------------------------|-------------------------------|-------|-------------------------------|-------|
|                                     | Amount                        | %     | Amount                        | %     |
|                                     | <i>(dollars in thousands)</i> |       |                               |       |
| Lessors of Nonresidential Buildings | \$228,182                     | 32 %  | \$178,060                     | 30 %  |
| Lessors of Residential Buildings    | 78,405                        | 11 %  | 61,460                        | 10 %  |
| Land Subdivision                    | 29,900                        | 4 %   | 28,854                        | 5 %   |
| New Car Dealers                     | 23,603                        | 3 %   | 27,079                        | 5 %   |
| Hotels                              | 24,171                        | 3 %   | 26,710                        | 4 %   |
| Other *                             | 339,745                       | 47 %  | 271,816                       | 46 %  |
| Total Commercial Real Estate Loans  | \$724,006                     | 100 % | \$593,979                     | 100 % |

\* "Other" consists of all other industries. None of these had concentrations greater than \$17.5 million, or 2.5% of total commercial real estate loans.

The Company's residential real estate loan portfolio consists of the following:

Certain loans that do not meet the criteria for sale into the secondary market. These are often structured as adjustable rate mortgages with maturities ranging from three to seven years to avoid the long-term interest rate risk. A limited amount of 15-year fixed rate residential real estate loans that met certain credit guidelines.

The remaining residential real estate loans originated by the Company were sold on the secondary market to avoid the interest rate risk associated with longer term fixed rate loans. Loans originated for this purpose were classified as held for sale and are included in the residential real estate loans above. In addition, the Company has not originated any subprime, Alt-A, no documentation, or stated income residential real estate loans throughout its history.

See Note 4 to the Consolidated Financial Statements for additional information regarding the Company's loan/lease portfolio.

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Changes in allowance for the three and six months ended June 30, 2013 and 2012 are presented as follows:

|   | Three Months<br>Ended         |                  | Six Months Ended |                  |
|---|-------------------------------|------------------|------------------|------------------|
|   | June 30,<br>2013              | June 30,<br>2012 | June 30,<br>2013 | June 30,<br>2012 |
|   | <i>(dollars in thousands)</i> |                  |                  |                  |
| Balance, beginning                                | \$20,769                      | \$19,007         | \$19,925         | \$18,789         |
| Provisions charged to expense                     | 1,520                         | 1,049            | 2,578            | 1,829            |
| Loans/leases charged off                          | (1,333 )                      | (1,735 )         | (1,636 )         | (2,559 )         |
| Recoveries on loans/leases previously charged off | 200                           | 404              | 289              | 666              |
| Balance, ending                                   | \$21,156                      | \$18,725         | \$21,156         | \$18,725         |

The allowance was \$21.2 million at June 30, 2013 compared to \$19.9 million at December 31, 2012 and \$18.7 million at June 30, 2012. The allowance was determined based on factors that included the overall composition of the loan/lease portfolio, types of loans/leases, past loss experience, loan/lease delinquencies, potential substandard and doubtful credits, economic conditions, collateral positions, governmental guarantees and other factors that, in management's judgment, deserved evaluation. To ensure that an adequate allowance was maintained, provisions were made based on a number of factors, including the increase/decrease in loans/leases and a detailed analysis of the loan/lease portfolio. The loan/lease portfolio was reviewed and analyzed monthly with specific detailed reviews completed on all loans risk-rated worse than "fair quality" and carrying aggregate exposure in excess of \$100 thousand. The adequacy of the allowance for estimated losses on loans/leases is monitored by the loan review staff and reported to management and the board of directors.

The Company's levels of criticized and classified loans are reported in the following table.

| Internally Assigned Risk Rating * | As of            |                      |                  |
|-----------------------------------|------------------|----------------------|------------------|
|                                   | June 30,<br>2013 | December<br>31, 2012 | June 30,<br>2012 |

*(dollars in thousands)*

|                            |          |           |          |
|----------------------------|----------|-----------|----------|
| Special Mention (Rating 6) | \$28,728 | \$ 22,056 | \$21,337 |
| Substandard (Rating 7)     | 57,895   | 48,248    | 52,030   |
| Doubtful (Rating 8)        | -        | -         | -        |
|                            | \$86,623 | \$ 70,304 | \$73,367 |
| <br>                       |          |           |          |
| Criticized Loans **        | \$86,623 | \$ 70,304 | \$73,367 |
| Classified Loans ***       | \$57,895 | \$ 48,248 | \$52,030 |

\* Amounts above include the government guaranteed portion, if any. For the calculation of allowance for estimated losses on loans/leases, the Company assigns internal risk ratings of Pass (Rating 2) for the government guaranteed portion.

\*\* Criticized loans are defined as commercial and industrial and commercial real estate loans with internally assigned risk ratings of 6, 7, or 8, regardless of performance.

\*\*\* Classified loans are defined as commercial and industrial and commercial real estate loans with internally assigned risk ratings of 7 or 8, regardless of performance.

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

At June 30, 2013, CNB had Special Mention loans of \$3.0 million and Substandard Loans of \$3.5 million for a total of \$6.5 million of criticized loans. Excluding CNB, the Company experienced some increase in criticized and classified loans during the second quarter which translated over to an increase in nonperforming loans. The increase was the result of a few specific, isolated commercial credits moving to Substandard and nonaccrual.

The following table summarizes the trend in the allowance as a percentage of gross loans/leases and as a percentage of nonperforming loans/leases as of June 30, 2013, December 31, 2012, and June 30, 2012.

|  | As of               |                      |                     |
|--|---------------------|----------------------|---------------------|
|  | June<br>30,<br>2013 | December<br>31, 2012 | June<br>30,<br>2012 |
| Allowance / Gross Loans/Leases           | 1.38 %              | 1.55 %               | 1.54 %              |
| Allowance / Nonperforming Loans/Leases * | 70.61 %             | 78.47 %              | 68.60 %             |

\*Nonperforming loan/leases consist of nonaccrual loans/leases, accruing loans/leases past due 90 days or more, and accruing troubled debt restructurings.

In accordance with generally accepted accounting principles for acquisition accounting, CNB's loans are recorded at market value; therefore, there is no allowance associated with CNB's loans at June 30, 2013. As a result, the Company's allowance to total loans/leases fell to 1.38% from 1.55% at December 31, 2012, and from 1.54% at June 30, 2012. Had CNB's loans remained at their historical carrying value with the related allowance as of the acquisition, the allowance to total loans/leases would be approximately 1.60%. Further, the Company's allowance to total nonperforming loans/leases was 71% at June 30, 2013 which is down from 78% at December 31, 2012 and up from 69% at June 30, 2012. Similarly, adjusting for CNB's loans at their historical carrying value with the related allowance as of the acquisition, the resulting ratio of allowance to nonperforming loans/leases would increase to approximately 82%.

Although management believes that the allowance at June 30, 2013 was at a level adequate to absorb losses on existing loans/leases, there can be no assurance that such losses will not exceed the estimated amounts or that the Company will not be required to make additional provisions for loan/lease losses in the future. Unpredictable future events could adversely affect cash flows for both commercial and individual borrowers, which could cause the Company to experience increases in problem assets, delinquencies and losses on loans/leases, and require further increases in the provision. Asset quality is a priority for the Company and its subsidiaries. The ability to grow profitably is in part dependent upon the ability to maintain that quality. The Company continually focuses efforts at its subsidiary banks and leasing company with the intention to improve the overall quality of the Company's loan/lease portfolio.

See Note 4 to the Consolidated Financial Statements for additional information regarding the Company's allowance for estimated losses on loans/leases.

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

The table below presents the amounts of nonperforming assets.

|  | As of<br>June 30,<br>2013     | As of<br>December<br>31,<br>2012 | As of<br>June 30,<br>2012 | As of<br>December<br>31,<br>2011 |
|--|-------------------------------|----------------------------------|---------------------------|----------------------------------|
|  | <i>(dollars in thousands)</i> |                                  |                           |                                  |
| Nonaccrual loans/leases (1) (2)                                      | \$27,782                      | \$ 17,932                        | \$16,247                  | \$ 18,995                        |
| Accruing loans/leases past due 90 days or more                       | 3                             | 159                              | 1,152                     | 1,111                            |
| Troubled debt restructurings - accruing                              | 2,178                         | 7,300                            | 9,897                     | 11,904                           |
| Other real estate owned  | 3,860                         | 3,955                            | 9,136                     | 8,386                            |
| Other repossessed assets   | 244                           | 212                              | 25                        | 109                              |
|  | \$34,067                      | \$ 29,558                        | \$36,457                  | \$ 40,505                        |
| Nonperforming loans/leases to total loans/leases                     | 1.96 %                        | 1.97 %                           | 2.25 %                    | 2.67 %                           |
| Nonperforming assets to total loans/leases plus repossessed property | 2.22 %                        | 2.29 %                           | 2.98 %                    | 3.35 %                           |
| Nonperforming assets to total assets                                 | 1.39 %                        | 1.41 %                           | 1.78 %                    | 2.06 %                           |
| Texas ratio (3)  | 21.15 %                       | 18.68 %                          | 23.91 %                   | 25.58 %                          |

(1) Includes government guaranteed portion of loans, as applicable.

(2) Includes troubled debt restructurings of \$7.7 million at June 30, 2013, \$5.7 million at December 31, 2012, \$6.1 million at June 30, 2012, and \$8.6 million at December 31, 2011.

(3) Texas Ratio = Nonperforming Assets (excluding Other Repossessed Assets) / Tangible Equity plus Allowance for Estimated Losses on Loans/Leases. Texas Ratio is a non-GAAP financial measure. Management included this ratio as this is considered by many investors and analysts to be a metric with which to analyze and evaluate asset quality. Other companies may calculate this ratio differently.



The large majority of the nonperforming assets consist of nonaccrual loans/leases, accruing troubled debt restructurings (“TDRs”), and OREO. For nonaccrual loans/leases and accruing TDRs, management has thoroughly reviewed these loans/leases and has provided specific allowances as appropriate. Additionally, a portion of several of the nonaccrual loans are guaranteed by the government. At June 30, 2013, government guaranteed amounts of nonaccrual loans totaled approximately \$4.2 million, or 15% of the \$27.8 million of total nonaccrual loans/leases. OREO is carried at the lower of carrying amount or fair value less costs to sell.

Nonperforming assets at June 30, 2013 were \$34.1 million, which is up \$10.4 million, or 44%, from March 31, 2013, and down \$2.4 million, or 7%, from June 30, 2012. In addition, the ratio of nonperforming assets-to-total assets was 1.39% at June 30, 2013, which was up from 1.10% at March 31, 2013, and down from 1.78% at June 30, 2012. The growth in nonperforming assets during the current quarter was driven by a few specific commercial credits moving to nonaccrual at our existing banks (\$7.5 million) as well as the addition of CNB’s nonperforming assets as a result of the Community National acquisition (\$2.9 million). Of the former, half of the exposure is guaranteed by the government through the SBA.

The Company’s lending/leasing practices remain unchanged and asset quality remains a top priority for management.

Deposits grew \$342.7 million, or 25%, during the first half of 2013. CNB’s deposits totaled \$245.6 million at June 30, 2013. Excluding CNB, the Company organically grew deposits \$97.1 million, or 7%, over the first half of 2013. The table below presents the composition of the Company’s deposit portfolio.

|                                     | As of<br>June 30, 2013 |       | December 31,<br>2012 |       | June 30, 2012 |       |
|-------------------------------------|------------------------|-------|----------------------|-------|---------------|-------|
|                                     | Amount                 | %     | Amount               | %     | Amount        | %     |
| <i>(dollars in thousands)</i>       |                        |       |                      |       |               |       |
| Noninterest bearing demand deposits | \$493,964              | 29 %  | \$450,660            | 33 %  | \$390,762     | 30 %  |
| Interest bearing demand deposits    | 710,745                | 42 %  | 587,201              | 43 %  | 555,804       | 42 %  |
| Time deposits                       | 451,991                | 26 %  | 290,933              | 21 %  | 316,445       | 24 %  |
| Brokered time deposits              | 60,080                 | 3 %   | 45,320               | 3 %   | 52,459        | 4 %   |
|                                     | \$1,716,780            | 100 % | \$1,374,114          | 100 % | \$1,315,470   | 100 % |

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
 FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

The table below presents the composition of CNB's deposits at June 30, 2013 (dollars in thousands):

|                                     | June 30, 2013 |      |
|-------------------------------------|---------------|------|
|                                     | Amount        | %    |
| Noninterest bearing demand deposits | \$40,650      | 17 % |
| Interest bearing demand deposits    | 130,370       | 53 % |
| Time deposits                       | 64,286        | 26 % |
| Brokered time deposits              | 10,272        | 4 %  |
|                                     | \$245,578     | 100% |

The Company has been successful in growing its noninterest bearing deposit portfolio over the past few years and this continued in the first half of 2013. Most of this growth continues to be derived from QCBT's correspondent banking business. The continued strength of the noninterest bearing deposit portfolio has provided flexibility to manage down deposit pricing and reduce reliance on higher cost wholesale funds, which has helped drive down the Company's interest expense.

Additionally, during the first half of 2013, the Company's subsidiary banks (excluding CNB) have been successful in growing its portfolio of time deposits with local municipalities. The average maturity of this portfolio is less than 6 months and the cost has been consistently lower than retail or wholesale alternatives.

The subsidiary banks offer short-term repurchase agreements to some of their significant customers. Also, the subsidiary banks purchase federal funds for short-term funding needs from the Federal Reserve Bank or from their correspondent banks. CNB did not have any overnight repurchase agreements or federal funds purchased as of June 30, 2013. The table below presents the composition of the Company's short-term borrowings.

As of

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  | June 30,<br>2013 | December<br>31, 2012 | June 30,<br>2012 |
|--|------------------|----------------------|------------------|
|--|------------------|----------------------|------------------|

*(dollars in thousands)*

|  |            |            |            |
|--|------------|------------|------------|
| Overnight repurchase agreements with customers | \$ 115,326 | \$ 104,943 | \$ 105,249 |
| Federal funds purchased                        | 41,860     | 66,140     | 80,150     |
|  | \$ 157,186 | \$ 171,083 | \$ 185,399 |

As a result of their memberships in either the Federal Home Loan Bank (“FHLB”) of Des Moines or Chicago, the subsidiary banks have the ability to borrow funds for short or long-term purposes under a variety of programs. FHLB advances are utilized for loan matching as a hedge against the possibility of rising interest rates, and when these advances provide a less costly or more readily available source of funds than customer deposits. FHLB advances increased slightly by \$4.6 million, or 2%, during the second quarter of 2013. During the second quarter of 2013, CRBT and RB&T had some short-term funding needs and borrowed via short-term FHLB advances, as the cost was less than federal funds purchased. CNB did not have any FHLB advances as of June 30, 2013.

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Other borrowings consist largely of structured repos which are utilized as an alternative funding source to FHLB advances and customer deposits. CNB did not have any structured repos as of June 30, 2013. The table below presents the composition of the Company's other borrowings.

As of  
 June 30,    December    June 30,  
 2013        31, 2012    2012

*(dollars in thousands)*

|                             |            |            |            |
|-----------------------------|------------|------------|------------|
| Structured repos            | \$ 130,000 | \$ 130,000 | \$ 130,000 |
| Term note                   | 10,000     | -          | -          |
| 364-day revolving note      | -          | 5,600      | 5,600      |
| Series A subordinated notes | 2,644      | 2,640      | 2,636      |
|                             | \$ 142,644 | \$ 138,240 | \$ 138,236 |

In order to fund the cash portion of the consideration for the acquisition and pay off the \$3.95 million of Community National term debt at acquisition, the Company borrowed \$4.4 million on its 364-day revolving note. The outstanding balance on the 364-day revolving note totaled \$10.0 million until maturity at June 26, 2013. Upon maturity, the credit facility was restructured whereby the \$10.0 million of outstanding debt was restructured into a secured 3-year term note with principal due quarterly and interest due monthly where the interest is calculated at the effective LIBOR rate plus 3.00% per annum (3.30% at June 30, 2013). Additionally, as part of the restructure, the Company maintained a secured 364-day revolving credit note with availability of \$10.0 million where the interest is calculated at the effective LIBOR rate plus 2.50%-per annum. At June 30, 2013, the Company had not borrowed on this revolving credit note and had the full amount available.

It is management's intention to continue to reduce the reliance on wholesale funding, including FHLB advances, structured repos, and brokered time deposits. Replacement of this funding with core deposits helps to reduce interest expense as the wholesale funding tends to be higher funding cost. The table below presents the maturity schedule including weighted average cost for the Company's combined wholesale funding portfolio.

| Maturity:   | June 30, 2013    |   | December 31, 2012 |  |
|---|------------------|---|-------------------|--|
|   | Amount Due       | Weighted Average Interest Rate at Quarter-End | Amount Due        | Weighted Average Interest Rate at Year-End |
| Year ending December 31: <i>(dollar amounts in thousands)</i> |                  |   |                   |  |
| 2013  | \$44,097         | 0.65  | % \$34,508        | 1.29 %                                     |
| 2014  | 48,380           | 2.49  | 39,170            | 2.88                                       |
| 2015  | 36,000           | 2.22  | 66,000            | 2.59                                       |
| 2016  | 63,435           | 3.91  | 85,992            | 3.72                                       |
| 2017  | 48,075           | 3.57  | 46,000            | 3.70                                       |
| Thereafter  | 160,042          | 3.28  | 106,000           | 3.66                                       |
| <b>Total Wholesale Funding</b>                                | <b>\$400,029</b> | <b>2.94</b>                                   | <b>\$377,670</b>  | <b>3.20</b>                                |

Importantly, a large portion of the above FHLB advances and structured repos have puttable options which allow the lender (FHLB or counterparty), at its discretion, to terminate the borrowing and require the subsidiary banks to repay at predetermined dates prior to the stated maturity.

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

As previously discussed, during the first quarter of 2013, QCBT modified \$50.0 million of fixed rate structured repos with a weighted average interest rate of 3.21% and a weighted average maturity of February 2016 into new fixed rate structured repos with a weighted average interest rate of 2.65% and a weighted average maturity of May 2020. This modification serves to reduce interest expense and improve net interest margin, and minimize the exposure to rising rates through duration extension of fixed rate liabilities.

In April 2011, CNB was named as one of 36 co-defendants in a complaint alleging unjust enrichment relating to participation loans originated, sold and repaid in a fraudulent scheme perpetuated by a loan broker. Some of the co-defendants have settled the claims. CNB has not settled the claims and, using all available information, including settlement amounts of many of the initial co-defendants, CNB's management recorded a contingent liability of \$1,028,000 which is included in other liabilities on the Company's balance sheet.

The table below presents the composition of the Company's stockholders' equity, including the common and preferred equity components.

|   | As of                         |      | December 31, |      | June 30, 2012 |      |
|---|-------------------------------|------|--------------|------|---------------|------|
|   | June 30, 2013                 |      | 2012         |      | June 30, 2012 |      |
|   | Amount                        | %    | Amount       | %    | Amount        | %    |
|   | <i>(dollars in thousands)</i> |      |              |      |               |      |
| Common stock                                  | \$5,918                       |      | \$5,039      |      | \$4,968       |      |
| Additional paid in capital - common           | 38,406                        |      | 25,804       |      | 27,071        |      |
| Retained earnings                             | 58,786                        |      | 53,327       |      | 48,831        |      |
| Accumulated other comprehensive income (loss) | (9,221 )                      |      | 4,707        |      | 4,479         |      |
| Noncontrolling interests                      | -                             |      | -            |      | 2,415         |      |
| Less: Treasury stock                          | (1,606 )                      |      | (1,606 )     |      | (1,606 )      |      |
| Total common stockholders' equity             | 92,283                        | 63 % | 87,271       | 62 % | 86,158        | 62 % |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|  |            |       |            |       |            |       |
|--|------------|-------|------------|-------|------------|-------|
| Preferred stock  | 55         |       | 55         |       | 55         |       |
| Additional paid in capital - preferred                         | 53,108     |       | 53,108     |       | 53,109     |       |
| Total preferred stockholders' equity                           | 53,163     | 37 %  | 53,163     | 38 %  | 53,164     | 38 %  |
| Total stockholders' equity                                     | \$ 145,446 | 100 % | \$ 140,434 | 100 % | \$ 139,322 | 100 % |
| Tangible common equity* / total tangible assets                | 3.51       | %     | 4.02       | %     | 3.94       | %     |
| TCE/TA excluding accumulated other comprehensive income (loss) | 3.89       | %     | 3.80       | %     | 3.72       | %     |

\*Tangible common equity is defined as total common stockholders' equity excluding equity of noncontrolling interests and excluding goodwill and other intangibles. This ratio is a non-GAAP financial measure. Management included this ratio as it is considered by many investors and analysts to be a metric with which to analyze and evaluate the equity composition. Other companies may calculate this ratio differently.

The following table presents the rollforward of stockholders equity for the three and six months ended June 30, 2013 and 2012, respectively.

|  | For the quarter ended<br>June 30, |           | For the six months<br>ended June 30, |           |
|--|-----------------------------------|-----------|--------------------------------------|-----------|
|  | 2013                              | 2012      | 2013                                 | 2012      |
|  | <i>(dollars in thousands)</i>     |           |                                      |           |
| Beginning balance  | \$142,198                         | \$145,767 | \$140,434                            | \$144,433 |
| Net income   | 4,045                             | 3,273     | 7,310                                | 6,676     |
| Other comprehensive income (loss), net of tax                          | (13,091 )                         | 1,241     | (13,928 )                            | (276 )    |
| Preferred and common cash dividends declared                           | (1,040 )                          | (1,125 )  | (1,852 )                             | (2,064 )  |
| Issuance of 834,715 shares of common stock for acquisition of CNB, net | 13,017                            | -         | 13,017                               | -         |
| Redemption of 10,223 shares of Series F Preferred Stock                | -                                 | (10,223 ) | -                                    | (10,223 ) |
| Other *  | 317                               | 389       | 465                                  | 776       |
| Ending balance   | \$145,446                         | \$139,322 | \$145,446                            | \$139,322 |

\*Includes mostly common stock issued for options exercised and the employee stock purchase plans, as well as stock-based compensation.

## Part I

## Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

The following table presents the details of the preferred stock issued and outstanding as of June 30, 2013.

|   | Date Issued    | Aggregate Purchase Price | Stated Dividend Rate | Annual Dividend |
|---|----------------|--------------------------|----------------------|-----------------|
| Series E Non-Cumulative Convertible Perpetual Preferred Stock | June 2010      | \$25,000,000             | 7.00 %               | \$1,750,000     |
| Series F Non-Cumulative Perpetual Preferred Stock             | September 2011 | 29,867,000               | 5.00 %               | 1,493,350       |
|   |                | \$54,867,000             |                      | \$3,243,350     |

The Series E Non-Cumulative Convertible Perpetual Preferred Stock (the "Series E Preferred Stock") is perpetually convertible by the holder into shares of common stock at a per share conversion price of \$12.15, subject to anti-dilution adjustments upon the occurrence of certain events. In addition, the Company can exercise a conversion option on or after the third anniversary of the issuance date (June 30, 2013) at the same \$12.15 conversion price if the Company's common stock price equals or exceeds \$17.22 for at least 20 trading days in a period of 30 consecutive trading days.

Regarding the Series F Non-Cumulative Perpetual Preferred Stock (the "Series F Preferred Stock"), non-cumulative dividends are payable quarterly, and the dividend rate is based on changes in the level of "Qualified Small Business Lending" or "QSBL" by the Company's wholly owned bank subsidiaries, QCBT, CRBT and RB&T. CNB's acquired loans are not eligible; however, any loans originated subsequent to acquisition would be eligible as QSBL should the specific loans meet all of the requirements. Based upon the change in the banks' level of QSBL over the baseline level (as defined by the SBLF, the baseline is the average of QSBL for the last two quarters of 2009 and the first two quarters of 2010), the dividend rate for the first 10 calendar quarters may be adjusted to between 1% and 5%. For the 11<sup>th</sup> calendar quarter through 4.5 years after issuance, the dividend rate will be fixed at between 1% and 5%, based upon the increase in QSBL from the baseline level to the level as of the end of the ninth dividend period (i.e. as of September 30, 2013), or will be fixed at 7% if there is no increase or there is a decrease in QSBL during such period. In addition, beginning on April 1, 2014 and ending on April 1, 2016, if there is no increase or there is a decrease in



QSBL from the baseline level to the level as of the end of the ninth dividend period (i.e. as of September 30, 2013), because of the Company's participation in the Treasury Capital Purchase Program, the Company will be subject to an additional lending incentive fee of 2% per year, or 9% dividend rate. After 4.5 years from issuance, regardless of QSBL growth over the baseline, the dividend rate will increase to 9%.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

As of June 30, 2013, the Company reported its QSBL in accordance with SBLF guidelines and calculated a net decline from the baseline of \$61.1 million, or 11%. As a result, the Company's dividend rate remains at 5% for the dividend payable October 1, 2013. The decline is primarily the result of the following:

The Company's strategic introduction into SBA and USDA lending in 2010. The government guaranteed portion of these loans (typically 50% to 85% of the total amount outstanding) is not eligible as QSBL per SBLF guidelines. Based on the size of the Company and its legal lending limit, the majority of commercial loan growth over the past several years has been to businesses whose revenues exceeded the limits defined as QSBL per SBLF guidelines. The Company had a strong small business loan portfolio as of the baseline, which coupled with the residual impact of the economic downturn and the increased competition for small business loans (as many competitor lenders shifted their focus from construction and non-owner occupied commercial real estate lending to small business lending), resulted in originations being outpaced by payments and maturities in the second half of 2010 and all of 2011.

The Company continues to support the lending needs of small businesses, although some of this support may be ineligible as QSBL per SBLF guidelines. Regardless of eligibility, the Company will continue to focus strongly on small business lending.

On June 29, 2012, the Company redeemed 10,223 shares of Series F Preferred Stock from the Treasury for an aggregate redemption amount of \$10.2 million plus unpaid dividends to the date of redemption of \$125 thousand. The remaining Series F Preferred Stock may be redeemed at any time at the option of the Company, subject to approval of the Company's primary federal banking regulator. All redemptions must be in amounts equal to the lesser of at least 25% of the number of originally issued shares, or 100% of the then-outstanding shares.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity measures the ability of the Company to meet maturing obligations and its existing commitments, to withstand fluctuations in deposit levels, to fund its operations, and to provide for customers' credit needs. The Company monitors liquidity risk through contingency planning stress testing on a regular basis. The Company seeks to avoid over concentration of funding sources and to establish and maintain contingent funding facilities that can be drawn upon if normal funding sources become unavailable. One source of liquidity is cash and short-term assets, such as interest-bearing deposits in other banks and federal funds sold, which totaled \$95.6 million at June 30, 2013, and averaged \$98.6 million during 2012 and \$128.0 million during 2011. The Company's on balance sheet liquidity position can fluctuate based on short-term activity in deposits and loans.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

The subsidiary banks have a variety of sources of short-term liquidity available to them, including federal funds purchased from correspondent banks, FHLB advances, structured repos, brokered time deposits, lines of credit, borrowing at the Federal Reserve Discount Window, sales of securities available for sale, and loan/lease participations or sales. The Company also generates liquidity from the regular principal payments and prepayments made on its loan/lease portfolio, and on the regular monthly payments on its residential mortgage-backed securities portfolio. At June 30, 2013, the subsidiary banks had 31 lines of credit totaling \$328.5 million, of which \$42.5 million was secured and \$286.0 million was unsecured. At June 30, 2013, \$306.5 million was available as \$22.0 million was utilized for short-term borrowing needs at QCBT. At December 31, 2012, the subsidiary banks had 31 lines of credit totaling \$311.7 million, of which \$52.7 million was secured and \$259.0 million was unsecured. At December 31, 2012, \$271.7 million was available as \$40.0 million was utilized for short-term borrowing needs at QCBT. The Company has emphasized growing the number and amount of lines of credit in an effort to strengthen this contingent source of liquidity. Additionally, the Company restructured its credit facility during the second quarter of 2013. Previously, the Company had a single \$20.0 million secured revolving credit note with variable interest rate and a maturity of June 27, 2013 with \$14.4 million available as the note carried an outstanding balance of \$5.6 million as of March 31, 2013. To help fund the acquisition of Community National on May 13, 2013, the Company borrowed an additional \$4.4 million on the revolving credit note bringing the total borrowed to \$10.0 million. At maturity, the \$10.0 million was converted to a secured term note with a variable interest rate and a maturity of June 27, 2016. The Company maintained a \$10.0 million secured revolving credit note with a variable interest rate and a maturity of June 26, 2014.

Investing activities used cash of \$117.1 million during the first half of 2013 compared to \$76.7 million for the same period of 2012. Proceeds from calls, maturities, and paydowns of securities were \$152.4 million for the first half of 2013 compared to \$216.1 million for the same period of 2012. Purchases of securities used cash of \$238.5 million for the first half of 2013 compared to \$311.4 million for the same period of 2012. The net increase in loans/leases used cash of \$51.7 million for the first half of 2013 compared to \$16.1 million for the same period of 2012. Net cash received from the Community National acquisition totaled \$3.0 million in 2013.

Financing activities provided cash of \$80.2 million for the first half of 2013 compared to \$70.7 million for same period of 2012. Net increases in deposits totaled \$87.6 million for the first half of 2013 compared to \$110.0 million for the same period of 2012. During the first half of 2012, the Company's short-term borrowings decreased \$28.1 million. Also, during 2012, the Company redeemed Series F Preferred Stock totaling \$10.2 million.

Total cash provided by operating activities was \$19.7 million for the first half of 2013 compared to \$4.6 million for the same period of 2012.

## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Throughout its history, the Company has secured additional capital through various resources, including the issuance of preferred stock (discussed above) and trust preferred securities. Trust preferred securities are reported on the Company's balance sheet as liabilities, but currently qualify for treatment as regulatory capital.

The following table presents the details of the trust preferred securities issued and outstanding as of June 30, 2013.

| Name                                   | Date Issued    | Amount Issued | Interest Rate            | Interest Rate as of 6/30/2013 | Interest Rate as of 12/31/2012 |
|--|----------------|---------------|--------------------------|-------------------------------|--------------------------------|
| QCR Holdings Statutory Trust II        | February 2004  | \$12,372,000  | 2.85% over 3-month LIBOR | 3.13 %                        | 3.21 %                         |
| QCR Holdings Statutory Trust III       | February 2004  | 8,248,000     | 2.85% over 3-month LIBOR | 3.13 %                        | 3.21 %                         |
| QCR Holdings Statutory Trust IV        | May 2005       | 5,155,000     | 1.80% over 3-month LIBOR | 2.08 %                        | 2.14 %                         |
| QCR Holdings Statutory Trust V         | February 2006  | 10,310,000    | 1.55% over 3-month LIBOR | 1.83 %                        | 1.89 %                         |
| Community National Statutory Trust II  | September 2004 | 3,093,000     | 2.17% over 3-month LIBOR | 2.45 %                        | N/A                            |
| Community National Statutory Trust III | March 2007     | 3,609,000     | 1.75% over 3-month LIBOR | 2.03 %                        | N/A                            |
|  |                | \$42,787,000  | Weighted Average Rate    | 2.55 %                        | 2.68 %                         |

The Company assumed the trust preferred securities originally issued by Community National. As a result of acquisition accounting, the liabilities were recorded a fair value upon acquisition with the resulting discount (totaling \$2.6 million) to be accreted as interest expense on a level yield basis over the expected term. See Note 5 to the Consolidated Financial Statements for additional information regarding the Company's trust preferred securities.



## Part I

## Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

The Company (on a consolidated basis) and the subsidiary banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and subsidiary banks' financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the subsidiary banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Quantitative measures established by regulation to ensure capital adequacy require the Company and the subsidiary banks to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets, each as defined by regulation. Management believes, as of June 30, 2013 and December 31, 2012, that the Company and the subsidiary banks met all capital adequacy requirements to which they were subject.

Under the regulatory framework for prompt corrective action, to be categorized as "well capitalized," an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. The Company and the subsidiary banks' actual capital amounts and ratios as of June 30, 2013 and December 31, 2012 are also presented in the following table (dollars in thousands). As of June 30, 2013 and December 31, 2012, the subsidiary banks met the requirements to be "well capitalized".

|                           | Actual    |        | Adequacy Purposes |         | To Be Well Capitalized Under Prompt Corrective Action Provisions |       |
|---------------------------|-----------|--------|-------------------|---------|--|-------|
|                           | Amount    | Ratio  | Amount            | Ratio   | Amount   | Ratio |
|                           |           |        |                   |         |  |       |
| As of June 30, 2013:      |           |        |                   |         |  |       |
| Company:                  |           |        |                   |         |  |       |
| Total risk-based capital  | \$210,884 | 12.20% | \$138,240         | ≥ 8.0 % | N/A  | N/A   |
| Tier 1 risk-based capital | 186,906   | 10.82% | 69,120            | ≥ 4.0   | N/A  | N/A   |



Edgar Filing: QCR HOLDINGS INC - Form 10-Q

|                            |          |         |          |        |          |          |
|----------------------------|----------|---------|----------|--------|----------|----------|
| Leverage ratio             | 186,906  | 8.07 %  | 92,666   | ≥4.0   | N/A      | N/A      |
| Quad City Bank & Trust:    |          |         |          |        |          |          |
| Total risk-based capital   | \$98,130 | 12.01 % | \$65,383 | ≥8.0 % | \$81,729 | ≥10.00 % |
| Tier 1 risk-based capital  | 89,494   | 10.95 % | 32,692   | ≥4.0   | 49,037   | ≥6.00 %  |
| Leverage ratio             | 89,494   | 7.19 %  | 49,773   | ≥4.0   | 62,216   | ≥5.00 %  |
| Cedar Rapids Bank & Trust: |          |         |          |        |          |          |
| Total risk-based capital   | \$56,513 | 12.27 % | \$36,860 | ≥8.0 % | \$46,075 | ≥10.00 % |
| Tier 1 risk-based capital  | 50,732   | 11.01 % | 18,430   | ≥4.0   | 27,645   | ≥6.00 %  |
| Leverage ratio             | 50,732   | 8.31 %  | 24,422   | ≥4.0   | 30,528   | ≥5.00 %  |
| Rockford Bank & Trust:     |          |         |          |        |          |          |
| Total risk-based capital   | \$37,768 | 14.70 % | \$20,549 | ≥8.0 % | \$25,686 | ≥10.00 % |
| Tier 1 risk-based capital  | 34,535   | 13.45 % | 10,274   | ≥4.0   | 15,412   | ≥6.00 %  |
| Leverage ratio             | 34,535   | 10.56 % | 13,081   | ≥4.0   | 16,351   | ≥5.00 %  |
| Community National Bank:   |          |         |          |        |          |          |
| Total risk-based capital   | \$25,468 | 12.91 % | \$15,778 | ≥8.0 % | \$19,722 | ≥10.00 % |
| Tier 1 risk-based capital  | 25,463   | 12.91 % | 7,889    | ≥4.0   | 11,833   | ≥6.00 %  |
| Leverage ratio             | 25,463   | 9.13 %  | 11,160   | ≥4.0   | 13,949   | ≥5.00 %  |

---

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

|                           | Actual    |         | For Capital Adequacy Purposes |         | To Be Well Capitalized Under Prompt Corrective Action Provisions |       |
|---------------------------|-----------|---------|-------------------------------|---------|--|-------|
|                           | Amount    | Ratio   | Amount                        | Ratio   | Amount   | Ratio |
| As of December 31, 2012:  |           |         |                               |         |  |       |
| Company:                  |           |         |                               |         |  |       |
| Total risk-based capital  | \$188,841 | 12.71 % | \$118,878                     | ≥ 8.0 % | N/A  | N/A   |
| Tier 1 risk-based capital | 167,475   | 11.27 % | 59,439                        | ≥ 4.0   | N/A  | N/A   |
| Tier 1 leverage ratio     | 167,475   | 8.13 %  | 82,357                        | ≥       |  |       |
| 4.0                       |           |         |                               |         |  |       |

N/A

N/A

Quad City Bank & Trust:

Total risk-based capital

\$98,789 12.12% \$65,218

≥

8.0% \$81,522

≥

10.00%

Tier 1 risk-based capital

90,533 11.11% 32,609

≥

4.0 48,913

≥

6.00%

Tier 1 leverage ratio

90,533 7.74% 46,784

≥

4.0 58,480

≥

5.00%

Cedar Rapids Bank & Trust:

Total risk-based capital

\$55,736 12.87% \$34,652

≥

8.0% \$43,315

≥

10.00%

Tier 1 risk-based capital

50,297 11.61% 17,326

≥

4.0 25,989

≥

6.00%

Tier 1 leverage ratio

50,297 8.49% 23,685

≥

4.0 29,606

≥

5.00%

Rockford Bank & Trust:

Total risk-based capital

\$36,894 15.33% \$19,255

≥

8.0% \$24,609

≥

10.00%

Tier 1 risk-based capital

33,870 14.07% 9,628

≥

4.0 14,441

≥

6.00%

Tier 1 leverage ratio

33,870 11.13% 12,177

≥

4.0 15,221

≥

5.00%

In July 2013, the U.S. federal banking authorities approved the implementation of the Basel III regulatory capital reforms and issued rules effecting certain changes required by the Dodd-Frank Act (the “Basel III Rules”). The Basel III Rules are applicable to all U.S. banks that are subject to minimum capital requirements, as well as to bank and savings and loan holding companies other than “small bank holding companies” (generally bank holding companies with consolidated assets of less than \$500 million). The Basel III Rules not only increase most of the required minimum regulatory capital ratios, but they introduce a new Common Equity Tier 1 Capital ratio and the concept of a capital conservation buffer. The Basel III Rules also expand the definition of capital as in effect currently by establishing criteria that instruments must meet to be considered Additional Tier 1 Capital (Tier 1 Capital in addition to Common Equity) and Tier 2 Capital. A number of instruments that now qualify as Tier 1 Capital will not qualify, or their qualifications will change. The Basel III Rules also permit smaller banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income, which currently does not affect regulatory capital. The Basel III Rules have maintained the general structure of the current prompt corrective action framework, while incorporating the increased requirements. The prompt corrective action guidelines were also revised to add the Common Equity Tier 1 Capital ratio. In order to be a “well-capitalized” depository institution under the new regime, a bank and holding company must maintain a Common Equity Tier 1 Capital ratio of 6.5% or more; a Tier 1 Capital ratio of 8% or more; a Total Capital ratio of 10% or more; and a leverage ratio of 5% or more. Generally, financial institutions become subject to the new Basel III Rules on January 1, 2015. Management is in the process of assessing the effect the Basel III Rules may have on the Company’s and the subsidiary banks’ capital positions and will monitor developments in this area.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

SPECIAL NOTE CONCERNING FORWARD-LOOKING STATEMENTS

**Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995.** This document (including information incorporated by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to management, are generally identifiable by the use of words such as "believe," "expect," "anticipate," "bode," "predict," "suggest," "project," "appear," "plan," "intend," "estimate," "may," "will," "would," "could," "should," "likely," or other similar expressions. Additional statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. The factors which could have a material adverse effect on the Company's operations and future prospects are detailed in the "Risk Factors" section included under Item 1A of Part I of the Company's Form 10-K. In addition to the risk factors described in that section, there are other factors that may impact any public company, including the Company, which could have a material adverse effect on the Company's operations and future prospects of the Company and its subsidiaries.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.





Part I

Item 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company, like other financial institutions, is subject to direct and indirect market risk. Direct market risk exists from changes in interest rates. The Company's net income is dependent on its net interest income. Net interest income is susceptible to interest rate risk to the degree that interest-bearing liabilities mature or reprice on a different basis than interest-earning assets. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income.

In an attempt to manage the Company's exposure to changes in interest rates, management monitors the Company's interest rate risk. Each subsidiary bank has an asset/liability management committee of the board of directors that meets quarterly to review the bank's interest rate risk position and profitability, and to make or recommend adjustments for consideration by the full board of each bank. Internal asset/liability management teams consisting of members of the subsidiary banks' management meet weekly to manage the mix of assets and liabilities to maximize earnings and liquidity and minimize interest rate and other risks. Management also reviews the subsidiary banks' securities portfolios, formulates investment strategies, and oversees the timing and implementation of transactions to assure attainment of the board's objectives in the most effective manner. Notwithstanding the Company's interest rate risk management activities, the potential for changing interest rates is an uncertainty that can have an adverse effect on net income.

In adjusting the Company's asset/liability position, the board of directors and management attempt to manage the Company's interest rate risk while maintaining or enhancing net interest margins. At times, depending on the level of general interest rates, the relationship between long-term and short-term interest rates, market conditions and competitive factors, the board of directors and management may decide to increase the Company's interest rate risk position somewhat in order to increase its net interest margin. The Company's results of operations and net portfolio values remain vulnerable to increases in interest rates and to fluctuations in the difference between long-term and short-term interest rates.

One method used to quantify interest rate risk is a short-term earnings at risk summary, which is a detailed and dynamic simulation model used to quantify the estimated exposure of net interest income to sustained interest rate changes. This simulation model captures the impact of changing interest rates on the interest income received and

interest expense paid on all interest sensitive assets and liabilities reflected on the Company's consolidated balance sheet. This sensitivity analysis demonstrates net interest income exposure annually over a five-year horizon, assuming no balance sheet growth and various interest rate scenarios including no change in rates; 200, 300, 400, and 500 basis point upward shifts; and a 100 basis point downward shift in interest rates, where interest-bearing assets and liabilities reprice at their earliest possible repricing date. The model assumes parallel and pro rata shifts in interest rates over a twelve-month period for the 200 basis point upward shift and 100 basis point downward shift. For the 300 basis point upward shift, the model assumes an instantaneous and parallel upward shift in rates. For the 400 basis point upward shift, the model assumes a parallel and pro rata shift in interest rates over a twenty-four month period. For the 500 basis point upward shift, the model assumes a flattening and pro rata shift in interest rates over a twelve-month period where the short-end of the yield curve shifts upward greater than the long-end of the yield curve. The asset/liability management committee of the board of directors has established policy limits of a 10% decline in net interest income for the 200 and the newly added 300 basis point upward shifts and the 100 basis point downward shift.

## Part I

## Item 3

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Application of the simulation model analysis at the most recent quarter-end available is presented in the following table. Please note the simulation model analysis as of June 30, 2013 is not yet available.

| INTEREST RATE SCENARIO         | NET INTEREST INCOME<br>EXPOSURE in YEAR 1 |                               |       |                               |   |
|--------------------------------|---|-------------------------------|-------|-------------------------------|---|
|                                | As<br>of                                  |                               | As of |                               |   |
|                                | March<br>31,<br>2013                      | As of<br>December<br>31, 2012 | %     | As of<br>December<br>31, 2011 | % |
| 100 basis point downward shift | -1.8%                                     | -1.5                          | %     | -1.5                          | % |
| 200 basis point upward shift   | -1.7%                                     | -0.9                          | %     | -3.1                          | % |
| 300 basis point upward shock   | -1.7%                                     | 0.8                           | %     | -4.2                          | % |

The simulation is within the board-established policy limit of a 10% decline in net interest income for all three scenarios.

Interest rate risk is considered to be one of the most significant market risks affecting the Company. For that reason, the Company engages the assistance of a national consulting firm and its risk management system to monitor and control the Company's interest rate risk exposure. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Company's business activities.

Part I

Item 4

CONTROLS AND PROCEDURES

**Evaluation of disclosure controls and procedures.** An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Exchange Act) as of June 30, 2013. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports filed and submitted under the Exchange Act was recorded, processed, summarized and reported as and when required.

**Changes in Internal Control over Financial Reporting.** There have been no significant changes to the Company's internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II

QCR HOLDINGS, INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION

Item  
1 Legal Proceedings

There are no material pending legal proceedings to which the Company or any of its subsidiaries is a party other than ordinary routine litigation incidental to their respective businesses.

Item  
1A Risk Factors

There have been no material changes in the risk factors applicable to the Company from those disclosed in Part I, Item 1.A. "Risk Factors," in the Company's 2012 Annual Report on Form 10-K. Please refer to that section of the Company's Form 10-K for disclosures regarding the risks and uncertainties related to the Company's business.

Item  
2 Unregistered Sales of Equity Securities and Use of Proceeds

None

Item  
3 Defaults Upon Senior Securities

None

Item  
4 Mine Safety Disclosures

Not applicable

Item  
5 Other Information

None

Part II

QCR HOLDINGS, INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION - continued

Item 6 Exhibits

Amended and Restated Rights Agreement, between QCR Holdings, Inc., and Quad City Bank and Trust Company, 4.1 as Rights Agent, including exhibits, dated May 8, 2013, incorporated herein by reference to Exhibit 4.1 of the Form 8-K filed by QCR Holdings, Inc., with the Securities and Exchange Commission on May 8, 2013.

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a).

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a).

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101\* Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012; (ii) Consolidated Statements of Income for the three months ended June 30, 2013 and June 30, 2012; (iii) Consolidated Statements of Comprehensive Income for the three months ended June 30, 2013 and June 30, 2012; (iv) Consolidated Statements of Changes in Stockholders' Equity for the three months ended June 30, 2013 and June 30, 2012; (v) Consolidated Statements of Cash Flows for the three months ended June 30, 2013 and June 30, 2012; and (vi) Notes to Consolidated Financial Statements.

\* As provided in Rule 406T of Regulation S-T, this information shall not be deemed "filed" for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934, or otherwise subject to liability under those sections.



SIGNATURES

Pursuant to the requirements of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

QCR HOLDINGS, INC.

(Registrant)

Date August 14, 2013

/s/ Douglas M. Hultquist  
Douglas M. Hultquist, President  
Chief Executive Officer

Date August 14, 2013

/s/ Todd A. Gipple  
Todd A. Gipple, Executive Vice  
President  
Chief Operating Officer  
Chief Financial Officer

Date August 14, 2013

/s/ John R. Oakes  
John R. Oakes, Vice President  
Controller  
Director of Financial Reporting  
Principal Accounting Officer