

QCR HOLDINGS INC
Form 10-Q
August 07, 2014

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 ended June 30, 2014

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 7th 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, 2014, the Registrant had outstanding 7,928,643 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, 2014 and December 31, 2013 | 2 |
| | Consolidated Statements of Income For the Three Months Ended June 30, 2014 and 2013 | 3 |
| | Consolidated Statements of Income For the Six Months Ended June 30, 2014 and 2013 | 4 |
| | Consolidated Statements of Comprehensive Income (Loss) For the Three and Six Months Ended June 30, 2014 and 2013 | 5 |
| | Consolidated Statements of Changes in Stockholders' Equity For the Six Months Ended June 30, 2014 and 2013 | 6 |
| | Consolidated Statements of Cash Flows For the Six Months Ended June 30, 2014 and 2013 | 7-8 |
| | Notes to the Consolidated Financial Statements | 9-31 |
| Item 2 | Management's Discussion and Analysis of Financial Condition and Results of Operations | 32-61 |
| Item 3 | Quantitative and Qualitative Disclosures About Market Risk | 62-64 |
| Item 4 | Controls and Procedures | 65 |
| <u>Part II</u> OTHER INFORMATION | | |
| Item 1 | Legal Proceedings | 66 |
| Item 1A | Risk Factors | 66 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|------------|---|----|
| Item 2 | Unregistered Sales of Equity Securities and Use of Proceeds | 66 |
| Item 3 | Defaults upon Senior Securities | 66 |
| Item 4 | Mine Safety Disclosures | 66 |
| Item 5 | Other Information | 66 |
| Item 6 | Exhibits | 67 |
| Signatures | | 68 |

QCR HOLDINGS, INC. AND SUBSIDIARIES**CONSOLIDATED BALANCE SHEETS (UNAUDITED)****As of June 30, 2014 and December 31, 2013**

| | June 30, 2014 | December 31, 2013 |
|---|------------------|----------------------|
| ASSETS | | |
| Cash and due from banks | \$56,292,577 | \$41,950,790 |
| Federal funds sold | 20,490,000 | 39,435,000 |
| Interest-bearing deposits at financial institutions | 36,786,049 | 33,044,917 |
| Securities held to maturity, at amortized cost | 166,787,372 | 145,451,895 |
| Securities available for sale, at fair value | 515,335,097 | 551,758,458 |
| Total securities | 682,122,469 | 697,210,353 |
| Loans receivable held for sale | 1,302,175 | 1,358,290 |
| Loans/leases receivable held for investment | 1,548,065,574 | 1,458,921,268 |
| Gross loans/leases receivable | 1,549,367,749 | 1,460,279,558 |
| Less allowance for estimated losses on loans/leases | (23,067,024) | (21,448,048) |
| Net loans/leases receivable | 1,526,300,725 | 1,438,831,510 |
| Premises and equipment, net | 36,313,537 | 36,755,364 |
| Goodwill | 3,222,688 | 3,222,688 |
| Core deposit intangible | 1,770,677 | 1,870,433 |
| Bank-owned life insurance | 52,844,877 | 52,002,041 |
| Restricted investment securities | 16,347,125 | 17,027,625 |
| Other real estate owned, net | 10,951,214 | 9,729,053 |
| Other assets | 21,397,545 | 23,873,150 |
| Total assets | \$2,464,839,483 | \$2,394,952,924 |

LIABILITIES AND STOCKHOLDERS' EQUITY LIABILITIES

| | | |
|---------------------------------|---------------|---------------|
| Deposits: | | |
| Noninterest-bearing | \$531,062,583 | \$542,566,087 |
| Interest-bearing | 1,146,305,692 | 1,104,425,156 |
| Total deposits | 1,677,368,275 | 1,646,991,243 |
| Short-term borrowings | 204,321,854 | 149,292,967 |
| Federal Home Loan Bank advances | 222,900,000 | 231,350,000 |
| Other borrowings | 151,452,927 | 142,448,362 |
| Junior subordinated debentures | 40,356,154 | 40,289,830 |
| Other liabilities | 33,797,744 | 37,003,742 |
| Total liabilities | 2,330,196,954 | 2,247,376,144 |

STOCKHOLDERS' EQUITY

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|---|-----------------|-----------------|
| Preferred stock, \$1 par value; shares authorized 250,000 | - | 29,867 |
| June 2014 - 0 shares issued and outstanding | | |
| December 2013 - 29,867 shares issued and outstanding | | |
| Common stock, \$1 par value; shares authorized 20,000,000 | 8,049,889 | 8,005,708 |
| June 2014 - 8,049,889 shares issued and 7,928,643 outstanding | | |
| December 2013 - 8,005,708 shares issued and 7,884,462 outstanding | | |
| Additional paid-in capital | 60,999,044 | 90,154,528 |
| Retained earnings | 71,137,294 | 64,637,173 |
| Accumulated other comprehensive loss | (3,937,188 |) (13,643,986) |
| Less treasury stock, June 2014 and December 2013 - 121,246 common shares, at cost | (1,606,510 |) (1,606,510) |
| Total stockholders' equity | 134,642,529 | 147,576,780 |
| Total liabilities and stockholders' equity | \$2,464,839,483 | \$2,394,952,924 |

See Notes to Consolidated Financial Statements (Unaudited)

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

| | 2014 | 2013 |
|---|---------------|---------------|
| Interest and dividend income: | | |
| Loans/leases, including fees | \$ 16,868,806 | \$ 16,369,605 |
| Securities: | | |
| Taxable | 2,573,649 | 2,629,832 |
| Nontaxable | 1,448,415 | 944,100 |
| Interest-bearing deposits at financial institutions | 71,243 | 61,724 |
| Restricted investment securities | 139,570 | 131,151 |
| Federal funds sold | 3,693 | 2,989 |
| Total interest and dividend income | 21,105,376 | 20,139,401 |
| Interest expense: | | |
| Deposits | 1,101,615 | 1,176,855 |
| Short-term borrowings | 60,811 | 103,435 |
| Federal Home Loan Bank advances | 1,495,980 | 1,726,622 |
| Other borrowings | 1,174,594 | 1,162,893 |
| Junior subordinated debentures | 307,033 | 261,544 |
| Total interest expense | 4,140,033 | 4,431,349 |
| Net interest income | 16,965,343 | 15,708,052 |
| Provision for loan/lease losses | 1,001,879 | 1,520,137 |
| Net interest income after provision for loan/lease losses | 15,963,464 | 14,187,915 |
| Noninterest income: | | |
| Trust department fees | 1,444,414 | 1,197,181 |
| Investment advisory and management fees | 710,858 | 695,094 |
| Deposit service fees | 1,091,923 | 1,054,223 |
| Gains on sales of residential real estate loans | 132,971 | 246,621 |
| Gains on sales government guaranteed portions of loans | 508,168 | 765,738 |
| Securities gains | 571 | 16,460 |
| Earnings on bank-owned life insurance | 388,672 | 423,883 |
| Bargain purchase gain on Community National Acquisition | - | 1,841,385 |
| Losses on other real estate owned, net | (126,657) | (83,339) |
| Other | 1,193,293 | 791,510 |
| Total noninterest income | 5,344,213 | 6,948,756 |
| Noninterest expense: | | |
| Salaries and employee benefits | 9,922,191 | 9,186,233 |
| Occupancy and equipment expense | 1,838,971 | 1,586,841 |
| Professional and data processing fees | 1,403,915 | 1,438,753 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|--|-------------|-------------|
| FDIC and other insurance | 695,365 | 627,390 |
| Loan/lease expense | 377,492 | 251,868 |
| Advertising and marketing | 501,548 | 412,041 |
| Postage and telephone | 258,121 | 257,611 |
| Stationery and supplies | 145,635 | 150,718 |
| Bank service charges | 324,397 | 284,345 |
| Acquisition and data conversion costs | - | 432,326 |
| Other | 638,894 | 606,223 |
| Total noninterest expense | 16,106,529 | 15,234,349 |
| Net income before income taxes | 5,201,148 | 5,902,322 |
| Federal and state income tax expense | 1,193,312 | 1,857,091 |
| Net income | \$4,007,836 | \$4,045,231 |
| Less: Preferred stock dividends | 373,869 | 810,838 |
| Net income attributable to QCR Holdings, Inc. common stockholders | \$3,633,967 | \$3,234,393 |
| Earnings per common share attributable to QCR Holdings, Inc. common shareholders | | |
| Basic | \$0.46 | \$0.60 |
| Diluted | \$0.45 | \$0.59 |
| Weighted average common shares outstanding | 7,924,624 | 5,393,062 |
| Weighted average common and common equivalent shares outstanding | 8,050,514 | 5,497,275 |
| 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,**

| | 2014 | 2013 |
|---|--------------|--------------|
| Interest and dividend income: | | |
| Loans/leases, including fees | \$33,644,396 | \$31,458,432 |
| Securities: | | |
| Taxable | 5,156,443 | 5,090,281 |
| Nontaxable | 2,902,471 | 1,746,573 |
| Interest-bearing deposits at financial institutions | 161,770 | 121,478 |
| Restricted investment securities | 268,495 | 256,256 |
| Federal funds sold | 7,012 | 3,863 |
| Total interest and dividend income | 42,140,587 | 38,676,883 |
| Interest expense: | | |
| Deposits | 2,203,208 | 2,293,646 |
| Short-term borrowings | 112,507 | 167,702 |
| Federal Home Loan Bank advances | 3,051,956 | 3,459,434 |
| Other borrowings | 2,346,125 | 2,353,648 |
| Junior subordinated debentures | 612,207 | 503,084 |
| Total interest expense | 8,326,003 | 8,777,514 |
| Net interest income | 33,814,584 | 29,899,369 |
| Provision for loan/lease losses | 2,096,041 | 2,577,919 |
| Net interest income after provision for loan/lease losses | 31,718,543 | 27,321,450 |
| Noninterest income: | | |
| Trust department fees | 2,944,756 | 2,236,851 |
| Investment advisory and management fees | 1,359,850 | 1,304,435 |
| Deposit service fees | 2,137,808 | 1,962,046 |
| Gains on sales of residential real estate loans | 196,458 | 537,772 |
| Gains on sales government guaranteed portions of loans | 702,187 | 1,610,962 |
| Securities gains | 21,196 | 16,460 |
| Earnings on bank-owned life insurance | 842,836 | 862,570 |
| Bargain purchase gain on Community National Acquisition | - | 1,841,385 |
| Losses on other real estate owned, net | (144,705) | (529,969) |
| Other | 2,030,668 | 2,310,273 |
| Total noninterest income | 10,091,054 | 12,152,785 |
| Noninterest expense: | | |
| Salaries and employee benefits | 19,940,109 | 17,928,916 |
| Occupancy and equipment expense | 3,733,259 | 3,015,711 |
| Professional and data processing fees | 2,988,321 | 2,578,814 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|--|-------------|-------------|
| FDIC and other insurance | 1,410,115 | 1,183,301 |
| Loan/lease expense | 723,128 | 496,959 |
| Advertising and marketing | 839,135 | 676,609 |
| Postage and telephone | 548,796 | 476,302 |
| Stationery and supplies | 297,386 | 261,388 |
| Bank service charges | 622,429 | 559,840 |
| Acquisition and data conversion costs | - | 788,904 |
| Other | 1,144,271 | 1,226,105 |
| Total noninterest expense | 32,246,949 | 29,192,849 |
| Net income before income taxes | 9,562,648 | 10,281,386 |
| Federal and state income tax expense | 1,665,597 | 2,971,011 |
| Net income | \$7,897,051 | \$7,310,375 |
| Less: Preferred stock dividends | 1,081,877 | 1,621,675 |
| Net income attributable to QCR Holdings, Inc. common stockholders | \$6,815,174 | \$5,688,700 |
| Earnings per common share attributable to QCR Holdings, Inc. common shareholders | | |
| Basic | \$0.86 | \$1.10 |
| Diluted | \$0.85 | \$1.08 |
| Weighted average common shares outstanding | 7,912,830 | 5,160,327 |
| Weighted average common and common equivalent shares outstanding | 8,040,279 | 5,265,809 |
| 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 CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

Six Months Ended June 30, 2014 and 2013

| | Preferred Stock | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total |
|--|--------------------|--------------------|----------------------------------|----------------------|---|----------------------|----------------------|
| Balance | | | | | | | |
| December 31, 2013 | \$29,867 | \$8,005,708 | \$90,154,528 | \$64,637,173 | \$(13,643,986) | \$(1,606,510) | \$147,576,780 |
| Net income | - | - | - | 3,889,215 | - | - | 3,889,215 |
| Other comprehensive income, net of tax | - | - | - | - | 5,230,784 | - | 5,230,784 |
| Preferred cash dividends declared | - | - | - | (708,008) | - | - | (708,008) |
| Redemption of 15,000 shares of Series F Noncumulative Perpetual Preferred Stock | (15,000) | - | (14,985,000) | - | - | - | (15,000,000) |
| Proceeds from issuance of 6,189 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan | - | 6,189 | 78,256 | - | - | - | 84,445 |
| Proceeds from issuance of 9,814 shares of common stock as a result of stock options exercised | - | 9,814 | 85,582 | - | - | - | 95,396 |
| Stock compensation | - | - | 347,752 | - | - | - | 347,752 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | |
|--|-----------------|--------------------|---------------------|---------------------|-----------------------|----------------------|----------------------|
| expense | | | | | | | |
| Tax benefit of nonqualified stock options exercised | - | - | 18,647 | - | - | - | 18,647 |
| Restricted stock awards | - | 27,197 | (27,197) | - | - | - | - |
| Exchange of 10,300 shares of common stock in connection with restricted stock vested, net | - | (10,300) | (167,684) | - | - | - | (177,984) |
| Balance March 31, 2014 | \$14,867 | \$8,038,608 | \$75,504,884 | \$67,818,380 | \$(8,413,202) | \$(1,606,510) | \$141,357,027 |
| Net income | - | - | - | 4,007,836 | - | - | 4,007,836 |
| Other comprehensive income, net of tax | - | - | - | - | 4,476,014 | - | 4,476,014 |
| Common cash dividends declared, \$0.04 per share | - | - | - | (315,053) | - | - | (315,053) |
| Preferred cash dividends declared | - | - | - | (373,869) | - | - | (373,869) |
| Redemption of 14,867 shares of Series F Noncumulative Perpetual Preferred Stock | (14,867) | - | (14,809,055) | - | - | - | (14,823,922) |
| Proceeds from issuance of 8,361 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan | - | 8,361 | 119,797 | - | - | - | 128,158 |
| Proceeds from issuance of 630 shares of common stock as a result of stock options exercised | - | 630 | 5,159 | - | - | - | 5,789 |
| | - | - | 179,265 | | | | 179,265 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | |
|---|------------|--------------------|---------------------|---------------------|-----------------------|----------------------|----------------------|
| Stock compensation expense | | | | | | | |
| Tax benefit of nonqualified stock options exercised | - | - | 1,284 | - | - | - | 1,284 |
| Restricted stock awards | - | 2,290 | (2,290) | - | - | - | - |
| Balance June 30, 2014 | \$- | \$8,049,889 | \$60,999,044 | \$71,137,294 | \$(3,937,188) | \$(1,606,510) | \$134,642,529 |

| | Preferred Stock | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total |
|--|-----------------|--------------------|----------------------------|---------------------|---|----------------------|----------------------|
| Balance December 31, 2012 | \$54,867 | \$5,039,448 | \$78,912,791 | \$53,326,542 | \$4,706,683 | \$(1,606,510) | \$140,433,821 |
| 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 options exercised | - | (7,048) | (111,628) | - | - | - | (118,676) |
| Stock compensation expense | - | - | 293,798 | - | - | - | 293,798 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | |
|---|-----------------|--------------------|---------------------|---------------------|--------------------|----------------------|----------------------|
| 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) |
| Balance March 31, 2013 | \$54,867 | \$5,057,562 | \$79,041,338 | \$55,780,849 | \$3,870,325 | \$(1,606,510) | \$142,198,431 |
| 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) |
| Proceeds from 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 Plan | - | 9,560 | 104,221 | - | - | - | 113,781 |
| Proceeds from issuance of 3,769 shares of common stock as a result of stock options exercised | - | 3,769 | 33,070 | - | - | - | 36,839 |
| | - | - | 162,123 | | | | 162,123 |

| | | | | | | | |
|---|------------------|---------------------|----------------------|----------------------|------------------------|-----------------------|-----------------------|
| Stock compensation expense | | | | | | | |
| Tax benefit of nonqualified stock options exercised | - | - | 4,197 | - | - | - | 4,197 |
| Restricted stock awards | - | 12,707 | (12,707) | - | - | - | - |
| Balance June 30, 2013 | \$ 54,867 | \$ 5,918,313 | \$ 91,514,136 | \$ 58,786,271 | \$ (9,221,164) | \$ (1,606,510) | \$ 145,445,913 |

See Notes to Consolidated Financial Statements (Unaudited)

QCR HOLDINGS, INC. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****Six Months Ended June 30, 2014 and 2013**

| | 2014 | 2013 |
|---|--------------|---------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$7,897,051 | \$7,310,375 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 1,390,389 | 1,280,550 |
| Provision for loan/lease losses | 2,096,041 | 2,577,919 |
| Stock-based compensation expense | 527,017 | 455,921 |
| Deferred compensation expense accrued | 684,984 | 419,956 |
| Losses on other real estate owned, net | 144,705 | 529,969 |
| Amortization of premiums on securities, net | 1,002,893 | 1,972,391 |
| Securities gains | (21,196) | (16,460) |
| Loans originated for sale | (22,215,215) | (52,272,708) |
| Proceeds on sales of loans | 23,169,975 | 56,915,600 |
| Gains on sales of residential real estate loans | (196,458) | (537,772) |
| Gains on sales of government guaranteed portions of loans | (702,187) | (1,610,962) |
| Amortization of core deposit intangible | 99,756 | - |
| Accretion of acquisition fair value adjustments, net | (304,876) | - |
| Gain on the sale of premises and equipment | (42,554) | - |
| Increase in cash value of bank-owned life insurance | (842,836) | (862,570) |
| Bargain purchase gain on Community National acquisition | - | (1,841,385) |
| Decrease (increase) in other assets | (1,870,989) | 6,556,417 |
| Decrease in other liabilities | (3,791,845) | (1,217,181) |
| Net cash provided by operating activities | \$7,024,655 | \$19,660,060 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Net decrease in federal funds sold | 18,945,000 | 22,229,000 |
| Net increase in interest-bearing deposits at financial institutions | (3,741,132) | (10,189,746) |
| Proceeds from sales of other real estate owned | 771,902 | 303,766 |
| Purchase of derivative instruments | (2,071,650) | - |
| Activity in securities portfolio: | | |
| Purchases | (36,089,884) | (238,534,747) |
| Calls, maturities and redemptions | 27,756,298 | 124,663,560 |
| Paydowns | 12,563,485 | 27,762,742 |
| Sales | 25,877,578 | 6,167,531 |
| Activity in restricted investment securities: | | |
| Purchases | (839,500) | (4,818,750) |
| Redemptions | 1,520,000 | 4,950,000 |
| Net increase in loans/leases originated and held for investment | (91,280,287) | (51,708,379) |
| Net cash received from the sale of premises and equipment | 291,006 | - |
| Purchase of premises and equipment | (1,197,014) | (950,802) |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|---|----------------|-----------------|
| Net cash received from Community National acquisition | - | 3,025,073 |
| Net cash used in investing activities | \$(47,494,198) | \$(117,100,752) |

CASH FLOWS FROM FINANCING ACTIVITIES

| | | |
|--|--------------|---------------|
| Net increase in deposit accounts | 30,392,132 | 87,620,739 |
| Net increase (decrease) in short-term borrowings | 55,028,887 | (13,896,757) |
| Activity in Federal Home Loan Bank advances: | | |
| Advances | 15,000,000 | 119,000,000 |
| Calls and maturities | (23,450,000) | (111,400,500) |
| Proceeds from term debt | 10,000,000 | 10,000,000 |
| Principal payments on term debt | (1,000,000) | - |
| Payment on 364-day revolving note | - | (5,600,000) |
| Repayment of Community National's other borrowings at acquisition | - | (3,950,000) |
| Payment of cash dividends on common and preferred stock | (1,649,555) | (1,813,624) |
| Redemption of 15,000 shares of Series F Noncumulative Perpetual Preferred Stock, net | (15,000,000) | - |
| Redemption of 14,867 shares of Series F Noncumulative Perpetual Preferred Stock, net | (14,823,922) | - |
| Proceeds from issuance of common stock, net | 313,788 | 229,278 |
| Net cash provided by financing activities | \$54,811,330 | \$80,189,136 |
| Net increase (decrease) in cash and due from banks | 14,341,787 | (17,251,556) |
| Cash and due from banks, beginning | 41,950,790 | 61,568,446 |
| Cash and due from banks, ending | \$56,292,577 | \$44,316,890 |

(Continued)

QCR HOLDINGS, INC. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) - continued****Six Months Ended June 30, 2014 and 2013**

| | 2014 | 2013 |
|---|--------------|-----------------|
| Supplemental disclosure of cash flow information, cash payments for: | | |
| Interest | \$8,376,272 | \$8,897,240 |
| Income/franchise taxes | \$3,057,500 | \$1,031,120 |
| Supplemental schedule of noncash investing activities: | | |
| Change in accumulated other comprehensive income (loss), unrealized gains (losses) on securities available for sale and derivative instruments, net | \$9,706,798 | \$(13,927,847) |
| Exchange of shares of common stock in connection with payroll taxes for restricted stock and in connection with stock options exercised | \$(177,984) | \$(424,587) |
| Transfers of loans to other real estate owned | \$2,138,768 | \$187,500 |
| Supplemental disclosure of cash flow information for Community National Acquisition: | | |
| Fair value of assets acquired: | | |
| 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 |
| Restricted investment securities | - | 1,259,375 |
| Other real estate owned | - | 550,326 |
| Other assets | - | 5,178,583 |
| Total assets acquired | \$- | \$288,314,518 |
| Fair value of liabilities assumed: | | |
| 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 |
| Consideration paid: | | |
| 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)

8

Part I

Item 1

QCR HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2014

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, 2013, included in QCR Holdings, Inc.'s (the "Company") Form 10-K filed with the Securities and Exchange Commission on March 10, 2014. 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, 2014, are not necessarily indicative of the results expected for the year ending December 31, 2014.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries which include three commercial banks: Quad City Bank & Trust Company ("QCBT"), Cedar Rapids Bank & Trust Company ("CRBT"), and Rockford Bank & Trust Company ("RB&T"). On May 13, 2013, the Company acquired Community National Bancorporation ("Community National") and its banking subsidiary Community National Bank ("CNB"). The Company operated CNB as a separate banking charter from the acquisition date until October 26, 2013, when CNB's charter was merged with and into CRBT. CNB's merged branch offices operate as a division of CRBT under the name of "Community Bank & Trust". QCBT, CRBT, and RB&T are all state-chartered commercial banks. The Company also engages in direct financing lease contracts through m2 Lease Funds, LLC ("m2 Lease Funds"), a wholly-owned subsidiary of QCBT. All material intercompany transactions and balances have been eliminated in consolidation.

Recent accounting developments: In January 2014, FASB issued ASU 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The objective of ASU 2014-04 is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU 2014-04 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Management is in the process of evaluating the impact of ASU 2014-04 on the Company's consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective on January 1, 2017 and is not expected to have a significant impact on the Company's financial statements.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

In June 2014, FASB issued ASU 2014-11, Transfers and Servicing. ASU 2014-11 requires that repurchase-to-maturity transactions be accounted for as secured borrowings, consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entail the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. The standard requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral and remaining tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 is effective on January 1, 2015 and is not expected to have a significant impact on the Company's consolidated financial statements.

Reclassifications: Certain amounts in the prior year consolidated 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 – INVESTMENT SECURITIES

The amortized cost and fair value of investment securities as of June 30, 2014 and December 31, 2013 are summarized as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value |
|--|-------------------|------------------------------|---------------------------------|----------------|
| June 30, 2014 | | | | |
| Securities held to maturity: | | | | |
| Municipal securities | \$ 165,737,372 | \$ 1,492,583 | \$(2,609,628) | \$ 164,620,327 |
| Other securities | 1,050,000 | - | - | 1,050,000 |
| | \$ 166,787,372 | \$ 1,492,583 | \$(2,609,628) | \$ 165,670,327 |
| Securities available for sale: | | | | |
| U.S. govt. sponsored agency securities | \$ 334,083,927 | \$ 109,470 | \$(8,572,941) | \$ 325,620,456 |
| Residential mortgage-backed and related securities | 152,965,071 | 2,200,301 | (1,270,158) | 153,895,214 |
| Municipal securities | 32,871,334 | 1,156,141 | (170,004) | 33,857,471 |
| Other securities | 1,401,827 | 560,129 | - | 1,961,956 |
| | \$ 521,322,159 | \$ 4,026,041 | \$(10,013,103) | \$ 515,335,097 |
| December 31, 2013: | | | | |
| Securities held to maturity: | | | | |
| Municipal securities | \$ 144,401,895 | \$ 299,789 | \$(7,111,579) | \$ 137,590,105 |
| Other securities | 1,050,000 | - | - | 1,050,000 |
| | \$ 145,451,895 | \$ 299,789 | \$(7,111,579) | \$ 138,640,105 |
| Securities available for sale: | | | | |
| U.S. govt. sponsored agency securities | \$ 376,574,132 | \$ 41,696 | \$(20,142,841) | \$ 356,472,987 |
| Residential mortgage-backed and related securities | 160,110,199 | 1,153,409 | (3,834,157) | 157,429,451 |
| Municipal securities | 35,813,866 | 923,315 | (778,324) | 35,958,857 |
| Other securities | 1,372,365 | 524,798 | - | 1,897,163 |
| | \$ 573,870,562 | \$ 2,643,218 | \$(24,755,322) | \$ 551,758,458 |

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, 2014 and December 31, 2013, are summarized as follows:

| | Less than 12 Months | | 12 Months or More | | Total | |
|--|---------------------|-------------------------|-------------------|-------------------------|---------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| June 30, 2014: | | | | | | |
| Securities held to maturity: | | | | | | |
| Municipal securities | \$37,351,435 | \$(982,726) | \$47,726,709 | \$(1,626,902) | \$85,078,144 | \$(2,609,628) |
| Securities available for sale: | | | | | | |
| U.S. govt. sponsored agency securities | \$284,171,721 | \$(8,502,103) | \$13,725,024 | \$(70,838) | \$297,896,745 | \$(8,572,941) |
| Residential mortgage-backed and related securities | 8,124,317 | (95,270) | 55,800,561 | (1,174,888) | 63,924,878 | (1,270,158) |
| Municipal securities | 8,765,260 | (131,548) | 2,184,122 | (38,456) | 10,949,382 | (170,004) |
| | \$301,061,298 | \$(8,728,921) | \$71,709,707 | \$(1,284,182) | \$372,771,005 | \$(10,013,103) |
| December 31, 2013: | | | | | | |
| Securities held to maturity: | | | | | | |
| Municipal securities | \$101,983,602 | \$(6,711,240) | \$2,697,375 | \$(400,339) | \$104,680,977 | \$(7,111,579) |
| Securities available for sale: | | | | | | |
| U.S. govt. sponsored agency securities | \$333,194,820 | \$(19,141,077) | \$10,978,390 | \$(1,001,764) | \$344,173,210 | \$(20,142,841) |
| Residential mortgage-backed and | 94,723,092 | (2,947,770) | 14,117,719 | (886,387) | 108,840,811 | (3,834,157) |

related securities

| | | | | | | |
|----------------------|---------------|----------------|--------------|---------------|---------------|----------------|
| Municipal securities | 13,890,692 | (724,939) | 985,687 | (53,385) | 14,876,379 | (778,324) |
| | \$441,808,604 | \$(22,813,786) | \$26,081,796 | \$(1,941,536) | \$467,890,400 | \$(24,755,322) |

At June 30, 2014, the investment portfolio included 529 securities. Of this number, 259 securities had current unrealized losses with aggregate depreciation of less than 4% from the total amortized cost basis. Of these, 98 securities had an unrealized loss for twelve months or more. 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, 2014 and December 31, 2013, equity securities represented less than 1% of the total portfolio.

The Company did not recognize other-than-temporary impairment on any debt or equity securities for the three and six months ended June 30, 2014 and 2013.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

All sales of securities for the three and six months ended June 30, 2014 and 2013, 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, 2014 | June 30, 2013 | June 30, 2014 | June 30, 2013 |
| Proceeds from sales of securities | \$18,856,953 | \$6,167,531 | \$25,877,578 | \$6,167,531 |
| Pre-tax gross gains from sales of securities | 571 | 16,460 | 21,196 | 16,460 |

The amortized cost and fair value of securities as of June 30, 2014 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" available for sale are excluded from the maturity categories as there is no fixed maturity date for those securities.

| | Amortized Cost | Fair Value |
|--|-------------------|---------------|
| Securities held to maturity: | | |
| Due in one year or less | \$2,927,386 | \$2,929,942 |
| Due after one year through five years | 10,861,031 | 10,874,917 |
| Due after five years | 152,998,955 | 151,865,468 |
| | \$166,787,372 | \$165,670,327 |
| Securities available for sale: | | |
| Due in one year or less | \$4,485,092 | \$4,498,204 |
| Due after one year through five years | 48,898,104 | 48,717,600 |
| Due after five years | 313,572,065 | 306,262,123 |
| | \$366,955,261 | \$359,477,927 |
| Residential mortgage-backed and related securities | 152,965,071 | 153,895,214 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|------------------|---------------|---------------|
| Other securities | 1,401,827 | 1,961,956 |
| | \$521,322,159 | \$515,335,097 |

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 par and at predetermined dates prior to the stated maturity, summarized as follows:

| | Amortized Cost | Fair Value |
|--|-------------------|---------------|
| Securities held to maturity: | | |
| Municipal securities | \$102,919,232 | \$102,260,651 |
| Securities available for sale: | | |
| U.S. govt. sponsored agency securities | 271,663,942 | 264,421,214 |
| Municipal securities | 20,829,274 | 21,268,094 |
| | \$292,493,216 | \$285,689,308 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 3 – LOANS/LEASES RECEIVABLE

The composition of the loan/lease portfolio as of June 30, 2014 and December 31, 2013 is presented as follows:

| | As of June 30, 2014 | As of December 31, 2013 |
|---|------------------------|-------------------------------|
| Commercial and industrial loans | \$480,494,321 | \$431,688,129 |
| Commercial real estate loans | | |
| Owner-occupied commercial real estate | 247,596,151 | 261,215,912 |
| Commercial construction, land development, and other land | 58,042,089 | 57,844,902 |
| Other non owner-occupied commercial real estate | 377,737,501 | 352,692,115 |
| | 683,375,741 | 671,752,929 |
| Direct financing leases * | 155,004,018 | 128,901,442 |
| Residential real estate loans ** | 153,199,719 | 147,356,323 |
| Installment and other consumer loans | 71,443,399 | 76,033,810 |
| | 1,543,517,198 | 1,455,732,633 |
| Plus deferred loan/lease origination costs, net of fees | 5,850,551 | 4,546,925 |
| | 1,549,367,749 | 1,460,279,558 |
| Less allowance for estimated losses on loans/leases | (23,067,024) | (21,448,048) |
| | \$1,526,300,725 | \$1,438,831,510 |
| | | |
| * Direct financing leases: | | |
| Net minimum lease payments to be received | \$175,772,051 | \$145,662,254 |
| Estimated unguaranteed residual values of leased assets | 1,642,309 | 1,694,499 |
| Unearned lease/residual income | (22,410,342) | (18,455,311) |
| | 155,004,018 | 128,901,442 |
| Plus deferred lease origination costs, net of fees | 5,935,700 | 4,814,183 |
| | 160,939,718 | 133,715,625 |
| Less allowance for estimated losses on leases | (3,319,131) | (2,517,217) |
| | \$157,620,587 | \$131,198,408 |

*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, 2014 and 2013.

**Includes residential real estate loans held for sale totaling \$1,302,175 and \$1,358,290 as of June 30, 2014, and December 31, 2013, 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, 2014 and December 31, 2013 is presented as follows:

| Classes of Loans/Leases | As of June 30, 2014 | | | | | | |
|---|---------------------|---------------------|---------------------|-----------------------------------|-------------------------|-----------------|---|
| | 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 | \$478,425,272 | \$162,344 | \$110,714 | \$41,950 | \$1,754,041 | \$480,494,321 | |
| Commercial Real Estate Owner-Occupied | 244,861,764 | 81,356 | 1,380,715 | 39,852 | 1,232,464 | 247,596,151 | |
| Commercial Construction, Land Development, and Other Land | 56,324,561 | 1,086,827 | - | - | 630,701 | 58,042,089 | |
| Other Non Owner-Occupied Commercial Real Estate | 366,941,393 | 924,340 | 18,800 | - | 9,852,968 | 377,737,501 | |
| Direct Financing Leases | 151,796,790 | 599,582 | 802,650 | 13,167 | 1,791,829 | 155,004,018 | |
| Residential Real Estate | 151,334,965 | 65,549 | 347,400 | - | 1,451,805 | 153,199,719 | |
| Installment and Other Consumer | 70,353,793 | 94,038 | 49,196 | 8,646 | 937,726 | 71,443,399 | |
| | \$1,520,038,538 | \$3,014,036 | \$2,709,475 | \$103,615 | \$17,651,534 | \$1,543,517,198 | |
| As a percentage of total loan/lease | 98.48 | % 0.20 | % 0.18 | % 0.01 | % 1.14 | % 100.00 | % |

portfolio

| Classes of Loans/Leases | As of December 31, 2013 | | | | | | |
|--|-------------------------|------------------------|------------------------|--|----------------------------|-----------------|---|
| | 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 Commercial Real Estate | \$429,557,699 | \$199,949 | \$185,500 | \$- | \$1,744,981 | \$431,688,129 | |
| Owner-Occupied Commercial Real Estate | 258,557,660 | 465,418 | 993,163 | 60,286 | 1,139,385 | 261,215,912 | |
| Commercial Construction, Land Development, and Other Land | 56,301,186 | 358,626 | - | - | 1,185,090 | 57,844,902 | |
| Other Non Owner-Occupied Commercial Real Estate | 341,743,730 | 476,877 | 151,017 | - | 10,320,491 | 352,692,115 | |
| Direct Financing Leases | 126,878,515 | 714,464 | 414,005 | - | 894,458 | 128,901,442 | |
| Residential Real Estate | 142,353,936 | 3,088,516 | 275,262 | 20,126 | 1,618,483 | 147,356,323 | |
| Installment and Other Consumer | 74,811,489 | 127,082 | 116,468 | 3,762 | 975,009 | 76,033,810 | |
| | \$1,430,204,215 | \$5,430,932 | \$2,135,415 | \$84,174 | \$17,877,897 | \$1,455,732,633 | |
| As a percentage of total loan/lease portfolio | 98.25 | % 0.37 | % 0.15 | % 0.01 | % 1.23 | % 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, 2014 and December 31, 2013 are presented as follows:

| Classes of Loans/Leases | As of June 30, 2014 | | | Total Nonperforming Loans/Leases | Percentage of Total Nonperforming Loans/Leases | |
|---|-----------------------------------|---------------------------|---|----------------------------------|--|---|
| | Accruing Past Due 90 Days or More | Nonaccrual Loans/Leases * | Troubled Debt Restructurings - Accruing | | | |
| Commercial and Industrial Commercial Real Estate | \$41,950 | \$1,754,041 | \$1,483,846 | \$3,279,837 | 16.45 | % |
| Owner-Occupied Commercial Real Estate | 39,852 | 1,232,464 | - | 1,272,316 | 6.38 | % |
| Commercial Construction, Land Development, and Other Land | - | 630,701 | - | 630,701 | 3.16 | % |
| Other Non Owner-Occupied Commercial Real Estate | - | 9,852,968 | - | 9,852,968 | 49.41 | % |
| Direct Financing Leases | 13,167 | 1,791,829 | - | 1,804,996 | 9.05 | % |
| Residential Real Estate | - | 1,451,805 | 343,322 | 1,795,127 | 9.00 | % |
| Installment and Other Consumer | 8,646 | 937,726 | 357,000 | 1,303,372 | 6.54 | % |
| | \$103,615 | \$17,651,534 | \$2,184,168 | \$19,939,317 | 100.00 | % |

*Nonaccrual loans/leases includes \$9,778,112 of troubled debt restructurings, including \$83,922 in commercial and industrial loans, \$8,897,061 in commercial real estate loans, \$156,800 in direct financing leases, \$443,224 in residential real estate loans, and \$197,105 in installment loans.

| Classes of Loans/Leases | As of December 31, 2013 | | | Total Nonperforming | Percentage of Total | |
|-------------------------|-------------------------|-------------------------|---------------|---------------------|---------------------|--|
| | Accruing Past | Nonaccrual Loans/Leases | Troubled Debt | | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | Due 90 Days or More | ** | Restructurings - Accruing | Loans/Leases | Nonperforming Loans/Leases | |
|--|---------------------------|---------------|------------------------------|---------------|-------------------------------|---|
| Commercial and Industrial Commercial Real Estate | \$- | \$ 1,744,981 | \$ 878,381 | \$ 2,623,362 | 12.81 | % |
| Owner-Occupied Commercial Real Estate | 60,286 | 1,139,385 | - | 1,199,671 | 5.86 | % |
| Commercial Construction, Land Development, and Other Land | - | 1,185,090 | - | 1,185,090 | 5.79 | % |
| Other Non Owner-Occupied Commercial Real Estate | - | 10,320,491 | 905,205 | 11,225,696 | 54.80 | % |
| Direct Financing Leases | - | 894,458 | - | 894,458 | 4.37 | % |
| Residential Real Estate | 20,126 | 1,618,483 | 371,995 | 2,010,604 | 9.82 | % |
| Installment and Other Consumer | 3,762 | 975,009 | 367,000 | 1,345,771 | 6.57 | % |
| | \$84,174 | \$ 17,877,897 | \$ 2,522,581 | \$ 20,484,652 | 100.00 | % |

**Nonaccrual loans/leases includes \$10,890,785 of troubled debt restructurings, including \$77,072 in commercial and industrial loans, \$10,077,501 in commercial real estate loans, \$446,996 in residential real estate loans, and \$289,216 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, 2014 and 2013, respectively, are presented as follows:

| | Three Months Ended June 30, 2014 | | | | | |
|---|----------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|--------------|
| | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
| Balance, beginning | \$6,647,658 | \$10,587,657 | \$2,820,239 | \$1,388,885 | \$1,208,831 | \$22,653,270 |
| Provisions (credits) charged to expense | 101,718 | (33,506) | 566,374 | 101,030 | 266,263 | 1,001,879 |
| Loans/leases charged off | (222,057) | (311,453) | (78,755) | (50,730) | (12,982) | (675,977) |
| Recoveries on loans/leases previously charged off | 22,059 | 34,994 | 11,273 | - | 19,526 | 87,852 |
| Balance, ending | \$6,549,378 | \$10,277,692 | \$3,319,131 | \$1,439,185 | \$1,481,638 | \$23,067,024 |
| | Three Months Ended June 30, 2013 | | | | | |
| | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
| Balance, beginning | \$4,466,264 | \$12,188,953 | \$2,296,523 | \$966,336 | \$851,386 | \$20,769,462 |
| Provisions (credits) 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 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 |

Six Months Ended June 30, 2014

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
|--|---------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|--------------|
| Balance, beginning | \$5,648,774 | \$10,705,434 | \$2,517,217 | \$1,395,849 | \$1,180,774 | \$21,448,048 |
| Provisions (credits) charged to expense | 1,078,508 | (263,491) | 919,021 | 96,675 | 265,328 | 2,096,041 |
| Loans/leases charged off | (226,080) | (315,551) | (144,488) | (53,442) | (15,737) | (755,298) |
| Recoveries on loans/leases previously charged off | 48,176 | 151,300 | 27,381 | 103 | 51,273 | 278,233 |
| Balance, ending | \$6,549,378 | \$10,277,692 | \$3,319,131 | \$1,439,185 | \$1,481,638 | \$23,067,024 |

Six Months Ended June 30, 2013

| | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
|--|---------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|--------------|
| Balance, beginning | \$4,531,545 | \$11,069,502 | \$1,990,395 | \$1,070,328 | \$1,263,434 | \$19,925,204 |
| Provisions (credits) 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 |

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, 2014 and December 31, 2013 is presented as follows:

| | As of June 30, 2014 | | | | | |
|---|------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|------------------|
| | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
| Allowance for loans/leases individually evaluated for impairment | \$ 848,593 | \$ 2,567,526 | \$ 534,043 | \$ 237,358 | \$ 471,025 | \$ 4,658,545 |
| Allowance for loans/leases collectively evaluated for impairment | 5,700,785 | 7,710,166 | 2,785,088 | 1,201,827 | 1,010,613 | 18,408,479 |
| | \$ 6,549,378 | \$ 10,277,692 | \$ 3,319,131 | \$ 1,439,185 | \$ 1,481,638 | \$ 23,067,024 |
| Loans/leases individually evaluated for impairment | \$ 2,104,768 | \$ 11,264,502 | \$ 1,791,828 | \$ 1,795,128 | \$ 1,294,726 | \$ 18,250,952 |
| Loans/leases collectively evaluated for impairment | 478,389,553 | 672,111,239 | 153,212,190 | 151,404,591 | 70,148,673 | 1,525,266,246 |
| | \$ 480,494,321 | \$ 683,375,741 | \$ 155,004,018 | \$ 153,199,719 | \$ 71,443,399 | \$ 1,543,517,198 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | | | | | | |
|---|-------|---|-------|---|-------|---|-------|---|-------|---|-------|---|
| Allowance as a percentage of loans/leases individually evaluated for impairment | 40.32 | % | 22.79 | % | 29.80 | % | 13.22 | % | 36.38 | % | 25.52 | % |
| Allowance as a percentage of loans/leases collectively evaluated for impairment | 1.19 | % | 1.15 | % | 1.82 | % | 0.79 | % | 1.44 | % | 1.21 | % |
| | 1.36 | % | 1.50 | % | 2.14 | % | 0.94 | % | 2.07 | % | 1.49 | % |

As of December 31, 2013

| | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total | | | | | | |
|--|---------------------------|------------------------|-------------------------|-------------------------|--------------------------------|-----------------|-------|---|-------|---|-------|---|
| Allowance for loans/leases individually evaluated for impairment | \$927,453 | \$3,174,704 | \$192,847 | \$246,266 | \$467,552 | \$5,008,822 | | | | | | |
| Allowance for loans/leases collectively evaluated for impairment | 4,721,321 | 7,530,730 | 2,324,370 | 1,149,583 | 713,222 | 16,439,226 | | | | | | |
| | \$5,648,774 | \$10,705,434 | \$2,517,217 | \$1,395,849 | \$1,180,774 | \$21,448,048 | | | | | | |
| Loans/leases individually evaluated for impairment | \$1,761,850 | \$12,956,915 | \$894,458 | \$2,116,747 | \$1,350,450 | \$19,080,420 | | | | | | |
| Loans/leases collectively evaluated for impairment | 429,926,279 | 658,796,014 | 128,006,984 | 145,239,576 | 74,683,360 | 1,436,652,213 | | | | | | |
| | \$431,688,129 | \$671,752,929 | \$128,901,442 | \$147,356,323 | \$76,033,810 | \$1,455,732,633 | | | | | | |
| Allowance as a percentage of loans/leases individually | 52.64 | % | 24.50 | % | 21.56 | % | 11.63 | % | 34.62 | % | 26.25 | % |

| | | | | | | | | | | | | |
|--|------|---|------|---|------|---|------|---|------|---|------|---|
| evaluated for impairment Allowance as a percentage of loans/leases collectively evaluated for impairment | 1.10 | % | 1.14 | % | 1.82 | % | 0.79 | % | 0.95 | % | 1.14 | % |
| | 1.31 | % | 1.59 | % | 1.95 | % | 0.95 | % | 1.55 | % | 1.47 | % |

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, 2014 are 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 |
|--|---------------------|--------------------------|-------------------|-----------------------------|----------------------------|---|
| Impaired Loans/Leases with No Specific Allowance Recorded: | | | | | | |
| Commercial and Industrial Commercial Real Estate | \$575,419 | \$730,020 | \$- | \$631,165 | \$ 1,899 | \$ 1,899 |
| Owner-Occupied Commercial Real Estate | 380,931 | 380,931 | - | 410,136 | - | - |
| Commercial Construction, Land Development, and Other Land | 1,622,016 | 1,856,416 | - | 1,923,766 | - | - |
| Other Non Owner-Occupied Commercial Real Estate | 1,941,116 | 1,941,116 | - | 2,695,138 | 13,283 | 13,283 |
| Direct Financing Leases | 793,247 | 793,247 | - | 651,516 | - | - |
| Residential Real Estate | 954,464 | 954,464 | - | 1,137,735 | 2,175 | 2,175 |
| Installment and Other Consumer | 457,611 | 457,611 | - | 501,576 | 1,780 | 1,780 |
| | \$6,724,804 | \$7,113,805 | \$- | \$7,951,032 | \$ 19,137 | \$ 19,137 |
| Impaired Loans/Leases with Specific Allowance Recorded: | | | | | | |
| Commercial and Industrial Commercial Real Estate | \$1,529,349 | \$2,049,051 | \$848,593 | \$855,050 | \$ - | \$ - |
| | 552,923 | 552,923 | 176,287 | 223,337 | - | - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | |
|---|--------------|--------------|-------------|--------------|-----------|-----------|
| Owner-Occupied Commercial Real Estate | | | | | | |
| Commercial Construction, Land Development, and Other Land | 600,920 | 600,920 | 461,671 | 605,198 | - | - |
| Other Non Owner-Occupied Commercial Real Estate | 6,166,596 | 6,866,187 | 1,929,568 | 5,974,240 | - | - |
| Direct Financing Leases | 998,581 | 998,581 | 534,043 | 648,487 | - | - |
| Residential Real Estate | 840,664 | 840,664 | 237,358 | 767,008 | 778 | 778 |
| Installment and Other Consumer | 837,115 | 837,115 | 471,025 | 788,112 | - | - |
| | \$11,526,148 | \$12,745,441 | \$4,658,545 | \$9,861,432 | \$ 778 | \$ 778 |
| | | | | | | |
| Total Impaired Loans/Leases: | | | | | | |
| Commercial and Industrial Commercial Real Estate | \$2,104,768 | \$2,779,071 | \$848,593 | \$1,486,215 | \$ 1,899 | \$ 1,899 |
| Owner-Occupied Commercial Real Estate | 933,854 | 933,854 | 176,287 | 633,473 | - | - |
| Commercial Construction, Land Development, and Other Land | 2,222,936 | 2,457,336 | 461,671 | 2,528,964 | - | - |
| Other Non Owner-Occupied Commercial Real Estate | 8,107,712 | 8,807,303 | 1,929,568 | 8,669,378 | 13,283 | 13,283 |
| Direct Financing Leases | 1,791,828 | 1,791,828 | 534,043 | 1,300,003 | - | - |
| Residential Real Estate | 1,795,128 | 1,795,128 | 237,358 | 1,904,743 | 2,953 | 2,953 |
| Installment and Other Consumer | 1,294,726 | 1,294,726 | 471,025 | 1,289,688 | 1,780 | 1,780 |
| | \$18,250,952 | \$19,859,246 | \$4,658,545 | \$17,812,464 | \$ 19,915 | \$ 19,915 |

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, 2014 and 2013, respectively, are presented as follows:

| Classes of Loans/Leases | Three Months Ended June 30, 2014 | | | Three Months Ended June 30, 2013 | | |
|---|----------------------------------|----------------------------|---|----------------------------------|----------------------------|---|
| | 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 |
| Impaired Loans/Leases with No Specific Allowance Recorded: | | | | | | |
| Commercial and Industrial Commercial Real Estate | \$589,889 | \$ 11 | \$ 11 | \$613,506 | \$ 1,937 | \$ 1,937 |
| Owner-Occupied Commercial Real Estate | 383,861 | - | - | 3,107,106 | - | - |
| Commercial Construction, Land Development, and Other Land | 1,642,205 | - | - | 325,000 | - | - |
| Other Non Owner-Occupied Commercial Real Estate | 2,222,582 | - | - | 353,972 | 657 | 657 |
| Direct Financing Leases | 700,607 | - | - | 822,718 | - | - |
| Residential Real Estate | 1,014,286 | 720 | 720 | 1,057,657 | - | - |
| Installment and Other Consumer | 465,820 | 890 | 890 | 915,478 | 2,686 | 2,686 |
| | \$7,019,250 | \$ 1,621 | \$ 1,621 | \$7,195,437 | \$ 5,280 | \$ 5,280 |
| Impaired Loans/Leases with Specific Allowance Recorded: | | | | | | |
| Commercial and Industrial Commercial Real Estate | \$989,979 | \$ - | \$ - | \$1,229,737 | \$ 15,307 | \$ 15,307 |
| Owner-Occupied Commercial Real Estate | 334,236 | - | - | 653,815 | - | - |
| Commercial Construction, Land Development, and Other Land | 602,498 | - | - | 3,656,226 | 2,716 | 2,716 |
| Other Non Owner-Occupied Commercial Real Estate | 6,057,384 | - | - | 10,143,708 | - | - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | |
|---|--------------|----------|----------|--------------|-----------|-----------|
| Direct Financing Leases | 855,628 | - | - | 133,038 | - | - |
| Residential Real Estate | 779,104 | 4 | 4 | 302,334 | - | - |
| Installment and Other Consumer | 817,994 | - | - | 430,427 | - | - |
| | \$10,436,823 | \$ 4 | \$ 4 | \$16,549,285 | \$ 18,023 | \$ 18,023 |
| Total Impaired Loans/Leases: | | | | | | |
| Commercial and Industrial | \$1,579,868 | \$ 11 | \$ 11 | \$1,843,243 | \$ 17,244 | \$ 17,244 |
| Commercial Real Estate | | | | | | |
| Owner-Occupied Commercial Real Estate | 718,097 | - | - | 3,760,921 | - | - |
| Commercial Construction, Land Development, and Other Land | 2,244,703 | - | - | 3,981,226 | 2,716 | 2,716 |
| Other Non Owner-Occupied Commercial Real Estate | 8,279,966 | - | - | 10,497,680 | 657 | 657 |
| Direct Financing Leases | 1,556,235 | - | - | 955,756 | - | - |
| Residential Real Estate | 1,793,390 | 724 | 724 | 1,359,991 | - | - |
| Installment and Other Consumer | 1,283,814 | 890 | 890 | 1,345,905 | 2,686 | 2,686 |
| | \$17,456,073 | \$ 1,625 | \$ 1,625 | \$23,744,722 | \$ 23,303 | \$ 23,303 |

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, 2013 are 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 | \$492,622 | \$568,951 | \$- |
| Owner-Occupied Commercial Real Estate | 392,542 | 392,542 | - |
| Commercial Construction, Land Development, and Other Land | 1,943,168 | 2,054,368 | - |
| Other Non Owner-Occupied Commercial Real Estate | 1,790,279 | 1,902,279 | - |
| Direct Financing Leases | 557,469 | 557,469 | - |
| Residential Real Estate | 1,071,927 | 1,071,927 | - |
| Installment and Other Consumer | 509,667 | 509,667 | - |
| | \$6,757,674 | \$7,057,203 | \$- |
| Impaired Loans/Leases with Specific Allowance Recorded: | | | |
| Commercial and Industrial Commercial Real Estate | \$1,269,228 | \$1,956,755 | \$927,453 |
| Owner-Occupied Commercial Real Estate | 159,247 | 159,247 | 67,498 |
| Commercial Construction, Land Development, and Other Land | 888,547 | 1,011,747 | 503,825 |
| Other Non Owner-Occupied Commercial Real Estate | 7,783,132 | 8,488,414 | 2,603,381 |
| Direct Financing Leases | 336,989 | 336,989 | 192,847 |
| Residential Real Estate | 1,044,820 | 1,044,820 | 246,266 |
| Installment and Other Consumer | 840,783 | 840,783 | 467,552 |
| | \$12,322,746 | \$13,838,755 | \$5,008,822 |
| Total Impaired Loans/Leases: | | | |
| Commercial and Industrial Commercial Real Estate | \$1,761,850 | \$2,525,706 | \$927,453 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | |
|---|---------------|---------------|--------------|
| Owner-Occupied Commercial Real Estate | 551,789 | 551,789 | 67,498 |
| Commercial Construction, Land Development, and Other Land | 2,831,715 | 3,066,115 | 503,825 |
| Other Non Owner-Occupied Commercial Real Estate | 9,573,411 | 10,390,693 | 2,603,381 |
| Direct Financing Leases | 894,458 | 894,458 | 192,847 |
| Residential Real Estate | 2,116,747 | 2,116,747 | 246,266 |
| Installment and Other Consumer | 1,350,450 | 1,350,450 | 467,552 |
| | \$ 19,080,420 | \$ 20,895,958 | \$ 5,008,822 |

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, 2014 and December 31, 2013:

| Internally Assigned Risk Rating | As of June 30, 2014 | | | | Total |
|---------------------------------|---------------------------|------------------------|--|--|-----------------|
| | Commercial and Industrial | Commercial Real Estate | Commercial Real Estate Development, and Other Land | Non Owner-Occupied Commercial Construction, Other Commercial Real Estate | |
| Pass (Ratings 1 through 5) | \$444,280,023 | \$228,602,988 | \$54,249,436 | \$349,022,456 | \$1,076,154,903 |
| Special Mention (Rating 6) | 22,616,136 | 10,214,621 | - | 1,475,286 | 34,306,043 |
| Substandard (Rating 7) | 13,598,162 | 8,778,542 | 3,792,653 | 27,239,759 | 53,409,116 |
| Doubtful (Rating 8) | - | - | - | - | - |
| | \$480,494,321 | \$247,596,151 | \$58,042,089 | \$377,737,501 | \$1,163,870,062 |

As of June 30, 2014

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| Delinquency Status * | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
|----------------------|-------------------------|-------------------------|--------------------------------|----------------|
| Performing | \$ 153,199,022 | \$ 151,404,592 | \$ 70,140,027 | \$ 374,743,641 |
| Nonperforming | 1,804,996 | 1,795,127 | 1,303,372 | 4,903,495 |
| | \$ 155,004,018 | \$ 153,199,719 | \$ 71,443,399 | \$ 379,647,136 |

As of December 31, 2013

| Internally Assigned Risk Rating | Commercial and Industrial | Commercial Real Estate | | | Total |
|---------------------------------|---------------------------|---------------------------------------|--|------------------------------|------------------|
| | | Owner-Occupied Commercial Real Estate | Non Owner-Occupied Commercial Construction, Land Development, and Other Land | Other Commercial Real Estate | |
| Pass (Ratings 1 through 5) | \$ 407,294,743 | \$ 250,028,731 | \$ 51,868,919 | \$ 326,168,882 | \$ 1,035,361,275 |
| Special Mention (Rating 6) | 11,355,713 | 8,318,232 | 1,588,086 | 3,310,017 | 24,572,048 |
| Substandard (Rating 7) | 13,037,673 | 2,868,949 | 4,387,897 | 23,213,216 | 43,507,735 |
| Doubtful (Rating 8) | - | - | - | - | - |
| | \$ 431,688,129 | \$ 261,215,912 | \$ 57,844,902 | \$ 352,692,115 | \$ 1,103,441,058 |

As of December 31, 2013

| Delinquency Status * | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
|----------------------|-------------------------|-------------------------|--------------------------------|----------------|
| Performing | \$ 128,006,984 | \$ 145,345,719 | \$ 74,688,039 | \$ 348,040,742 |
| Nonperforming | 894,458 | 2,010,604 | 1,345,771 | 4,250,833 |
| | \$ 128,901,442 | \$ 147,356,323 | \$ 76,033,810 | \$ 352,291,575 |

*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, 2014 and December 31, 2013, troubled debt restructurings totaled \$11,962,280 and \$13,413,366, 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, 2014 and 2013. 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, 2014 | | | | For the three months ended June 30, 2013 | | | |
|---|--|--------------------------------------|---------------------------------------|--------------------|--|--------------------------------------|---------------------------------------|--------------------|
| | 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 |
| CONCESSION - Significant payment delay | | | | | | | | |
| Commercial and Industrial | 3 | \$ 889,154 | \$ 889,154 | \$ 239,783 | - | \$ - | \$ - | \$ - |
| Residential Real Estate | - | \$ - | \$ - | \$ - | 1 | \$ 91,581 | \$ 91,581 | \$ - |
| Installment and Other Consumer | - | \$ - | \$ - | \$ - | 1 | \$ 370,000 | \$ 370,000 | \$ - |
| | 3 | \$ 889,154 | \$ 889,154 | \$ 239,783 | 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 | \$ - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | |
|---------------------------|---|--------------|--------------|------------|---|------------|------------|
| CONCESSION - Other | | | | | | | |
| Commercial and Industrial | 1 | \$ 427,849 | \$ 427,849 | \$ 113,449 | - | \$ - | \$ - |
| | 1 | \$ 427,849 | \$ 427,849 | \$ 113,449 | - | \$ - | \$ - |
| TOTAL | 4 | \$ 1,317,003 | \$ 1,317,003 | \$ 353,232 | 4 | \$ 959,708 | \$ 959,708 |

| Classes of Loans/Leases | For the six months ended June 30, 2014 | | | | For the six months ended June 30, 2013 | | | |
|---|--|--|---|-----------------------|--|--|---|-----------------------|
| | 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 |
| CONCESSION - Significant payment delay | | | | | | | | |
| Commercial and Industrial | 3 | \$ 889,154 | \$ 889,154 | \$ 239,783 | - | \$ - | \$ - | \$ - |
| Owner-Occupied Commercial Real Estate | - | \$ - | \$ - | \$ - | 1 | \$ 47,958 | \$ 47,958 | \$ - |
| Direct Financing Leases | 1 | \$ 89,443 | \$ 89,443 | \$ - | - | \$ - | \$ - | \$ - |
| Residential Real Estate | - | \$ - | \$ - | - | 1 | \$ 91,581 | \$ 91,581 | \$ - |
| Installment and Other Consumer | - | \$ - | \$ - | - | 1 | \$ 370,000 | \$ 370,000 | \$ - |
| | 4 | \$ 978,597 | \$ 978,597 | \$ 239,783 | 3 | \$ 509,539 | \$ 509,539 | \$ - |
| 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 | \$ - |
| CONCESSION - Extension of maturity | | | | | | | | |
| Commercial and Industrial | - | \$ - | \$ - | \$ - | 3 | \$ 809,494 | \$ 809,494 | \$ 188,700 |
| Direct Financing Leases | 1 | \$ 70,144 | \$ 70,144 | \$ 24,246 | - | \$ - | \$ - | \$ - |
| | 1 | \$ 70,144 | \$ 70,144 | \$ 24,246 | 3 | \$ 809,494 | \$ 809,494 | \$ 188,700 |
| CONCESSION - Other | | | | | | | | |
| Commercial and Industrial | 1 | \$ 427,849 | \$ 427,849 | \$ 113,449 | - | \$ - | \$ - | \$ - |
| | 1 | \$ 427,849 | \$ 427,849 | \$ 113,449 | - | \$ - | \$ - | \$ - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | | |
|-------|---|--------------|--------------|------------|---|--------------|--------------|------------|
| TOTAL | 6 | \$ 1,476,590 | \$ 1,476,590 | \$ 377,478 | 8 | \$ 1,817,160 | \$ 1,817,160 | \$ 188,700 |
|-------|---|--------------|--------------|------------|---|--------------|--------------|------------|

23

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Of the troubled debt restructurings reported above, four with a post-modification recorded investment totaling \$168,751 were on nonaccrual as of June 30, 2014, and three with post-modification recorded investments totaling \$178,007 were on nonaccrual as of June 30, 2013.

For the three and six months ended June 30, 2014 and 2013, 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 4 - EARNINGS PER SHARE

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|-------------|------------------------------|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | \$4,007,836 | \$4,045,231 | \$7,897,051 | \$7,310,375 |
| Less: Preferred stock dividends | 373,869 | 810,838 | 1,081,877 | 1,621,675 |
| Net income attributable to QCR Holdings, Inc. common stockholders | \$3,633,967 | \$3,234,393 | \$6,815,174 | \$5,688,700 |
| Earnings per common share attributable to QCR Holdings, Inc. common stockholders | | | | |
| Basic | \$0.46 | \$0.60 | \$0.86 | \$1.10 |
| Diluted | \$0.45 | \$0.59 | \$0.85 | \$1.08 |
| Weighted average common shares outstanding | 7,924,624 | 5,393,062 | 7,912,830 | 5,160,327 |
| Weighted average common shares issuable upon exercise of stock options and under the employee stock purchase plan | 125,890 | 104,213 | 127,449 | 105,482 |
| Weighted average common and common equivalent shares outstanding | 8,050,514 | 5,497,275 | 8,040,279 | 5,265,809 |

NOTE 5 – 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 three subsidiary banks wholly-owned by the Company: QCBT, CRBT, and RB&T. CRBT includes CNB's operations from the date of its acquisition 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 three 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, 2014 and 2013.

| | Commercial Banking | | | Wealth | | Intercompany | Consolidated |
|---|---------------------------|------------------------------|--------------------------|-------------------|------------------|---------------------|---------------------|
| | Quad City Bank & Trust | Cedar Rapids Bank & Trust | Rockford Bank & Trust | Management | All Other | Eliminations | Total |
| Three Months Ended June 30, 2014 | | | | | | | |
| Total revenue | \$11,962,820 | \$8,710,753 | \$3,701,841 | \$2,155,272 | \$5,266,342 | \$(5,347,439) | \$26,449,589 |
| Net interest income | \$9,080,775 | \$5,739,056 | \$2,576,734 | \$- | \$(431,222) | \$- | \$16,965,343 |
| Net income | \$2,454,422 | \$1,781,987 | \$614,264 | \$386,913 | \$4,007,836 | \$(5,237,586) | \$4,007,836 |
| Total assets | \$1,278,200,724 | \$826,278,230 | \$351,309,896 | \$- | \$208,242,778 | \$(199,192,145) | \$2,464,839,483 |
| Provision for loan/lease losses | \$560,879 | \$250,000 | \$191,000 | \$- | \$- | \$- | \$1,001,879 |
| Goodwill | \$3,222,688 | \$- | \$- | \$- | \$- | \$- | \$3,222,688 |
| Core deposit intangible | \$- | \$1,770,677 | \$- | \$- | \$- | \$- | \$1,770,677 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

**Three
Months
Ended
June 30,
2013**

| | | | | | | | |
|---------------------------------|------------------|----------------|----------------|--------------|----------------|------------------|------------------|
| Total revenue | \$ 11,810,586 | \$ 8,140,723 | \$ 3,649,811 | \$ 1,728,074 | \$ 6,439,309 | \$(4,680,346) | \$ 27,088,157 |
| Net interest income | \$ 8,485,092 | \$ 5,177,399 | \$ 2,434,391 | \$- | \$(388,830) | \$- | \$ 15,708,052 |
| Net income | \$ 1,951,271 | \$ 1,864,374 | \$ 719,480 | \$ 232,035 | \$ 4,045,231 | \$(4,767,160) | \$ 4,045,231 |
| Total assets | \$ 1,226,928,751 | \$ 896,869,042 | \$ 333,996,843 | \$- | \$ 211,484,709 | \$(222,507,868) | \$ 2,446,771,477 |
| Provision for loan/lease losses | \$ 1,020,123 | \$ 100,014 | \$ 400,000 | \$- | \$- | \$- | \$ 1,520,137 |
| Goodwill | \$ 3,222,688 | \$- | \$- | \$- | \$- | \$- | \$ 3,222,688 |
| Core deposit intangible | \$- | \$ 3,440,076 | \$- | \$- | \$- | \$- | \$ 3,440,076 |

**Six
Months
Ended
June 30,
2014**

| | | | | | | | |
|---------------------------------|------------------|----------------|----------------|--------------|----------------|------------------|------------------|
| Total revenue | \$ 23,900,953 | \$ 17,014,378 | \$ 7,184,717 | \$ 4,304,606 | \$ 10,490,207 | \$(10,663,220) | \$ 52,231,641 |
| Net interest income | \$ 18,001,813 | \$ 11,641,115 | \$ 5,052,416 | \$- | \$(880,760) | \$- | \$ 33,814,584 |
| Net income | \$ 4,795,705 | \$ 3,716,757 | \$ 1,085,303 | \$ 846,207 | \$ 7,897,051 | \$(10,443,972) | \$ 7,897,051 |
| Total assets | \$ 1,278,200,724 | \$ 826,278,230 | \$ 351,309,896 | \$- | \$ 208,242,778 | \$(199,192,145) | \$ 2,464,839,483 |
| Provision for loan/lease losses | \$ 1,170,041 | \$ 550,000 | \$ 376,000 | \$- | \$- | \$- | \$ 2,096,041 |
| Goodwill | \$ 3,222,688 | \$- | \$- | \$- | \$- | \$- | \$ 3,222,688 |
| Core deposit intangible | \$- | \$ 1,770,677 | \$- | \$- | \$- | \$- | \$ 1,770,677 |

**Six
Months
Ended
June 30,
2013**

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | |
|---------------------------------|-----------------|---------------|---------------|-------------|---------------|-----------------|-----------------|
| Total revenue | \$23,866,247 | \$15,069,074 | \$6,833,870 | \$3,377,085 | \$11,171,879 | \$(9,488,487) | \$50,829,668 |
| Net interest income | \$16,876,630 | \$9,022,281 | \$4,739,468 | \$- | \$(739,010) | \$- | \$29,899,369 |
| Net income | \$4,448,296 | \$3,585,185 | \$815,722 | \$445,042 | \$7,310,375 | \$(9,294,245) | \$7,310,375 |
| Total assets | \$1,226,928,751 | \$896,869,042 | \$333,996,843 | \$- | \$211,484,709 | \$(222,507,868) | \$2,446,771,477 |
| Provision for loan/lease losses | \$1,377,905 | \$400,014 | \$800,000 | \$- | \$- | \$- | \$2,577,919 |
| Goodwill | \$3,222,688 | \$- | \$- | \$- | \$- | \$- | \$3,222,688 |
| Core deposit intangible | \$- | \$3,440,076 | \$- | \$- | \$- | \$- | \$3,440,076 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 6 – 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, 2014 and December 31, 2013:

| | | Fair Value Measurements at Reporting Date Using | | |
|--|-------------------|---|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | Fair Value | | | |
| <u>June 30, 2014:</u> | | | | |
| Securities available for sale: | | | | |
| U.S. gov't. sponsored agency securities | \$325,620,456 | \$- | \$325,620,456 | \$ - |
| Residential mortgage-backed and related securities | 153,895,214 | - | 153,895,214 | - |
| Municipal securities | 33,857,471 | - | 33,857,471 | - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | |
|------------------------|---------------|-----------|---------------|------|
| Other securities | 1,961,956 | 318,370 | 1,643,586 | - |
| Derivative instruments | 1,820,501 | - | 1,820,501 | - |
| | \$517,155,598 | \$318,370 | \$516,837,228 | \$ - |

December 31, 2013:

Securities available for sale:

| | | | | |
|--|---------------|-----------|---------------|------|
| U.S. govt. sponsored agency securities | \$356,472,987 | \$- | \$356,472,987 | \$ - |
| Residential mortgage-backed and related securities | 157,429,451 | - | 157,429,451 | - |
| Municipal securities | 35,958,857 | - | 35,958,857 | - |
| Other securities | 1,897,163 | 317,698 | 1,579,465 | - |
| | \$551,758,458 | \$317,698 | \$551,440,760 | \$ - |

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, 2014 and 2013.

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).

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Derivative instruments consist of interest rate caps that are used for the purpose of hedging interest rate risk. See Note 8 to the Consolidated Financial Statements for the details of these instruments. The fair values are determined by pricing models that consider observable market data for derivative instruments with similar structures (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, 2014 and December 31, 2013:

| | Fair Value | Fair Value Measurements at Reporting Date Using | | |
|---------------------------|--------------|---|---------|--------------|
| | | Level 1 | Level 2 | Level 3 |
| <u>June 30, 2014:</u> | | | | |
| Impaired loans/leases | \$8,281,725 | \$- | \$- | \$8,281,725 |
| Other real estate owned | 11,827,311 | - | - | 11,827,311 |
| | \$20,109,036 | \$- | \$- | \$20,109,036 |
| <u>December 31, 2013:</u> | | | | |
| Impaired loans/leases | \$9,009,557 | \$- | \$- | \$9,009,557 |
| Other real estate owned | 10,507,377 | - | - | 10,507,377 |
| | \$19,516,934 | \$- | \$- | \$19,516,934 |

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.

The following table presents additional quantitative information about assets measured at fair value on a non-recurring basis for which the Company has utilized Level 3 inputs to determine fair value:

Quantitative Information about Level Fair Value Measurements
Fair Value Valuation Technique Unobservable Input Range

June 30, 2014:

| | | | | |
|-------------------------|-------------|-------------------------|-----------------------|---------------------|
| Impaired loans/leases | \$8,281,725 | Appraisal of collateral | Appraisal adjustments | -10.00% to -50.00 % |
| Other real estate owned | 11,827,311 | Appraisal of collateral | Appraisal adjustments | 0.00% to -35.00 % |

Quantitative Information about Level Fair Value Measurements
Fair Value Valuation Technique Unobservable Input Range

December 31, 2013:

| | | | | |
|-------------------------|-------------|-------------------------|-----------------------|---------------------|
| Impaired loans/leases | \$9,009,557 | Appraisal of collateral | Appraisal adjustments | -10.00% to -50.00 % |
| Other real estate owned | 10,507,377 | Appraisal of collateral | Appraisal adjustments | 0.00% to -35.00 % |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

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, 2014 and 2013.

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, 2014 | | As of December 31, 2013 | |
|---|----------------------------|---------------------|----------------------|-------------------------|----------------------|
| | | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Cash and due from banks | Level 1 | \$56,292,577 | \$56,292,577 | \$41,950,790 | \$41,950,790 |
| Federal funds sold | Level 2 | 20,490,000 | 20,490,000 | 39,435,000 | 39,435,000 |
| Interest-bearing deposits at financial institutions | Level 2 | 36,786,049 | 36,786,049 | 33,044,917 | 33,044,917 |
| Investment securities: | | | | | |
| Held to maturity | Level 3 | 166,787,372 | 165,670,327 | 145,451,895 | 138,640,105 |
| Available for sale | See Previous Table | 517,155,598 | 517,155,598 | 551,758,458 | 551,758,458 |
| Loans/leases receivable, net | Level 3 | 7,668,264 | 8,281,725 | 8,342,182 | 9,009,557 |
| Loans/leases receivable, net | Level 2 | 1,518,632,461 | 1,521,236,736 | 1,430,489,328 | 1,441,952,443 |
| Derivative Instruments | Level 2 | 1,820,501 | 1,820,501 | - | - |
| Deposits: | | | | | |
| Nonmaturity deposits | Level 2 | 1,291,304,395 | 1,291,304,395 | 1,256,209,352 | 1,256,209,352 |
| Time deposits | Level 2 | 386,063,880 | 387,275,000 | 390,781,891 | 391,923,000 |
| Short-term borrowings | Level 2 | 204,321,854 | 204,321,854 | 149,292,967 | 149,292,967 |
| Federal Home Loan Bank advances | Level 2 | 222,900,000 | 235,770,000 | 231,350,000 | 241,623,000 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | |
|--------------------------------|---------|-------------|-------------|-------------|-------------|
| Other borrowings | Level 2 | 151,452,927 | 162,038,000 | 142,448,362 | 152,761,000 |
| Junior subordinated debentures | Level 2 | 40,356,154 | 28,332,467 | 40,289,830 | 28,094,228 |

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.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

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.

NOTE 7 – FULL REDEMPTION OF SERIES F PREFERRED STOCK

On June 30, 2014, the Company redeemed the remaining 14,867 shares of its Series F Non-Cumulative Perpetual Preferred Stock (the “Series F Preferred Stock”) from the United States Department of the Treasury (“Treasury”) for an aggregate redemption amount of \$14,823,922, plus unpaid dividends to the date of redemption of \$373,869.

Previously, on September 15, 2011, the Company issued 40,090 shares of Series F Preferred Stock to the Treasury for an aggregate purchase price of \$40,090,000. The sale of Series F Preferred Stock was the result of an investment by Treasury under the Small Business Lending Fund. On June 29, 2012, the Company redeemed 10,223 shares of Series F Preferred Stock and on March 31, 2014, the Company redeemed an additional 15,000 shares.

With the final redemption on June 30, 2014, the Company no longer has any outstanding preferred stock and all preferred stock dividend payment commitments have been eliminated.

NOTE 8 – DERIVATIVES AND HEDGING ACTIVITIES

The Company enters into derivative financial instruments as part of its strategy to manage its exposure to changes in interest rates.

Derivative instruments represent contracts between parties that result in one party delivering cash to the other party based on a notional amount and an underlying index (such as a rate, security price or price index) as specified in the contract. The amount of cash delivered from one party to the other is determined based on the interaction of the notional amount of the contract with the underlying index.

The derivative financial instruments currently used by the Company to manage its exposure to interest rate risk include: (1) interest rate lock commitments provided to customers to fund certain mortgage loans to be sold into the secondary market (although this type of derivative is negligible); and (2) interest rate caps to manage the interest rate risk of certain fixed and variable rate assets and variable rate liabilities. This footnote will address the latter.

During the second quarter of 2014, the Company executed and designated two interest rate cap derivatives as cash flow hedges of short-term FHLB advances. The short-term FHLB advances rates will fluctuate with rate movements; therefore the Bank determined it was necessary to hedge against this increase in interest expense in a rising rate environment. The caps purchased will essentially set a ceiling on the rate paid on the FHLB advances, minimizing the risk associated with rate increases.

Below is a summary of the interest rate cap derivatives held by the Company as of June 30, 2014. An initial premium of \$2.1 million was paid for the two caps. The fair value of these assets will fluctuate with market value changes, as well as amortization of the initial premium to interest expense.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

| Effective Date | Maturity Date | Balance Sheet Location | Notional Amount | Accounting Treatment | Fair Value |
|----------------|---------------|---------------------------|--------------------|----------------------|--------------|
| June 5, 2014 | June 5, 2019 | Other Assets | \$ 15,000,000 | Cash Flow Hedging | \$ 707,710 |
| June 5, 2014 | June 5, 2021 | Other Assets | 15,000,000 | Cash Flow Hedging | 1,112,791 |
| | | | \$ 30,000,000 | | \$ 1,820,501 |

Changes in the fair values of derivative financial instruments accounted for as cash flow hedges, to the extent they are effective hedges, are recorded as a component of accumulated other comprehensive income. The following is a summary of how accumulated other comprehensive income was impacted during the reporting periods:

| | Three and Six Months Ended |
|--|-------------------------------------|
| | June 30, 2014 |
| Unrealized loss at beginning of period | \$- |
| Amount reclassified from accumulated other comprehensive income to interest expense on FHLB Advances | - |
| Amount of loss recognized in other comprehensive income | (251,149) |
| Unrealized loss at end of period | \$(251,149) |

Changes in the fair value related to the ineffective portion of cash flow hedges are reported in non-interest income during the period of the change. No portion of the change in fair value, both for the current period and year-to-date, was due to ineffectiveness.

Derivative financial instruments are valued by the transaction counterparty on a monthly basis and corroborated by a third party annually. The company uses the hypothetical derivative method to assess and measure effectiveness in

accordance with ASC 815, *Derivatives and Hedging*.

31

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, and RB&T.

QCBT and CRBT are Iowa-chartered commercial banks, and RB&T is an Illinois-chartered commercial bank. 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. On October 26, 2013, CNB, which was acquired by the Company on May 13, 2013, merged with and into CRBT. CNB's merged branch offices operate as a division of CRBT under the name "Community Bank & Trust," and serve Cedar Falls and Waterloo, Iowa and adjacent communities through its three offices (two in Waterloo and one in Cedar Falls).

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.

OVERVIEW

The Company recognized net income of \$4.0 million for the quarter ended June 30, 2014. After preferred stock dividends of \$374 thousand, the Company reported net income attributable to common stockholders of \$3.6 million, or diluted earnings per common share of \$0.45. By comparison, for the second quarter of 2013, the Company recognized net income of \$4.0 million, which included net pre-tax revenue from the acquisition of CNB totaling \$1.4 million, consisting of a \$1.8 million bargain purchase gain partially offset by \$432 thousand of acquisition costs. 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.

Although pre-tax core earnings (excluding the aforementioned net revenue from the acquisition of CNB in 2013) increased approximately 27% in the second quarter of 2014 compared to the second quarter of 2013, diluted earnings per common share decreased by \$0.14, or 24%, due to the issuance of new common stock related to the CNB acquisition in the second quarter of 2013 (834,715 shares issued), as well as the conversion of Series E Preferred Stock to common stock that was executed in the fourth quarter of 2013 (2,057,502 shares issued). These two events increased weighted average common shares outstanding approximately 47%, resulting in the lower diluted earnings per share in the second quarter of 2014.

Part I

Item 2

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

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

| | For the three months ended | | For the six months ended | |
|---|----------------------------|---------------|--------------------------|---------------|
| | June 30, 2014 | June 30, 2013 | June 30, 2014 | June 30, 2013 |
| Net income | \$4,007,836 | \$4,045,231 | \$7,897,051 | \$7,310,375 |
| Less: Preferred stock dividends | 373,869 | 810,838 | 1,081,877 | 1,621,675 |
| Net income attributable to QCR Holdings, Inc. common stockholders | \$3,633,967 | \$3,234,393 | \$6,815,174 | \$5,688,700 |
| Diluted earnings per common share | \$0.45 | \$0.59 | \$0.85 | \$1.08 |
| Weighted average common and common equivalent outstanding | 8,050,514 | 5,497,275 | 8,040,279 | 5,265,809 |

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, 2014 | March 31, 2014 | June 30, 2013 | June 30, 2014 | June 30, 2013 |
| Net interest income | \$16,965,343 | \$16,849,241 | \$15,708,052 | \$33,814,584 | \$29,899,369 |
| Provision for loan/lease losses | (1,001,879) | (1,094,162) | (1,520,137) | (2,096,041) | (2,577,919) |
| Noninterest income | 5,344,213 | 4,746,841 | 6,948,756 | 10,091,054 | 12,152,785 |
| Noninterest expense | (16,106,529) | (16,140,420) | (15,234,349) | (32,246,949) | (29,192,849) |
| Federal and state income tax | (1,193,312) | (472,285) | (1,857,091) | (1,665,597) | (2,971,011) |
| Net income | \$4,007,836 | \$3,889,215 | \$4,045,231 | \$7,897,051 | \$7,310,375 |

In comparing quarter-over-quarter, following are some noteworthy changes in the Company's financial results:

Provision for loan/lease losses decreased 8% compared to the first quarter of 2014.

Noninterest income increased 13% compared to the first quarter of 2014. Gains on the sale of government guaranteed portions of loans accounted for a large portion of this increase. The first quarter of 2014 was historically low in this category, whereas the second quarter of 2014 showed improvement.

Noninterest expense stayed relatively flat, decreasing less than 1%.

Federal and state income tax expense more than doubled as the growth in taxable income outpaced the growth in nontaxable income in the second quarter of 2014. Additionally, the Company recognized a one-time tax benefit in the first quarter of 2014 related to the finalization of tax issues in connection with the Community National acquisition following the filing of the acquired entity's final tax returns.

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 \$1.6 million, or 10%, to \$17.9 million for the quarter ended June 30, 2014, from \$16.3 million for the same period of 2013. The increase in net interest income was primarily driven by the acquisition of CNB in May 2013. The Company has also improved net interest income as the result of:

- Organic loan/lease growth,
- Further diversification of the Company's securities portfolio with increased investment in tax-exempt municipal securities,
- Continued reductions in the cost of deposits, and
- Continued growth in noninterest bearing deposits.

A comparison of yields, spread and margin from the second quarter of 2013 to the second quarter of 2014 is as follows (on a tax equivalent basis):

- The average yield on interest-earning assets increased 6 basis points.
- The average cost of interest-bearing liabilities decreased 9 basis points.
- The net interest spread increased 15 basis points from 2.72% to 2.87%.
- The net interest margin improved 15 basis points from 2.99% to 3.14%.

Net interest income, on a tax equivalent basis, increased \$4.5 million, or 14%, to \$35.6 million for the first half of 2014, from \$31.1 million for the first half of 2013. The increase in net interest income was primarily driven by the acquisition of CNB in May 2013, as well as by the additional items listed above.

A comparison of yields, spread and margin from the first half of 2013 to the first half of 2014 is as follows (on a tax equivalent basis):

The average yield on interest-earning assets was flat at 3.85%.

The average cost of interest-bearing liabilities decreased 13 basis points.

The net interest spread increased 13 basis points from 2.71% to 2.84%.

The net interest margin improved 12 basis points from 3.00% to 3.12%.

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 while balancing interest rate risk. Management continually addresses this issue with pricing and other balance sheet management strategies including, but not limited to, the use of alternative funding sources. 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. Also, the Company's management has focused on reducing the cost of portions of the Company's existing wholesale funding. 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.

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, 2014 | | | 2013 | | |
|---|--|-------------------------------|--------------------------------|--------------------|-------------------------------|--------------------------------|
| | Average Balance (dollars in thousands) | Interest Earned or Paid | Average Yield or Cost | Average Balance | Interest Earned or Paid | Average Yield or Cost |
| ASSETS | | | | | | |
| Interest earning assets: | | | | | | |
| Federal funds sold | \$ 12,323 | \$ 4 | 0.13 % | \$ 8,410 | \$ 3 | 0.14 % |
| Interest-bearing deposits at financial institutions | 43,445 | 71 | 0.66 % | 35,158 | 62 | 0.71 % |
| Investment securities (1) | 702,579 | 4,765 | 2.72 % | 714,808 | 4,040 | 2.27 % |
| Restricted investment securities | 16,604 | 139 | 3.36 % | 16,531 | 131 | 3.18 % |
| Gross loans/leases receivable (1) (2) (3) | 1,518,902 | 17,093 | 4.51 % | 1,418,389 | 16,530 | 4.67 % |
| Total interest earning assets | \$ 2,293,853 | \$ 22,072 | 3.86 % | \$ 2,193,296 | \$ 20,766 | 3.80 % |
| Noninterest-earning assets: | | | | | | |
| Cash and due from banks | \$ 44,406 | | | \$ 41,791 | | |
| Premises and equipment | 36,524 | | | 35,698 | | |
| Less allowance for estimated losses on loans/leases | (22,876) | | | (22,192) | | |
| Other | 73,758 | | | 74,743 | | |
| Total assets | \$ 2,425,665 | | | \$ 2,323,336 | | |

**LIABILITIES AND
STOCKHOLDERS'
EQUITY**

Interest-bearing liabilities:

| | | | | | | |
|------------------------------------|--------------|----------|--------|--------------|----------|--------|
| Interest-bearing deposits | \$ 721,687 | \$ 453 | 0.25 % | \$ 632,932 | \$ 398 | 0.25 % |
| Time deposits | 379,064 | 649 | 0.69 % | 416,085 | 779 | 0.75 % |
| Short-term borrowings | 162,314 | 61 | 0.15 % | 195,202 | 103 | 0.21 % |
| Federal Home Loan Bank advances | 227,226 | 1,496 | 2.64 % | 216,725 | 1,727 | 3.20 % |
| Junior subordinated debentures | 40,339 | 307 | 3.05 % | 41,398 | 261 | 2.53 % |
| Other borrowings | 144,105 | 1,174 | 3.27 % | 140,091 | 1,163 | 3.33 % |
| Total interest-bearing liabilities | \$ 1,674,735 | \$ 4,140 | 0.99 % | \$ 1,642,433 | \$ 4,431 | 1.08 % |

Noninterest-bearing demand deposits

\$ 576,774

\$ 502,078

Other noninterest-bearing liabilities

31,626

32,154

Total liabilities

\$ 2,283,135

\$ 2,176,665

Stockholders' equity

142,530

146,671

Total liabilities and stockholders' equity

\$ 2,425,665

\$ 2,323,336

Net interest income

\$ 17,932

\$ 16,335

Net interest spread

2.87 %

2.72 %

Net interest margin

3.14 %

2.99 %

Ratio of average interest-earning assets to average interest-bearing liabilities

136.97 %

133.54 %

(1) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 35% 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, 2014**

| | Inc./Decrease | | |
|---|-------------------------------|-------------|---------------|
| | Components | | |
| | from of Change (1) | | |
| | Prior | Rate | Volume |
| | Period | | |
| | 2014 vs. 2013 | | |
| | (dollars in thousands) | | |
| INTEREST INCOME | | | |
| Federal funds sold | \$1 | \$(2) | \$3 |
| Interest-bearing deposits at financial institutions | 9 | (25) | 34 |
| Investment securities (2) | 725 | 1,178 | (453) |
| Restricted investment securities | 8 | 8 | 0 |
| Gross loans/leases receivable (3) (4) | 563 | (2,885) | 3,448 |
| Total change in interest income | \$1,306 | \$(1,726) | \$3,032 |
| INTEREST EXPENSE | | | |
| Interest-bearing deposits | \$55 | \$(5) | \$60 |
| Time deposits | (130) | (64) | (66) |
| Short-term borrowings | (42) | (26) | (16) |
| Federal Home Loan Bank advances | (231) | (706) | 475 |
| Junior subordinated debentures | 46 | 89 | (43) |
| Other borrowings | 11 | (101) | 112 |
| Total change in interest expense | \$(291) | \$(813) | \$522 |
| Total change in net interest income | \$1,597 | \$(913) | \$2,510 |

- 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 35% 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

| | For the six months ended June 30, | | | | | |
|---|--|-----------------|---------------|--------------------|-----------------|---------------|
| | 2014 | | | 2013 | | |
| | Average | Interest | Average | Average | Interest | Average |
| | Balance | Earned | Yield | Balance | Earned | Yield |
| | (dollars in thousands) | or Paid | or | Balance | or Paid | or |
| | | | Cost | | | Cost |
| ASSETS | | | | | | |
| Interest earning assets: | | | | | | |
| Federal funds sold | \$11,659 | \$7 | 0.12 % | \$5,379 | \$4 | 0.15 % |
| Interest-bearing deposits at financial institutions | 65,911 | 162 | 0.50 % | 36,496 | 122 | 0.67 % |
| Investment securities (1) | 712,400 | 9,419 | 2.67 % | 681,723 | 7,697 | 2.28 % |
| Restricted investment securities | 16,927 | 269 | 3.20 % | 15,973 | 256 | 3.23 % |
| Gross loans/leases receivable (1) (2) (3) | 1,491,982 | 34,060 | 4.60 % | 1,348,715 | 31,782 | 4.75 % |
| Total interest earning assets | \$2,298,877 | \$43,917 | 3.85 % | \$2,088,286 | \$39,861 | 3.85 % |
| Noninterest-earning assets: | | | | | | |
| Cash and due from banks | \$44,118 | | | \$40,849 | | |
| Premises and equipment | 36,628 | | | 33,450 | | |
| Less allowance for estimated losses on loans/leases | (22,385) | | | (21,208) | | |
| Other | 72,674 | | | 75,297 | | |
| Total assets | \$2,429,912 | | | \$2,216,674 | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing deposits | \$718,371 | \$899 | 0.25 % | \$597,918 | \$807 | 0.27 % |
| Time deposits | 380,893 | 1,304 | 0.69 % | 374,890 | 1,487 | 0.80 % |
| Short-term borrowings | 156,152 | 113 | 0.15 % | 185,454 | 167 | 0.18 % |
| Federal Home Loan Bank advances | 230,927 | 3,052 | 2.67 % | 209,672 | 3,459 | 3.33 % |
| Junior subordinated debentures | 40,323 | 612 | 3.06 % | 38,742 | 503 | 2.61 % |
| Other borrowings | 143,211 | 2,346 | 3.30 % | 139,151 | 2,354 | 3.41 % |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | | |
|--|-------------|----------|------|---|-------------|----------|------|---|
| Total interest-bearing liabilities | \$1,669,875 | \$8,326 | 1.01 | % | \$1,545,827 | \$8,777 | 1.14 | % |
| Noninterest-bearing demand deposits | \$581,108 | | | | \$494,671 | | | |
| Other noninterest-bearing liabilities | 32,633 | | | | 32,249 | | | |
| Total liabilities | \$2,283,615 | | | | \$2,072,747 | | | |
| Stockholders' equity | 146,297 | | | | 143,927 | | | |
| Total liabilities and stockholders' equity | \$2,429,912 | | | | \$2,216,674 | | | |
| Net interest income | | \$35,591 | | | | \$31,084 | | |
| Net interest spread | | | 2.84 | % | | | 2.71 | % |
| Net interest margin | | | 3.12 | % | | | 3.00 | % |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 137.67 | % | | | 135.09 | % | | |

- (1) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 35% 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, 2014**

| | Inc./Dec. Components from of Change (1) | | |
|---|--|-------------|---------------|
| | Prior Period | Rate | Volume |
| | 2014 vs. 2013 | | |
| | (dollars in thousands) | | |
| INTEREST INCOME | | | |
| Federal funds sold | \$3 | \$(3) | \$ 6 |
| Interest-bearing deposits at financial institutions | 40 | (88) | 128 |
| Investment securities (2) | 1,722 | 1,364 | 358 |
| Restricted investment securities | 13 | (6) | 19 |
| Gross loans/leases receivable (3) (4) | 2,278 | (2,576) | 4,854 |
| Total change in interest income | \$4,056 | \$(1,309) | \$ 5,365 |
| INTEREST EXPENSE | | | |
| Interest-bearing deposits | \$92 | \$(149) | \$ 241 |
| Time deposits | (183) | (250) | 67 |
| Short-term borrowings | (54) | (30) | (24) |
| Federal Home Loan Bank advances | (408) | (1,207) | 799 |
| Junior subordinated debentures | 110 | 89 | 21 |
| Other borrowings | (8) | (148) | 140 |
| Total change in interest expense | \$(451) | \$(1,695) | \$ 1,244 |
| Total change in net interest income | \$4,507 | \$386 | \$ 4,121 |

(1) The column "Inc./(Dec.) from Prior Period" is segmented into the changes attributable to variations in volume and 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 35% 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 for loan/lease losses ("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, 2014 was 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 \$966 thousand, or 5%, comparing the second quarter of 2014 to the same period of 2013. For the first half of 2014, interest income grew \$3.5 million, or 9%, compared to the first half of 2013. The majority of this growth was the result of the acquisition of CNB and the addition of its earning assets. Secondly, the Company's three legacy charters had success growing loans and leases over the last twelve months. Overall, the Company's earning assets increased a total of \$100.6 million, comparing June 30, 2014 to June 30, 2013. The securities portfolio yield continued to increase (from 2.27% for the second quarter of 2013 to 2.72% for the second quarter of 2014 and from 2.28% for the first half of 2013 to 2.67% for the first half of 2014) as 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, in an effort to increase interest income. 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 2014 decreased \$291 thousand, or 7%, from the second quarter of 2013. For the first half of 2014, interest expense decreased \$451 thousand, or 5%, compared to the first half of 2013. Considering the growth of interest-bearing liabilities (average balances grew \$124.0 million, or 8%, from the first half of 2013 to the same period of 2014) from the acquisition of CNB as well as organic growth at the Company's legacy charters, the Company has been successful in maintaining pricing discipline on deposits and decreasing the cost of borrowings, which has more than offset the growth impact and contributed to the net 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 been replaced by core deposits, or, to a lesser extent, have been replaced by new wholesale funds at significantly reduced cost. Continuing this trend will strengthen the Company's franchise value, reduce funding costs, and increase fee income opportunities through deposit service charges.

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. An important consideration to these strategies is the impact on the Company's interest rate risk position, as some of its wholesale funding was originally borrowed to help strengthen the Company's net interest income in rising interest rate scenarios.

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.

The provision totaled \$1.0 million for the second quarter of 2014, which was down \$92 thousand from the prior quarter, and down \$518 thousand from the second quarter of 2013. The provision totaled \$2.1 million for the first half of 2014, compared to \$2.6 million for the first half of 2013. The Company had net charge-offs of \$588 thousand for the second quarter of 2014 which, when coupled with the provision of \$1.0 million, increased the Company’s allowance to \$23.1 million at June 30, 2014. As of June 30, 2014, the Company’s allowance to total loans/leases was 1.49%, which was down from 1.52% at March 31, 2014, and up from 1.38% at June 30, 2013.

A more detailed discussion of the Company’s allowance can be found in the “Financial Condition” section of this report.

NONINTEREST INCOME

The following tables set forth the various categories of noninterest income for the three and six months ended June 30, 2014 and 2013.

| Three Months Ended | | \$ Change | % Change |
|--------------------|---------------|-----------|----------|
| June 30, 2014 | June 30, 2013 | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | |
|---|-------------|-------------|---------------|---------|----|
| Trust department fees | \$1,444,414 | \$1,197,181 | \$247,233 | 20.7 | % |
| Investment advisory and management fees | 710,858 | 695,094 | 15,764 | 2.3 | |
| Deposit service fees | 1,091,923 | 1,054,223 | 37,700 | 3.6 | |
| Gains on sales of residential real estate loans | 132,971 | 246,621 | (113,650) | (46.1) |) |
| Gains on sales of government guaranteed portions of loans | 508,168 | 765,738 | (257,570) | (33.6) |) |
| Earnings on bank-owned life insurance | 388,672 | 423,883 | (35,211) | (8.3) |) |
| Subtotal | \$4,277,006 | \$4,382,740 | \$(105,734) | (2.4) |) |
| Losses on other real estate owned, net | (126,657) | (83,339) | (43,318) | 52.0 | |
| Securities gains | 571 | 16,460 | (15,889) | (96.5) |) |
| Bargain purchase gain on Community National acquisition | - | 1,841,385 | (1,841,385) | (100.0) |) |
| Other | 1,193,293 | 791,510 | 401,783 | 50.8 | |
| Total noninterest income | \$5,344,213 | \$6,948,756 | \$(1,604,543) | (23.1) |)% |

| | Six Months Ended June 30, 2014 | June 30, 2013 | \$ Change | % Change | |
|---|-----------------------------------|---------------|----------------|----------|----|
| Trust department fees | \$ 2,944,756 | \$ 2,236,851 | \$ 707,905 | 31.6 | % |
| Investment advisory and management fees | 1,359,850 | 1,304,435 | 55,415 | 4.2 | |
| Deposit service fees | 2,137,808 | 1,962,046 | 175,762 | 9.0 | |
| Gains on sales of residential real estate loans | 196,458 | 537,772 | (341,314) | (63.5) |) |
| Gains on sales of government guaranteed portions of loans | 702,187 | 1,610,962 | (908,775) | (56.4) |) |
| Earnings on bank-owned life insurance | 842,836 | 862,570 | (19,734) | (2.3) |) |
| Subtotal | \$ 8,183,895 | \$ 8,514,636 | \$ (330,741) | (3.9) |) |
| Losses on other real estate owned, net | (144,705) | (529,969) | 385,264 | (72.7) |) |
| Securities gains | 21,196 | 16,460 | 4,736 | 28.8 | |
| Bargain purchase gain on Community National acquisition | - | 1,841,385 | (1,841,385) | (100.0) |) |
| Other | 2,030,668 | 2,310,273 | (279,605) | (12.1) |) |
| Total noninterest income | \$ 10,091,054 | \$ 12,152,785 | \$ (2,061,731) | (17.0) |)% |

Part I

Item 2

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

Trust department fees continue to be a significant contributor to noninterest income. Trust department fees grew 21% from the second quarter of 2013 to the second quarter of 2014, and grew 32% from the first half of 2013 to the first half of 2014. Part of the increase stems from the addition of CNB's trust department, which recognized \$253 thousand of trust department fees for the second quarter of 2014 and \$521 thousand of trust department fees for the first half of 2014. 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 organically expanding its customer base at its legacy charters, which has helped drive the recent increases in fee income.

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 2014 to the same period of 2013, and grew 4% comparing the first half of 2014 to the first half of 2013. Similar to trust department fees, these fees are largely determined based on the value of the investments managed. Continued expansion of the customer base in the Company's legacy markets has helped drive the recent increases in fee income. CNB did not provide investment advisory and management services; however, the Company is in the process of leveraging its existing infrastructure to efficiently offer these services in the communities previously served by CNB.

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 expanded 4% comparing the second quarter of 2014 to the same period in 2013, and expanded 9% comparing the first half of 2014 to the same period in 2013. Most of this growth is attributable to the acquisition of CNB and its deposit portfolio. Additionally, the Company continues its emphasis on shifting the mix of deposits from brokered and retail time deposits to non-maturity demand deposits across all its markets. 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 46% comparing the second quarter of 2014 to the second quarter of 2013, and fell 64% when comparing the first half of 2014 to the same period in 2013. With the sustained historically low interest rate environment, refinancing activity has slowed as many of the Company's existing and prospective customers have already executed a refinancing.

Since the first quarter of 2012, the Company's average quarterly gains on sales of government guaranteed portions of loans has been \$392 thousand. The Company's gains for the second quarter of 2014 totaled \$508 thousand, which was 30% greater than the quarterly average since 2012. 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, this remains a core strategy for the Company and the pipelines are active.

Part I

Item 2

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

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, as evidenced by the minimal losses recognized thus far in 2014.

In accordance with acquisition accounting rules, the Company recognized a bargain purchase gain of \$1.8 million in recording the acquisition of Community National during the second quarter of 2013.

The following table sets forth the various categories of other noninterest income for the three and six months ended June 30, 2014 and 2013.

| | Three Months Ended | | | |
|--|--------------------|------------------|-----------|-------------|
| | June 30, 2014 | June 30, 2013 | \$ Change | % Change |
| Debit card fees | \$280,800 | \$257,200 | \$23,600 | 9.2 % |
| Correspondent banking fees | 218,502 | 163,494 | 55,008 | 33.6 |
| Participation service fees on commercial loan participations | 208,007 | 182,144 | 25,863 | 14.2 |
| Income earned on other real estate owned | 196,858 | 3,300 | 193,558 | 5,865.4 |
| Credit card issuing fees, net of processing costs | 91,045 | 85,017 | 6,028 | 7.1 |
| Gain on the disposal of leased assets | 70,815 | 1,447 | 69,368 | 4,793.9 |
| Miscellaneous | 127,266 | 98,908 | 28,358 | 28.7 |
| Other noninterest income | \$1,193,293 | \$791,510 | \$401,783 | 50.8 % |
| | Six Months Ended | | | |
| | June 30, 2014 | June 30, 2013 | \$ Change | % Change |
| Debit card fees | \$511,405 | \$487,100 | \$24,305 | 5.0 % |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | |
|--|-------------|-------------|-------------|----------|
| Correspondent banking fees | 450,647 | 321,605 | 129,042 | 40.1 |
| Participation service fees on commercial loan participations | 414,201 | 349,470 | 64,731 | 18.5 |
| Income earned on other real estate owned | 231,044 | 3,300 | 227,744 | 6,901.3 |
| Credit card issuing fees, net of processing costs | 182,383 | 134,971 | 47,412 | 35.1 |
| Gain on the disposal of leased assets | 19,223 | 42,257 | (23,034) | (54.5) |
| Fees on interest rate swaps on commercial loans | 62,000 | 6,720 | 55,280 | 822.6 |
| Gain on sale of credit card loan portfolio | - | 495,405 | (495,405) | (100.0) |
| Gain on sale of credit card issuing operations | - | 355,268 | (355,268) | (100.0) |
| Miscellaneous | 159,765 | 114,177 | 45,588 | 39.9 |
| Other noninterest income | \$2,030,668 | \$2,310,273 | \$(279,605) | (12.1)% |

Debit card fees are the interchange fees paid on certain debit card customer transactions. The debit card fees increased 9% comparing the second quarter of 2014 to the second quarter of 2013, and increased 5% comparing the first half of 2014 to the first half of 2013. As an opportunity to maximize fees, the Company's legacy charters offer a deposit product with a modest increased interest rate that incentivizes debit card activity. Offering a similar product in the Company's newest markets, Waterloo and Cedar Falls, Iowa, is currently under strategic review.

Correspondent banking fees increased 34% comparing the second quarter of 2014 to the second quarter of 2013, and increased 40% comparing the first half of 2014 to the first half of 2013. Correspondent banking continues to be a core strategy for the Company, as this line of business provides a high level of noninterest bearing deposits that can be used to fund additional loan growth as well as a steady source of fee income.

Part 1

Item 2

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

Participation service fees on commercial loan participations represent fees paid annually to the Company by the participant(s) to cover servicing expenses incurred by the Company. The fee is generally 25 basis points of the participated loan amount. Additionally, the Company receives a mandated 1% servicing fee on the sold portion of government guaranteed loans. Participation service fees grew 14% comparing the second quarter of 2014 to the second quarter of 2013, and grew 19% comparing the first half of 2014 to the first half 2013. A portion of this growth is the result of the acquisition of CNB's participated loan portfolio as well as organic growth of commercial loan participations across the Company's legacy charters.

Income earned on other real estate owned is comprised mostly of rental income on properties that the Company has repossessed. In accordance with accounting rules, all revenues recognized and expenses incurred from these types of properties must be accounted for on a gross basis; therefore, the increased revenue helps to offset holding expenses related to maintaining the properties until they are sold.

In recent years, as a result of the sustained historically low interest rate environment, CRBT 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 of its subsidiary banks as the circumstances are appropriate for the borrower and the Company.

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.

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, 2014 and 2013.

| | Three Months Ended | | | | |
|---------------------------------------|--------------------|------------------|-------------|-------------|---|
| | June 30, 2014 | June 30, 2013 | \$ Change | % Change | |
| Salaries and employee benefits | \$9,922,191 | \$9,186,233 | \$735,958 | 8.0 | % |
| Occupancy and equipment expense | 1,838,971 | 1,586,841 | 252,130 | 15.9 | |
| Professional and data processing fees | 1,403,915 | 1,438,753 | (34,838) | (2.4) |) |
| FDIC and other insurance | 695,365 | 627,390 | 67,975 | 10.8 | |
| Loan/lease expense | 377,492 | 251,868 | 125,624 | 49.9 | |
| Advertising and marketing | 501,548 | 412,041 | 89,507 | 21.7 | |
| Postage and telephone | 258,121 | 257,611 | 510 | 0.2 | |
| Stationery and supplies | 145,635 | 150,718 | (5,083) | (3.4) |) |
| Bank service charges | 324,397 | 284,345 | 40,052 | 14.1 | |
| Subtotal | \$15,467,635 | \$14,195,800 | \$1,271,835 | 9.0 | |
| Acquisition and data conversion costs | - | 432,326 | (432,326) | (100.0) |) |
| Other | 638,894 | 606,223 | 32,671 | 5.4 | |
| Total noninterest expense | \$16,106,529 | \$15,234,349 | \$872,180 | 5.7 | % |

| | Six Months Ended | | | | |
|---------------------------------------|------------------|------------------|-------------|-------------|---|
| | June 30, 2014 | June 30, 2013 | \$ Change | % Change | |
| Salaries and employee benefits | \$19,940,109 | \$17,928,916 | \$2,011,193 | 11.2 | % |
| Occupancy and equipment expense | 3,733,259 | 3,015,711 | 717,548 | 23.8 | |
| Professional and data processing fees | 2,988,321 | 2,578,814 | 409,507 | 15.9 | |
| FDIC and other insurance | 1,410,115 | 1,183,301 | 226,814 | 19.2 | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | |
|---------------------------------------|--------------|--------------|-------------|----------|
| Loan/lease expense | 723,128 | 496,959 | 226,169 | 45.5 |
| Advertising and marketing | 839,135 | 676,609 | 162,526 | 24.0 |
| Postage and telephone | 548,796 | 476,302 | 72,494 | 15.2 |
| Stationery and supplies | 297,386 | 261,388 | 35,998 | 13.8 |
| Bank service charges | 622,429 | 559,840 | 62,589 | 11.2 |
| Subtotal | \$31,102,678 | \$27,177,840 | \$3,924,838 | 14.4 |
| Acquisition and data conversion costs | - | 788,904 | (788,904) | (100.0) |
| Other | 1,144,271 | 1,226,105 | (81,834) | (6.7) |
| Total noninterest expense | \$32,246,949 | \$29,192,849 | \$3,054,100 | 10.5 % |

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 impacted the Company's noninterest expenses. Management executed on its integration plan for CNB over the second half of 2013 to help increase efficiency and realize cost savings.

Salaries and employee benefits, which is the largest component of noninterest expense, increased from the second quarter of 2013 to the second quarter of 2014 by 8%. This increase was largely the result of:

The addition of CNB's cost structure.

Customary annual salary and benefits increases for the majority of the Company's employee base in 2014.

Part I

Item 2

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

Continued increases in health insurance-related employee benefits for the majority of the Company's employee base. Higher accrued incentive compensation based on improved financial performance for the first six months of 2014.

Occupancy and equipment expense increased for the year to date with the addition of CNB's branch network. Additionally, throughout 2013, the Company purchased additional technology for enhanced customer service and for improved fraud detection and prevention systems.

Professional and data processing fees increased from the prior year due to the addition of CNB's cost structure. In addition, professional and data processing fees can fluctuate depending on certain one-time project costs. Management will continue to focus on minimizing these one-time costs and driving those recurring costs down through contract renegotiation or managed reduction in activity where costs are determined on a usage basis.

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. The increase from the prior year was primarily attributable to the addition of CNB's assets, as well as growth at the three legacy charters.

Loan/lease expense increased 50% comparing the second quarter of 2014 to the same quarter of 2013, and increased 46% comparing the first half of 2014 to the same period of 2013. Some of the increase was the result of the addition of CNB's cost structure. In addition, the Company incurred elevated levels of expense at the legacy banks for certain existing nonperforming loans as workouts progressed. Generally, loan/lease expense has a direct relationship with the level of nonperforming loans/leases; however, it may deviate depending upon the individual nonperforming loans/leases. Management expects these historically elevated levels of expense to continue to decline in line with the declining trend in nonperforming loans/leases. Additionally, a portion of these expenses are offset by the increase in income earned on other real estate owned, as the income and expense related to repossessed properties must be recognized on a gross basis.

The Company incurred additional expenses for advertising and marketing compared to the prior year. Most of the increase was the addition of CNB's advertising and marketing costs, including the cost of rebranding CNB to Community Bank & Trust.

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 recent years. Moreover, the addition of CNB's items processing has added additional expense in this category.

With the acquisition of CNB 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 as the Company incurred professional fees (legal, investment banking, and accounting) in preparation for the closing of the acquisition. In accordance with generally accepted accounting principles, the Company expensed these costs as incurred.

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 \$1.2 million, or an effective tax rate of 23%, for the second quarter of 2014 compared to \$1.9 million, or an effective tax rate of 31%, for the same quarter of 2013. For the first half of 2014, the provision for income taxes totaled \$1.7 million, or an effective tax rate of 17% compared to \$3.0 million, or an effective tax rate of 29% for the same period of 2013. The decline in effective tax rate was partly the result of continued growth in nontaxable income from increased investments in tax-exempt municipal securities, as the Company grew its portfolio of tax-exempt municipal securities by 41% from June 30, 2013 to June 30, 2014. The growth in nontaxable income outpaced the growth in taxable income which helped to reduce the effective tax rate. Additionally, the Company recognized a one-time tax benefit in the first quarter of 2014 of \$381 thousand as a result of the finalization of the tax issues related to the Community National acquisition following the filing of the acquired entity's final tax returns.

FINANCIAL CONDITION

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

| | As of | | June 30, 2014 | | March 31, 2014 | | December 31, 2013 | | June 30, 2013 | |
|---|-------------|-------|---------------|-------|----------------|-------|-------------------|-------|---------------|---|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Cash, federal funds sold, and interest-bearing deposits | \$113,569 | 5 % | \$111,403 | 5 % | \$114,431 | 5 % | \$95,557 | 4 % | | |
| Securities | 682,122 | 28 % | 707,107 | 29 % | 697,210 | 29 % | 703,467 | 29 % | | |
| Net loans/leases | 1,526,301 | 62 % | 1,469,926 | 61 % | 1,438,832 | 60 % | 1,509,570 | 62 % | | |
| Other assets | 142,847 | 5 % | 137,883 | 5 % | 144,480 | 6 % | 138,177 | 5 % | | |
| Total assets | \$2,464,839 | 100 % | \$2,426,319 | 100 % | \$2,394,953 | 100 % | \$2,446,771 | 100 % | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | | |
|--|-------------|------|-------------|------|-------------|------|-------------|------|
| Total deposits | \$1,677,368 | 69 % | \$1,671,893 | 69 % | \$1,646,991 | 68 % | \$1,716,780 | 70 % |
| Total borrowings | 619,031 | 25 % | 583,843 | 24 % | 563,381 | 24 % | 549,990 | 22 % |
| Other liabilities | 33,797 | 1 % | 29,226 | 1 % | 37,004 | 2 % | 34,555 | 1 % |
| Total stockholders' equity | 134,643 | 5 % | 141,357 | 6 % | 147,577 | 6 % | 145,446 | 6 % |
| Total liabilities and stockholders' equity | \$2,464,839 | 100% | \$2,426,319 | 100% | \$2,394,953 | 100% | \$2,446,771 | 100% |

During the second quarter of 2014, the Company's total assets grew \$38.5 million, or 2%, to a total of \$2.46 billion. Net loans/leases grew \$56.4 million, or 4%, while securities decreased \$25.0 million, or 4%. A large portion of the loan growth was funded through the sale of securities. The remaining growth was funded with short-term borrowings.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

INVESTMENT SECURITIES. The composition of the Company's securities portfolio is managed to meet liquidity needs while prioritizing the impact on the Company's 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 tax-exempt 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 cashflow from the securities portfolio (calls and maturities of government sponsored agencies, paydowns on residential mortgage-backed securities, and/or targeted sales of securities that meet certain criteria as defined by management).

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

| | As of | | December 31, | | June 30, 2013 | |
|--|-------------------------------|-------|--------------|-------|---------------|-------|
| | June 30, 2014 | | 2013 | | June 30, 2013 | |
| | Amount | % | Amount | % | Amount | % |
| | <i>(dollars in thousands)</i> | | | | | |
| U.S. govt. sponsored agency securities | \$325,620 | 48 % | \$356,473 | 51 % | \$380,916 | 54 % |
| Municipal securities | 199,595 | 29 % | 180,361 | 26 % | 141,381 | 21 % |
| Residential mortgage-backed and related securities | 153,895 | 23 % | 157,429 | 23 % | 178,546 | 25 % |
| Other securities | 3,012 | 0 % | 2,947 | 0 % | 2,624 | 0 % |
| | \$682,122 | 100 % | \$697,210 | 100 % | \$703,467 | 100 % |
| As a % of Total Assets | 27.67 | % | 29.11 | % | 28.75 | % |
| Net Unrealized Gains/(Losses) as a % of Amortized Cost | -1.03 | % | -4.02 | % | -2.88 | % |
| Duration (in years) | 4.4 | | 4.7 | | 4.1 | |

With the increase in long-term interest rates during the middle 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.

Part I

Item 2

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

The duration of the securities portfolio has lengthened over the recent years for two reasons:

A portion of the government-sponsored agency securities contain call options at the discretion of the issuer whereby the issuer can call the security at par at certain times which vary by individual security. With the sharp increase in longer-term rates in 2013, the duration of these callable agency securities lengthened as the likelihood of a call became less likely.

The increased investment in tax-exempt municipal securities which tend to be longer term (average maturity is approximately 7 years). Management understands that this extended the duration of its securities portfolio and continually evaluates the combined benefit of increased interest income and reduced effective income tax rate and the impact on interest rate risk.

The Company has not invested in commercial mortgage-backed securities or pooled trust preferred securities. Additionally, the Company has not invested in the types of securities subject to the Volcker Rule (a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act, known as the "Dodd-Frank Act").

See Note 2 to the Consolidated Financial Statements for additional information regarding the Company's investment securities.

LOANS/LEASES. Total loans/leases grew 4% during the second quarter of 2014, and 6% over the first half of 2014. 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 was similar to the Company's three legacy banks. The mix of the loan/lease types within the Company's loan/lease portfolio is presented in the following table.

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | As of | | | | | |
|---|-------------------------------|-------|-------------------|-------|---------------|-------|
| | June 30, 2014 | | December 31, 2013 | | June 30, 2013 | |
| | Amount | % | Amount | % | Amount | % |
| | <i>(dollars in thousands)</i> | | | | | |
| Commercial and industrial loans | \$480,494 | 31 % | \$431,688 | 30 % | \$470,416 | 31 % |
| Commercial real estate loans | 683,376 | 44 % | 671,753 | 46 % | 724,006 | 47 % |
| Direct financing leases | 155,004 | 10 % | 128,902 | 9 % | 114,755 | 8 % |
| Residential real estate loans | 153,200 | 10 % | 147,356 | 10 % | 143,093 | 9 % |
| Installment and other consumer loans | 71,443 | 5 % | 76,034 | 5 % | 74,569 | 5 % |
| Total loans/leases | \$1,543,517 | 100 % | \$1,455,733 | 100 % | \$1,526,839 | 100 % |
| Plus deferred loan/lease origination costs, net of fees | 5,851 | | 4,547 | | 3,887 | |
| Less allowance for estimated losses on loans/leases | (23,067) | | (21,448) | | (21,156) | |
| Net loans/leases | \$1,526,301 | | \$1,438,832 | | \$1,509,570 | |

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, 2014 and December 31, 2013, approximately 36% and 39%, respectively, of the commercial real estate loan portfolio was owner-occupied.

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, 2014 and December 31, 2013:

| | As of June 30, 2014 | | As of December 31, 2013 | |
|---|-------------------------------|-------------|-------------------------------|-------------|
| | Amount | % | Amount | % |
| | <i>(dollars in thousands)</i> | | | |
| Lessors of Nonresidential Buildings | \$235,187 | 34 % | \$229,284 | 34 % |
| Lessors of Residential Buildings | 65,237 | 10 % | 64,659 | 10 % |
| Land Subdivision | 28,234 | 4 % | 29,117 | 4 % |
| Nursing Care Facilities | 22,626 | 3 % | 19,212 | 3 % |
| Hotels | 20,207 | 3 % | 20,975 | 3 % |
| Lessors of Other Real Estate Property | 16,642 | 3 % | 15,509 | 2 % |
| New Car Dealers | 16,010 | 2 % | 16,597 | 2 % |
| Other * | 279,233 | 41 % | 276,400 | 42 % |
| Total Commercial Real Estate Loans | \$683,376 | 100% | \$671,753 | 100% |

* "Other" consists of all other industries. None of these had concentrations greater than \$16.0 million, or 2.3% 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 3 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

ALLOWANCE FOR ESTIMATED LOSSES ON LOANS/LEASES. Changes in the allowance for the three and six months ended June 30, 2014 and 2013 are presented as follows:

| | Three Months Ended | | Six Months Ended | |
|---|-------------------------------|---------------|-------------------------------|---------------|
| | June 30, 2014 | June 30, 2013 | June 30, 2014 | June 30, 2013 |
| | <i>(dollars in thousands)</i> | | <i>(dollars in thousands)</i> | |
| Balance, beginning | \$22,653 | \$20,769 | \$21,448 | \$19,925 |
| Provisions charged to expense | 1,002 | 1,520 | 2,096 | 2,578 |
| Loans/leases charged off | (676) | (1,333) | (755) | (1,636) |
| Recoveries on loans/leases previously charged off | 88 | 200 | 278 | 289 |
| Balance, ending | \$23,067 | \$21,156 | \$23,067 | \$21,156 |

The allowance was \$23.1 million at June 30, 2014 compared to \$21.4 million at December 31, 2013 and \$21.2 million at June 30, 2013. Net charge-offs of loans/leases for the second quarter and first half of 2014 was a modest 3 basis points of average loans/leases which compares favorably to 8 basis points of average loans/leases for the second quarter of 2013, and 10 basis points of average loans/leases for the first half of 2013. 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 in loans/leases and a detailed analysis of the loan/lease portfolio. The loan/lease portfolio is 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 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, 2014 | December 31, 2013 | June 30, 2013 |
| | <i>(dollars in thousands)</i> | | |
| Special Mention (Rating 6) | \$34,306 | \$ 24,572 | \$28,728 |
| Substandard (Rating 7) | 53,409 | 43,508 | 57,895 |
| Doubtful (Rating 8) | - | - | - |
| | \$87,715 | \$ 68,080 | \$86,623 |
| Criticized Loans ** | \$87,715 | \$ 68,080 | \$86,623 |
| Classified Loans *** | \$53,409 | \$ 43,508 | \$57,895 |

* 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

The Company experienced some increase in criticized and classified loans during the first half of 2014, as compared to December 31, 2013, but this did not translate to an increase in nonperforming loans. Nonperforming loans/leases actually decreased \$545 thousand, or 3%, during the same period. The ratio of the Company's performing delinquent loans/leases (as defined as those past due 30 days or more and accruing) to total loans/leases has improved over the first half of 2014 (39 basis points of total loans/leases at June 30, 2014, which is down from 53 basis points of total loans/leases at December 31, 2013). The Company continues its strong focus on improving credit quality, including close management of criticized and classified loans as well as performing delinquent loans/leases, in an effort to limit translation to impairment and growth in nonperforming loans/leases.

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 | |
|--|----------|----------|---------|------|
| | June | December | June | June |
| | 30, | 31, 2013 | 30, | 30, |
| | 2014 | | 2013 | 2013 |
| Allowance / Gross Loans/Leases | 1.49 % | 1.47 % | 1.38 % | |
| Allowance / Nonperforming Loans/Leases * | 115.68 % | 104.70 % | 70.61 % | |

*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, the acquired CNB loans were recorded at market value; therefore, there was no allowance associated with CNB's loans at acquisition which caused a drop in the Company's allowance to total loans/leases percentage during the second quarter of 2013. This ratio has steadily increased since then. Further, the Company's allowance to total nonperforming loans/leases was 116% at June 30, 2014 which was up from all prior periods presented in the table above.

Although management believes that the allowance at June 30, 2014 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 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 3 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

NONPERFORMING ASSETS. The table below presents the amounts of nonperforming assets.

| | As of June 30, 2014 | As of December 31, 2013 | As of June 30, 2013 | As of December 31, 2012 |
|--|-------------------------------|----------------------------------|---------------------------|----------------------------------|
| | <i>(dollars in thousands)</i> | | | |
| Nonaccrual loans/leases (1) (2) | \$17,652 | \$ 17,878 | \$27,782 | \$ 17,932 |
| Accruing loans/leases past due 90 days or more | 104 | 84 | 3 | 159 |
| Troubled debt restructurings - accruing | 2,184 | 2,523 | 2,178 | 7,300 |
| Total nonperforming loans/leases | 19,940 | 20,485 | 29,963 | 25,391 |
| Other real estate owned | 10,951 | 9,729 | 3,860 | 3,955 |
| Other repossessed assets | 290 | 346 | 244 | 212 |
| Total nonperforming assets | \$31,181 | \$ 30,560 | \$34,067 | \$ 29,558 |
| Nonperforming loans/leases to total loans/leases | 1.29 % | 1.40 % | 1.96 % | 1.97 % |
| Nonperforming assets to total loans/leases plus repossessed property | 2.00 % | 2.08 % | 2.22 % | 2.29 % |
| Nonperforming assets to total assets | 1.27 % | 1.28 % | 1.39 % | 1.41 % |
| Texas ratio (3) | 20.23 % | 18.43 % | 21.15 % | 18.68 % |

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

(2) Includes troubled debt restructurings of \$9.8 million at June 30, 2014, \$10.9 million at December 31, 2013, \$7.7 million at June 30, 2013, and \$5.7 million at December 31, 2012.

Texas Ratio = Nonperforming Assets (excluding Other Repossessed Assets) / Tangible Equity plus Allowance for

(3) 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, 2014, government guaranteed amounts of nonaccrual loans totaled approximately \$914 thousand, or 5% of the \$17.7 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, 2014 were \$31.2 million, which were up \$621 thousand, or 2%, from December 31, 2013, and down \$2.9 million, or 8%, from June 30, 2013. In addition, the ratio of nonperforming assets to total assets was 1.27% at June 30, 2014, which was down from 1.28% at December 31, 2013, and down from 1.39% at June 30, 2013. During the first half of 2014, the Company experienced fluctuations in the performance of several individual credits. Several of these credits experienced improved performance (sustained performance of accruing TDRs and payoffs of nonaccrual loans) and other isolated credits experienced degradation (new nonaccrual loans/leases and OREO).

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

Part I

Item 2

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

DEPOSITS. Deposits grew \$5.5 million during the second quarter of 2014, mostly in short-term, low cost brokered time deposits. The table below presents the composition of the Company's deposit portfolio.

| | As of | | December 31, | | June 30, 2013 | |
|-------------------------------------|-------------------------------|-------|--------------|-------|---------------|-------|
| | June 30, 2014 | | 2013 | | June 30, 2013 | |
| | <i>(dollars in thousands)</i> | | | | | |
| | Amount | % | Amount | % | Amount | % |
| Noninterest bearing demand deposits | \$531,063 | 31 % | \$542,566 | 33 % | \$493,964 | 29 % |
| Interest bearing demand deposits | 760,242 | 46 % | 715,643 | 43 % | 710,745 | 42 % |
| Time deposits | 298,011 | 18 % | 326,852 | 20 % | 451,991 | 26 % |
| Brokered time deposits | 88,052 | 5 % | 61,930 | 4 % | 60,080 | 3 % |
| | \$1,677,368 | 100 % | \$1,646,991 | 100 % | \$1,716,780 | 100 % |

The Company has been successful in growing its noninterest bearing deposit portfolio over the past few years, growing average balances \$74.7 million, or 15%, comparing the quarterly average for the second quarter of 2014 to the same period 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.

BORROWINGS. 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. 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, 2014 | December 31, 2013 | June 30, 2013 |
|--|-------------------------------|----------------------|------------------|
| | <i>(dollars in thousands)</i> | | |
| Overnight repurchase agreements with customers | \$114,712 | \$98,823 | \$115,326 |
| Federal funds purchased | 89,610 | 50,470 | 41,860 |
| | \$204,322 | \$149,293 | \$157,186 |

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 decreased by \$12.8 million, or 5%, during the second quarter of 2014.

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. The table below presents the composition of the Company's other borrowings.

| | As of | | |
|-----------------------------|-------------------------------|----------------------|------------------|
| | June 30, 2014 | December 31, 2013 | June 30, 2013 |
| | <i>(dollars in thousands)</i> | | |
| Structured repos | \$ 130,000 | \$ 130,000 | \$ 130,000 |
| Term note | 18,800 | 9,800 | 10,000 |
| 364-day revolving note | - | - | - |
| Series A subordinated notes | 2,653 | 2,648 | 2,644 |
| | \$ 151,453 | \$ 142,448 | \$ 142,644 |

In June of 2014, the Company restructured its existing term debt (\$8.8 million at the time of restructure which was the net remaining amount after the acquisition of CNB) and borrowed an additional \$10.0 million of term debt to help assist with the final redemption of the Series F Preferred Stock. The term debt is secured by common stock of the Company's subsidiary banks and has a 4-year term with principal and interest due quarterly. Interest is calculated at the effective LIBOR rate plus 3.00% per annum (3.23% at June 30, 2014). Additionally, the Company continued to maintain its \$10.0 million revolving line of credit note. At June 30, 2014, the Company had not borrowed on this revolving credit note and had the full \$10.0 million line 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. However, the Company may choose to utilize advances to supplement funding needs, as this is a way for the Company to effectively and efficiently manage interest rate risk. The table below presents the maturity schedule including weighted average cost for the Company's combined wholesale funding portfolio.

June 30, 2014

December 31, 2013

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | Weighted Average Interest Rate | | Weighted Average Interest Rate |
|--------------------------------|--------------------------------------|--------------------------------------|------------------|---|
| Maturity: | Amount Due | at Quarter-End | Amount Due | at Year-End |
| Year ending December 31: | <i>(dollar amounts in thousands)</i> | | | |
| 2014 | \$118,123 | 0.55 | \$110,521 | 1.24 |
| 2015 | 46,000 | 1.82 | 41,000 | 2.00 |
| 2016 | 48,642 | 3.63 | 48,642 | 3.63 |
| 2017 | 48,145 | 3.17 | 43,075 | 3.43 |
| 2018 | 58,042 | 3.47 | 58,042 | 3.47 |
| Thereafter | 122,000 | 3.33 | 122,000 | 3.33 |
| Total Wholesale Funding | \$440,952 | 2.46 | \$423,280 | 2.72 |

During the first half of 2014, wholesale funding maturing in 2014 increased by \$7.6 million. This is the net result of \$20.3 million of maturities more than offset by the addition of \$27.9 million in short-term, low cost FHLB advances and brokered time deposits.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Importantly, a large portion of the Company's 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.

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

| | As of June 30, 2014 | | December 31, 2013 | | June 30, 2013 | |
|---|-------------------------------|-------|-------------------|-------|---------------|-------|
| | Amount | % | Amount | % | Amount | % |
| | <i>(dollars in thousands)</i> | | | | | |
| Common stock | \$ 8,050 | | \$ 8,006 | | \$ 5,918 | |
| Additional paid in capital - common | 60,999 | | 60,360 | | 38,406 | |
| Retained earnings | 71,137 | | 64,637 | | 58,786 | |
| Accumulated other comprehensive income (loss) | (3,937) | | (13,644) | | (9,221) | |
| Less: Treasury stock | (1,606) | | (1,606) | | (1,606) | |
| Total common stockholders' equity | 134,643 | 100 % | 117,753 | 80 % | 92,283 | 63 % |
| Preferred stock | - | | 30 | | 55 | |
| Additional paid in capital - preferred | - | | 29,794 | | 53,108 | |
| Total preferred stockholders' equity | - | 0 % | 29,824 | 20 % | 53,163 | 37 % |
| Total stockholders' equity | \$ 134,643 | 100 % | \$ 147,577 | 100 % | \$ 145,446 | 100 % |
| Tangible common equity (TCE)* / total tangible | 5.27 % | | 4.71 % | | 3.51 % | |

| | | | | | |
|---|------|---|------|---|--------|
| assets (TA) | | | | | |
| TCE/TA excluding accumulated other comprehensive income (loss) | 5.43 | % | 5.29 | % | 3.89 % |

*Tangible common equity is defined as total common stockholders' equity 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, 2014 and 2013, respectively.

| | For the quarter ended June 30, | | For the six months ended June 30, | |
|---|-----------------------------------|-----------|--------------------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| | <i>(dollars in thousands)</i> | | | |
| Beginning balance | \$141,357 | \$142,198 | \$147,577 | \$140,434 |
| Net income | 4,008 | 4,045 | 7,897 | 7,310 |
| Other comprehensive income (loss), net of tax | 4,476 | (13,091) | 9,707 | (13,928) |
| Preferred and common cash dividends declared | (689) | (1,040) | (1,397) | (1,852) |
| Issuance of 834,715 shares of common stock for acquisition of CNB, net | - | 13,017 | - | 13,017 |
| Redemption of 15,000 shares of Series F Preferred Stock | - | - | (15,000) | - |
| Redemption of 14,867 shares of Series F Preferred Stock | (14,824) | - | (14,824) | - |
| Other * | 315 | 317 | 683 | 465 |
| Ending balance | \$134,643 | \$145,446 | \$134,643 | \$145,446 |

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

With the final redemption of the remaining Series F Preferred Stock on June 30, 2014, the Company has completely retired all preferred stock and eliminated the associated dividend payment commitments. See Note 7 to the Consolidated Financial Statements for additional information regarding the Company's final redemption of the Series F Preferred Stock.

Part I

Item 2

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

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 averaged \$100.2 million during the second quarter of 2014, \$102.8 million during 2013 and \$98.6 million during 2012. The Company's on balance sheet liquidity position can fluctuate based on short-term activity in deposits and loans.

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 securities portfolio (both residential mortgage-backed securities and municipal securities). At June 30, 2014, the subsidiary banks had 33 lines of credit totaling \$348.4 million, of which \$18.9 million was secured and \$329.5 million was unsecured. At June 30, 2014, \$258.8 million was available as \$89.6 million was utilized for short-term borrowing needs at the three banks. At December 31, 2013, the subsidiary banks had 33 lines of credit totaling \$351.3 million, of which \$26.8 million was secured and \$324.5 million was unsecured. At December 31, 2013, \$315.3 million was available as \$36.0 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 maintains its \$10.0 million secured revolving credit note with a variable interest rate and a maturity of June 24, 2015. At June 30, 2014, the Company had not borrowed on this revolving credit note and had the full amount available.

Investing activities used cash of \$47.5 million during the first six months of 2014 compared to \$117.1 million for the same period of 2013. Proceeds from calls, maturities, paydowns, and sales of securities were \$66.2 million for the first six months of 2014 compared to \$158.6 million for the same period of 2013. Purchases of securities used cash of \$36.1 million for the first six months of 2014 compared to \$238.5 million for the same period of 2013. The net

increase in loans/leases used cash of \$91.3 million for the first six months of 2014 compared to \$51.7 million for the same period of 2013.

Financing activities provided cash of \$54.8 million for the first six months of 2014 compared to \$80.2 million for same period of 2013. Net increases in deposits totaled \$30.4 million for the first six months of 2014 compared to \$87.6 million for the same period of 2013. During the first half of 2014, the Company's short-term borrowings increased \$55.0 million. Also, during the first quarter of 2014, the Company partially redeemed its outstanding shares of Series F Preferred Stock totaling \$15.0 million and then fully redeemed the remaining \$14.8 million in the second quarter of 2014.

Total cash provided by operating activities was \$7.0 million for the first six months of 2014 compared to \$19.7 million for the same period of 2013.

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, 2014.

| Name | Date Issued | Amount Issued | Interest Rate | Interest Rate | Interest Rate |
|--|----------------|---------------|--------------------------|---------------|---------------|
| | | | | as of | as of |
| | | | | 6/30/2014 | 12/31/2013 |
| QCR Holdings Statutory Trust II | February 2004 | \$12,372,000 | 2.85% over 3-month LIBOR | 3.08 % | 3.10 % |
| QCR Holdings Statutory Trust III | February 2004 | 8,248,000 | 2.85% over 3-month LIBOR | 3.08 % | 3.10 % |
| QCR Holdings Statutory Trust IV | May 2005 | 5,155,000 | 1.80% over 3-month LIBOR | 2.03 % | 2.04 % |
| QCR Holdings Statutory Trust V | February 2006 | 10,310,000 | 1.55% over 3-month LIBOR | 1.78 % | 1.79 % |
| Community National Statutory Trust II | September 2004 | 3,093,000 | 2.17% over 3-month LIBOR | 2.40 % | 2.42 % |
| Community National Statutory Trust III | March 2007 | 3,609,000 | 1.75% over 3-month LIBOR | 1.98 % | 1.99 % |
| | | \$42,787,000 | Weighted Average Rate | 2.50 % | 2.51 % |

The Company assumed the trust preferred securities originally issued by Community National in connection with its acquisition in May 2013. As a result of acquisition accounting, the liabilities were recorded at fair value upon acquisition with the resulting discount being accreted as interest expense on a level yield basis over the expected term. The original discount totaled \$2.6 million. As of June 30, 2014, the remaining discount was \$2.4 million.

On June 30, 2014, the Company filed a universal shelf registration statement on Form S-3 with the Securities and Exchange Commission ("SEC"). This registration statement, declared effective by the SEC on July 14, 2014, will allow the Company to issue various types of securities, including common stock, preferred stock, debt securities or warrants, from time to time, up to an aggregate amount of \$75.0 million. The specific terms and prices of the securities will be determined at the time of any future offering and described in a separate prospectus supplement, which would be filed with the SEC at the time of the particular offering, if any.

The Company (on a consolidated basis) and its 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 tables) 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, 2014 and December 31, 2013, that the Company and the subsidiary banks met all capital adequacy requirements to which they were subject.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

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, 2014 and December 31, 2013 are also presented in the following tables (dollars in thousands). As of June 30, 2014 and December 31, 2013, the subsidiary banks met the requirements to be "well capitalized".

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|----------------------------|------------|---------|-------------------------------|---------|--|-----------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of June 30, 2014: | | | | | | |
| Company: | | | | | | |
| Total risk-based capital | \$ 195,631 | 11.09 % | \$ 141,138 | ≥ 8.0 % | N/A | N/A |
| Tier 1 risk-based capital | 170,665 | 9.67 % | 70,569 | ≥ 4.0 | N/A | N/A |
| Leverage ratio | 170,665 | 7.06 % | 96,747 | ≥ 4.0 | N/A | N/A |
| Quad City Bank & Trust: | | | | | | |
| Total risk-based capital | \$ 101,756 | 11.59 % | \$ 70,261 | ≥ 8.0 % | \$ 87,826 | ≥ 10.00 % |
| Tier 1 risk-based capital | 91,410 | 10.41 % | 35,131 | ≥ 4.0 | 52,696 | ≥ 6.00 % |
| Leverage ratio | 91,410 | 7.13 % | 51,280 | ≥ 4.0 | 64,100 | ≥ 5.00 % |
| Cedar Rapids Bank & Trust: | | | | | | |
| Total risk-based capital | \$ 74,853 | 11.98 % | \$ 49,999 | ≥ 8.0 % | \$ 62,498 | ≥ 10.00 % |
| Tier 1 risk-based capital | 67,028 | 10.72 % | 24,999 | ≥ 4.0 | 37,499 | ≥ 6.00 % |
| Leverage ratio | 67,028 | 8.27 % | 32,414 | ≥ 4.0 | 40,517 | ≥ 5.00 % |
| Rockford Bank & Trust: | | | | | | |
| Total risk-based capital | \$ 34,805 | 12.73 % | \$ 21,875 | ≥ 8.0 % | \$ 27,343 | ≥ 10.00 % |
| Tier 1 risk-based capital | 31,381 | 11.48 % | 10,937 | ≥ 4.0 | 16,406 | ≥ 6.00 % |
| Leverage ratio | 31,381 | 9.01 % | 13,926 | ≥ 4.0 | 17,407 | ≥ 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, 2013: | | | | | | |
| Company: | | | | | | |
| Total risk-based capital | \$217,011 | 12.87% | \$134,935 | ≥ 8.0 % | N/A | N/A |
| Tier 1 risk-based capital | 193,044 | 11.45% | 67,468 | ≥ 4.0 % | N/A | N/A |
| Tier 1 leverage | 193,044 | 7.96 % | 97,029 | ≥ 4.0 % | N/A | N/A |
| Quad City Bank & Trust: | | | | | | |
| Total risk-based capital | \$101,168 | 12.25% | \$66,049 | ≥ 8.0 % | \$82,562 | ≥10.00% |
| Tier 1 risk-based capital | 91,820 | 11.12% | 33,025 | ≥ 4.0 | 49,537 | ≥6.00 % |
| Tier 1 leverage | 91,820 | 7.13 % | 51,527 | ≥ 4.0 | 64,408 | ≥5.00 % |
| Cedar Rapids Bank & Trust: | | | | | | |
| Total risk-based capital | \$74,912 | 12.54% | \$47,808 | ≥ 8.0 % | \$59,760 | ≥10.00% |
| Tier 1 risk-based capital | 67,432 | 11.28% | 23,904 | ≥ 4.0 | 35,856 | ≥6.00 % |
| Tier 1 leverage | 67,432 | 8.78 % | 30,736 | ≥ 4.0 | 38,420 | ≥5.00 % |
| Rockford Bank & Trust: | | | | | | |
| Total risk-based capital | \$38,778 | 14.59% | \$21,263 | ≥ 8.0 % | \$26,579 | ≥10.00% |
| Tier 1 risk-based capital | 35,449 | 13.34% | 10,631 | ≥ 4.0 | 15,947 | ≥6.00 % |
| Tier 1 leverage | 35,449 | 10.54% | 13,459 | ≥ 4.0 | 16,824 | ≥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 (which includes the Company and its subsidiary banks) 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. At present, management believes that its current capital structure and the execution of its existing capital plan will be more than sufficient to meet and exceed the revised regulatory capital ratios as required by the new Basel III Rules.

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.

Part I

Item 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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 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. Further, in recent years, the Company added additional interest rate scenarios where interest rates experience a parallel and instantaneous shift upward 100, 200, 300, and 400 basis points and a parallel and instantaneous shift downward 100 basis points. The Company will run additional interest rate scenarios on an as-needed basis. The asset/liability management committees of the subsidiary bank boards of directors have established policy limits of a 10% decline in net interest income for the 200 basis point upward parallel shift and the 100 basis point downward parallel shift. For the 300 basis point upward shock, the established policy limit has been increased to 25% decline in net interest income. The increased policy limit is appropriate as the shock scenario is extreme and unlikely and warrants a higher limit than the more realistic and traditional parallel/pro-rata shift scenarios.

Application of the simulation model analysis for select interest rate scenarios at the most recent quarter-end available is presented in the following table:

| INTEREST RATE SCENARIO | POLICY LIMIT | NET INTEREST INCOME EXPOSURE in YEAR 1 | | | | | |
|--------------------------------|--------------|--|-------------------------|-------------------------|--|--|--|
| | | As of March 31, 2014 | As of December 31, 2013 | As of December 31, 2012 | | | |
| 100 basis point downward shift | -10.0 % | -1.0 % | -1.0 % | -1.5 % | | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | | |
|------------------------------|-------|---|-------|---|-------|---|------|---|
| 200 basis point upward shift | -10.0 | % | -4.6 | % | -4.8 | % | -0.9 | % |
| 300 basis point upward shock | -25.0 | % | -11.4 | % | -11.0 | % | 0.8 | % |

The simulation is within the board-established policy limits for all three scenarios. Additionally, for all of the various interest rate scenarios modeled and measured by management (as described above), the results at March 31, 2014 (the most recent quarter available) were within established risk tolerances as established by policy or by best practice (if the interest rate scenario didn't have a specific policy limit).

Part I

Item 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the second quarter of 2014, the Company executed two interest rate cap transactions, each with a notional value of \$15.0 million, for a total of \$30.0 million. The initial cost (prepaid premium) of the interest rate caps totaled \$2.1 million. This amount was recorded in the Other Assets section of the balance sheet. This asset will be amortized to interest expense according to a predetermined schedule and will also be adjusted to fair value on a recurring basis. The change in fair value will flow through Accumulated Other Comprehensive Income and the derivative transaction will be tested for effectiveness according to cash flow hedge accounting standards. The interest rate caps purchased will essentially set a ceiling to the interest rate paid on the \$30.0 million of short-term FHLB advances that are being hedged, minimizing the interest rate risk associated with rising interest rates. The Company will continue to analyze and evaluate similar transactions as an alternative and cost effective way to mitigate interest rate risk.

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

CONTROL 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 Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of June 30, 2014. 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, as of the end of the period covered by this report, 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.

In May 2013, the Committee of Sponsoring Organization of the Treadway Commission ("COSO") released an updated version of its Internal Control – Integrated Framework. The updated version supersedes the 1992 version effective December 15, 2014. The Company's management has evaluated the updated COSO framework and will use the new framework to evaluate the adequacy of their internal control over financial reporting for the year ending December 31, 2014. The Company's management expects no material changes to existing internal controls over financial reporting as a result of using the updated framework.

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 2013 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

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.

Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013; (ii) Consolidated Statements of Income for the three and six months ended June 30, 2014 and June 30, 2013; (iii) Consolidated Statements of Comprehensive Income (Loss) for the three months and six 101 months ended June 30, 2014 and June 30, 2013; (iv) Consolidated Statements of Changes in Stockholders' Equity for the three and six months ended June 30, 2014 and June 30, 2013; (v) Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and June 30, 2013; and (vi) Notes to the Consolidated Financial Statements.

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 7, 2014

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

Date August 7, 2014

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

Date August 7, 2014

/s/ John R. Oakes
John R. Oakes, 1st Vice President
Director of Financial Reporting
Principal Accounting Officer