

QCR HOLDINGS INC

Form 10-Q

August 08, 2017

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, 2017

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) 736-3580

(Registrant's telephone number, including area code)

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

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," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller reporting company Emerging growth company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of August 2, 2017, the Registrant had outstanding 13,181,153 shares of common stock, \$1.00 par value per share.

QCR HOLDINGS, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

| | Page Number(s) |
|---|-------------------|
| <u>Part I</u> FINANCIAL INFORMATION | |
| Item 1 Consolidated Financial Statements (Unaudited) | |
| Consolidated Balance Sheets As of June 30, 2017 and December 31, 2016 | 3 |
| Consolidated Statements of Income For the Three Months Ended June 30, 2017 and 2016 | 4 |
| Consolidated Statements of Income For the Six Months Ended June 30, 2017 and 2016 | 5 |
| Consolidated Statements of Comprehensive Income For the Three and Six Months Ended June 30, 2017 and 2016 | 6 |
| Consolidated Statements of Changes in Stockholders' Equity For the Three and Six Months Ended June 30, 2017 and 2016 | 7 |
| Consolidated Statements of Cash Flows For the Six Months Ended June 30, 2017 and 2016 | 8 |
| Notes to Consolidated Financial Statements | 10 |
| Note 1. Summary of Significant Accounting Policies | 10 |
| Note 2. Investment Securities | 12 |
| Note 3. Loans/Leases Receivable | 17 |
| Note 4. Earnings Per Share | 27 |
| Note 5. Fair Value | |

| | |
|---|----|
| | 27 |
| Note 6. Business Segment Information | 31 |
| Note 7. Regulatory Capital Requirements | 32 |
| Note 8. Acquisition of Guaranty Bank and Trust Company | 34 |
| Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations | |
| Introduction | 35 |
| General | 35 |
| Executive Overview | 36 |
| Long-Term Financial Goals | 37 |
| Strategic Developments | 38 |
| GAAP to Non-GAAP Reconciliations | 40 |
| Net Interest Income (Tax Equivalent Basis) | 43 |
| Critical Accounting Policies | 48 |
| Results of Operations | |
| Interest Income | 49 |
| Interest Expense | 49 |
| Provision for Loan/Lease Losses | 50 |
| Noninterest Income | 51 |
| Noninterest Expense | 54 |
| Income Taxes | 56 |

| | |
|--|-----------|
| Financial Condition | 56 |
| Investment Securities | 57 |
| Loans/Leases | 58 |
| Allowance for Estimated Losses on Loans/Leases | 61 |
| Nonperforming Assets | 63 |
| Deposits | 64 |
| Borrowings | 64 |
| Stockholders' Equity | 66 |
| Liquidity and Capital Resources | 67 |
| Special Note Concerning Forward-Looking Statements | 69 |
| Item 3 Quantitative and Qualitative Disclosures About Market Risk | 70 |
| Item 4 Controls and Procedures | 72 |
| <u>Part II</u> OTHER INFORMATION | |
| Item 1 Legal Proceedings | 73 |
| Item 1A Risk Factors | 73 |
| Item 2 Unregistered Sales of Equity Securities and Use of Proceeds | 73 |
| Item 3 Defaults upon Senior Securities | 73 |
| Item 4 Mine Safety Disclosures | 73 |
| Item 5 Other Information | 73 |
| Item 6 Exhibits | 74 |
| Signatures | 75 |
| Throughout the Notes to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations, we use certain | |

**acronyms and
abbreviations,
as defined in
Note 1.**

2

**QCR HOLDINGS,
INC. AND
SUBSIDIARIES
CONSOLIDATED
BALANCE
SHEETS
(UNAUDITED)
As of June 30,
2017 and
December 31, 2016**

| | June 30, 2017 | December 31, 2016 |
|---|------------------|----------------------|
| ASSETS | | |
| Cash and due from banks | \$77,161,353 | \$70,569,993 |
| Federal funds sold | 19,183,000 | 22,257,000 |
| Interest-bearing deposits at financial institutions | 53,171,325 | 63,948,925 |
| Securities held to maturity, at amortized cost | 324,203,634 | 322,909,056 |
| Securities available for sale, at fair value | 269,281,713 | 251,113,139 |
| Total securities | 593,485,347 | 574,022,195 |
| Loans receivable held for sale | 705,800 | 1,135,500 |
| Loans/leases receivable held for investment | 2,552,859,808 | 2,404,351,485 |
| Gross loans/leases receivable | 2,553,565,608 | 2,405,486,985 |
| Less allowance for estimated losses on loans/leases | (33,356,632) | (30,757,448) |
| Net loans/leases receivable | 2,520,208,976 | 2,374,729,537 |
| Bank-owned life insurance | 58,186,098 | 57,257,051 |
| Premises and equipment, net | 61,218,425 | 60,643,508 |
| Restricted investment securities | 16,103,925 | 14,997,025 |
| Other real estate owned, net | 5,173,521 | 5,523,104 |
| Goodwill | 13,110,913 | 13,110,913 |
| Core deposit intangible | 6,919,480 | 7,381,213 |
| Other assets | 33,264,332 | 37,503,284 |
| Total assets | \$3,457,186,695 | \$3,301,943,748 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposits: | | |
| Noninterest-bearing | \$760,624,943 | \$797,415,090 |
| Interest-bearing | 2,109,609,296 | 1,871,846,183 |
| Total deposits | 2,870,234,239 | 2,669,261,273 |
| Short-term borrowings | 18,217,393 | 39,971,387 |
| Federal Home Loan Bank advances | 106,500,000 | 137,500,000 |
| Other borrowings | 72,000,000 | 80,000,000 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|--------------------------------|---------------|---------------|
| Junior subordinated debentures | 33,546,425 | 33,480,202 |
| Other liabilities | 51,605,203 | 55,690,087 |
| Total liabilities | 3,152,103,260 | 3,015,902,949 |

STOCKHOLDERS' EQUITY

| | | |
|---|-----------------|-----------------|
| Preferred stock, \$1 par value; shares authorized 250,000 June 2017 and December 2016 - No shares issued or outstanding | - | - |
| Common stock, \$1 par value; shares authorized 20,000,000 June 2017 - 13,175,234 shares issued and outstanding December 2016 - 13,106,845 shares issued and outstanding | 13,175,234 | 13,106,845 |
| Additional paid-in capital | 158,001,006 | 156,776,642 |
| Retained earnings | 135,254,306 | 118,616,901 |
| Accumulated other comprehensive loss: | | |
| Securities available for sale | (468,190) | (1,527,433) |
| Interest rate cap derivatives | (878,921) | (932,156) |
| Total stockholders' equity | 305,083,435 | 286,040,799 |
| Total liabilities and stockholders' equity | \$3,457,186,695 | \$3,301,943,748 |

See Notes to Consolidated Financial Statements (Unaudited)

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

| | 2017 | 2016 |
|---|--------------|--------------|
| Interest and dividend income: | | |
| Loans/leases, including fees | \$28,114,729 | \$20,238,179 |
| Securities: | | |
| Taxable | 1,260,575 | 1,192,541 |
| Nontaxable | 2,688,243 | 2,276,203 |
| Interest-bearing deposits at financial institutions | 219,714 | 62,242 |
| Restricted investment securities | 131,890 | 133,546 |
| Federal funds sold | 38,117 | 10,573 |
| Total interest and dividend income | 32,453,268 | 23,913,284 |
| Interest expense: | | |
| Deposits | 2,990,603 | 1,344,398 |
| Short-term borrowings | 19,157 | 18,065 |
| FHLB advances | 354,213 | 415,933 |
| Other borrowings | 695,669 | 824,437 |
| Junior subordinated debentures | 346,929 | 301,638 |
| Total interest expense | 4,406,571 | 2,904,471 |
| Net interest income | 28,046,697 | 21,008,813 |
| Provision for loan/lease losses | 2,022,993 | 1,197,850 |
| Net interest income after provision for loan/lease losses | 26,023,704 | 19,810,963 |
| Noninterest income: | | |
| Trust department fees | 1,692,001 | 1,512,083 |
| Investment advisory and management fees | 868,835 | 692,738 |
| Deposit service fees | 1,458,359 | 946,810 |
| Gains on sales of residential real estate loans | 112,628 | 84,413 |
| Gains on sales of government guaranteed portions of loans | 87,053 | 1,603,890 |
| Swap fee income | 327,577 | 167,582 |
| Securities gains, net | 38,464 | 18,030 |
| Earnings on bank-owned life insurance | 459,359 | 480,520 |
| Debit card fees | 743,521 | 343,748 |
| Correspondent banking fees | 200,057 | 244,939 |
| Other | 794,664 | 667,648 |
| Total noninterest income | 6,782,518 | 6,762,401 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|--|-------------|-------------|
| Noninterest expense: | | |
| Salaries and employee benefits | 12,930,944 | 10,917,473 |
| Occupancy and equipment expense | 2,698,336 | 1,884,556 |
| Professional and data processing fees | 2,340,699 | 1,542,322 |
| Acquisition costs | - | 354,969 |
| FDIC insurance, other insurance and regulatory fees | 645,277 | 649,604 |
| Loan/lease expense | 260,284 | 154,349 |
| Net cost of operations of other real estate | 27,957 | 277,911 |
| Advertising and marketing | 567,588 | 433,451 |
| Bank service charges | 447,445 | 415,350 |
| Correspondent banking expense | 201,693 | 181,776 |
| Other | 1,284,406 | 931,992 |
| Total noninterest expense | 21,404,629 | 17,743,753 |
| Net income before income taxes | 11,401,593 | 8,829,611 |
| Federal and state income tax expense | 2,635,576 | 2,153,144 |
| Net income | \$8,766,017 | \$6,676,467 |
| Basic earnings per common share | \$0.67 | \$0.54 |
| Diluted earnings per common share | \$0.65 | \$0.53 |
| Weighted average common shares outstanding | 13,170,283 | 12,335,077 |
| Weighted average common and common equivalent shares outstanding | 13,516,592 | 12,516,474 |
| Cash dividends declared per common share | \$0.05 | \$0.04 |

See Notes to
Consolidated
Financial
Statements
(Unaudited)

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

| | 2017 | 2016 |
|---|--------------|--------------|
| Interest and dividend income: | | |
| Loans/leases, including fees | \$55,326,146 | \$39,938,549 |
| Securities: | | |
| Taxable | 2,402,810 | 2,548,744 |
| Nontaxable | 5,335,965 | 4,518,218 |
| Interest-bearing deposits at financial institutions | 418,366 | 122,559 |
| Restricted investment securities | 262,320 | 264,110 |
| Federal funds sold | 52,760 | 23,163 |
| Total interest and dividend income | 63,798,367 | 47,415,343 |
| Interest expense: | | |
| Deposits | 5,223,359 | 2,634,196 |
| Short-term borrowings | 43,117 | 61,131 |
| FHLB advances | 757,682 | 857,637 |
| Other borrowings | 1,378,877 | 1,649,520 |
| Junior subordinated debentures | 679,752 | 606,524 |
| Total interest expense | 8,082,787 | 5,809,008 |
| Net interest income | 55,715,580 | 41,606,335 |
| Provision for loan/lease losses | 4,128,102 | 3,270,835 |
| Net interest income after provision for loan/lease losses | 51,587,478 | 38,335,500 |
| Noninterest income: | | |
| Trust department fees | 3,432,208 | 3,087,990 |
| Investment advisory and management fees | 1,830,434 | 1,351,123 |
| Deposit service fees | 2,774,749 | 1,877,889 |
| Gains on sales of residential real estate loans | 208,951 | 144,799 |
| Gains on sales of government guaranteed portions of loans | 1,037,694 | 2,482,418 |
| Swap fee income | 441,097 | 1,024,540 |
| Securities gains, net | 38,464 | 376,510 |
| Earnings on bank-owned life insurance | 929,046 | 874,129 |
| Debit card fees | 1,446,322 | 651,399 |
| Correspondent banking fees | 445,246 | 547,069 |
| Other | 1,482,061 | 1,167,008 |
| Total noninterest income | 14,066,272 | 13,584,874 |
| Noninterest expense: | | |
| Salaries and employee benefits | 26,238,275 | 21,718,380 |
| Occupancy and equipment expense | 5,200,555 | 3,711,544 |
| Professional and data processing fees | 4,424,091 | 2,989,735 |
| Acquisition costs | - | 354,969 |
| FDIC insurance, other insurance and regulatory fees | 1,266,519 | 1,283,969 |
| Loan/lease expense | 553,822 | 317,168 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|--|--------------|--------------|
| Net cost of operations of other real estate | 42,187 | 380,094 |
| Advertising and marketing | 1,177,019 | 819,710 |
| Bank service charges | 871,346 | 831,281 |
| Losses on debt extinguishment, net | - | 83,197 |
| Correspondent banking expense | 400,044 | 358,765 |
| Other | 2,503,888 | 1,849,439 |
| Total noninterest expense | 42,677,746 | 34,698,251 |
| Net income before income taxes | 22,976,004 | 17,222,123 |
| Federal and state income tax expense | 5,025,022 | 4,172,167 |
| Net income | \$17,950,982 | \$13,049,956 |
| Basic earnings per common share | \$1.36 | \$1.08 |
| Diluted earnings per common share | \$1.33 | \$1.07 |
| Weighted average common shares outstanding | 13,151,833 | 12,064,349 |
| Weighted average common and common equivalent shares outstanding | 13,502,505 | 12,235,212 |
| Cash dividends declared per common share | \$0.10 | \$0.08 |

See Notes to
Consolidated
Financial
Statements
(Unaudited)

QCR HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
Three and Six Months Ended June 30, 2017 and 2016

| | Three Months Ended June 30, | |
|---|--------------------------------|--------------|
| | 2017 | 2016 |
| Net income | \$8,766,017 | \$6,676,467 |
| Other comprehensive income: | | |
| Unrealized gains on securities available for sale: | | |
| Unrealized holding gains arising during the period before tax | 1,170,310 | 2,081,800 |
| Less reclassification adjustment for gains included in net income before tax | 38,464 | 18,030 |
| | 1,131,846 | 2,063,770 |
| Unrealized losses on interest rate cap derivatives: | | |
| Unrealized holding losses arising during the period before tax | (132,352) | (159,691) |
| Less reclassification adjustment for ineffectiveness and caplet amortization before tax | (136,639) | 20,154 |
| | 4,287 | (179,845) |
| Other comprehensive income, before tax | 1,136,133 | 1,883,925 |
| Tax expense | 434,394 | 703,292 |
| Other comprehensive income, net of tax | 701,739 | 1,180,633 |
| Comprehensive income | \$9,467,756 | \$7,857,100 |
| | | |
| | Six Months Ended June 30, | |
| | 2017 | 2016 |
| Net income | \$17,950,982 | \$13,049,956 |
| Other comprehensive income: | | |
| Unrealized gains on securities available for sale: | | |
| Unrealized holding gains arising during the period before tax | 1,768,500 | 6,945,518 |
| Less reclassification adjustment for gains included in net income before tax | 38,464 | 376,510 |
| | 1,730,036 | 6,569,008 |
| Unrealized losses on interest rate cap derivatives: | | |
| Unrealized holding losses arising during the period before tax | (177,554) | (549,627) |
| Less reclassification adjustment for ineffectiveness and caplet amortization before tax | (259,452) | 35,591 |
| | 81,898 | (585,218) |
| Other comprehensive income, before tax | 1,811,934 | 5,983,790 |
| Tax expense | 699,456 | 2,277,746 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|--|--------------|--------------|
| Other comprehensive income, net of tax | 1,112,478 | 3,706,044 |
| Comprehensive income | \$19,063,460 | \$16,756,000 |

See Notes to Consolidated Financial Statements (Unaudited)

6

QCR HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)
Three Months and Six Months Ended June 30, 2017 and 2016

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|--|---------------------|----------------------------------|----------------------|--|----------------------|
| Balance, December 31, 2016 | \$13,106,845 | \$156,776,642 | \$118,616,901 | \$ (2,459,589) | \$286,040,799 |
| Net income | - | - | 9,184,965 | - | 9,184,965 |
| Other comprehensive income, net of tax | - | - | - | 410,739 | 410,739 |
| Common cash dividends declared, \$0.05 per share | - | - | (656,574) | - | (656,574) |
| Proceeds from issuance of 3,573 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan | 3,573 | 83,091 | - | - | 86,664 |
| Proceeds from issuance of 44,284 shares of common stock as a result of stock options exercised | 44,284 | 630,290 | - | - | 674,574 |
| Stock compensation expense | - | 388,753 | - | - | 388,753 |
| Restricted stock awards - 13,289 shares of common stock | 13,289 | (13,289) | - | - | - |
| Exchange of 6,772 shares of common stock in connection with stock options exercised and restricted stock vested | (6,772) | (283,518) | - | - | (290,290) |
| Balance, March 31, 2017 | \$13,161,219 | \$157,581,969 | \$127,145,292 | \$ (2,048,850) | \$295,839,630 |
| Net income | - | - | 8,766,017 | - | 8,766,017 |
| Other comprehensive income, net of tax | - | - | - | 701,739 | 701,739 |
| Common cash dividends declared, \$0.05 per share | - | - | (657,003) | - | (657,003) |
| Proceeds from issuance of 4,582 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan | 4,582 | 170,061 | - | - | 174,643 |
| Proceeds from issuance of 8,027 shares of common stock as a result of stock options exercised | 8,027 | 109,392 | - | - | 117,419 |
| Stock compensation expense | - | 168,314 | - | - | 168,314 |
| Restricted stock awards - 2,000 shares of common stock | 2,000 | (2,000) | - | - | - |
| Exchange of 594 shares of common stock in connection with stock options exercised | (594) | (26,730) | - | - | (27,324) |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | |
|--|---------------------|----------------------------------|----------------------|--|------------------------|
| Balance June 30, 2017 | \$13,175,234 | \$158,001,006 | \$135,254,306 | \$(1,347,111) |) \$305,083,435 |
| | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
| Balance, December 31, 2015 | \$11,761,083 | \$123,282,851 | \$92,965,645 | \$(2,123,829) |) \$225,885,750 |
| Net income | - | - | 6,373,489 | - | 6,373,489 |
| Other comprehensive income, net of tax | - | - | - | 2,525,411 | 2,525,411 |
| Common cash dividends declared, \$0.04 per share | - | - | (470,873) | - | (470,873) |
| Proceeds from issuance of 5,054 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan | 5,054 | 94,560 | - | - | 99,614 |
| Proceeds from issuance of 46,020 shares of common stock as a result of stock options exercised | 46,020 | 729,473 | - | - | 775,493 |
| Stock compensation expense | - | 382,761 | - | - | 382,761 |
| Tax benefit of nonqualified stock options exercised | - | 22,508 | - | - | 22,508 |
| Restricted stock awards - 22,382 shares of common stock | 22,382 | (22,382) | - | - | - |
| Exchange of 19,628 shares of common stock in connection with stock options exercised and restricted stock vested | (19,628) | (431,806) | - | - | (451,434) |
| Balance, March 31, 2016 | \$11,814,911 | \$124,057,965 | \$98,868,261 | \$401,582 |) \$235,142,719 |
| Net income | - | - | 6,676,467 | - | 6,676,467 |
| Other comprehensive income, net of tax | - | - | - | 1,180,633 | 1,180,633 |
| Common cash dividends declared, \$0.04 per share | - | - | (520,701) | - | (520,701) |
| Proceeds from the issuance of 1,215,000 shares of common stock, net of issuance costs | 1,215,000 | 28,613,916 | - | - | 29,828,916 |
| Proceeds from issuance of 6,982 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan | 6,982 | 142,887 | - | - | 149,869 |
| Proceeds from issuance of 20,975 shares of common stock as a result of stock options exercised | 20,975 | 230,671 | - | - | 251,646 |
| Tax basis adjustment related to the acquisition of noncontrolling interest in m2 Lease Funds | - | 2,132,415 | - | - | 2,132,415 |
| Stock compensation expense | - | 187,569 | - | - | 187,569 |
| Tax benefit of nonqualified stock options exercised | - | 87,858 | - | - | 87,858 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | |
|---|---------------------|---|----------------------|----------------------|--------------------|----------------------|
| Restricted stock awards - 500 shares of common stock | (500 |) | 500 | - | - | - |
| Balance June 30, 2016 | \$13,057,368 | | \$155,453,781 | \$105,024,027 | \$1,582,215 | \$275,117,391 |

See Notes to
Consolidated
Financial
Statements
(Unaudited)

7

**QCR HOLDINGS,
INC. AND
SUBSIDIARIES
CONSOLIDATED
STATEMENTS
OF CASH
FLOWS
(UNAUDITED)
Six Months Ended
June 30, 2017 and
2016**

| | 2017 | 2016 |
|---|---------------|---------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 17,950,982 | \$ 13,049,956 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 1,847,963 | 1,552,176 |
| Provision for loan/lease losses | 4,128,102 | 3,270,835 |
| Stock-based compensation expense | 557,067 | 570,330 |
| Deferred compensation expense accrued | 724,422 | 623,831 |
| Losses on other real estate owned, net | 3,596 | 157,739 |
| Amortization of premiums on securities, net | 1,005,121 | 611,900 |
| Securities gains, net | (38,464) | (376,510) |
| Loans originated for sale | (32,130,683) | (43,526,263) |
| Proceeds on sales of loans | 33,807,027 | 45,160,830 |
| Gains on sales of residential real estate loans | (208,951) | (144,799) |
| Gains on sales of government guaranteed portions of loans | (1,037,694) | (2,482,418) |
| Losses on debt extinguishment, net | - | 83,197 |
| Amortization of core deposit intangible | 461,733 | 99,756 |
| Accretion of acquisition fair value adjustments, net | (3,578,379) | (61,065) |
| Increase in cash value of bank-owned life insurance | (929,046) | (874,129) |
| Decrease (increase) in other assets | 3,412,207 | (4,330,548) |
| Increase (decrease) in other liabilities | (7,059,305) | 1,386,323 |
| Net cash provided by operating activities | \$ 18,915,698 | \$ 14,771,141 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Net decrease (increase) in federal funds sold | 3,074,000 | (975,000) |
| Net decrease (increase) in interest-bearing deposits at financial institutions | 10,777,600 | (11,293,339) |
| Proceeds from sales of other real estate owned | 487,815 | 864,817 |
| Activity in securities portfolio: | | |
| Purchases | (85,169,891) | (97,132,279) |
| Calls, maturities and redemptions | 33,079,683 | 96,704,276 |
| Paydowns | 21,606,220 | 13,321,512 |
| Sales | 13,554,075 | 61,075,145 |
| Activity in restricted investment securities: | | |
| Purchases | (2,407,600) | (1,857,200) |
| Redemptions | 1,300,700 | - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | |
|---|-----------------|-----------------|
| Net increase in loans/leases originated and held for investment | (146,365,255) | (124,972,098) |
| Purchase of premises and equipment | (2,422,880) | (2,953,356) |
| Net cash used in investing activities | \$(152,485,534) | \$(67,217,522) |

CASH FLOWS FROM FINANCING ACTIVITIES

| | | |
|--|----------------|---------------|
| Net increase in deposit accounts | 201,041,035 | 92,920,820 |
| Net decrease in short-term borrowings | (21,753,994) | (93,100,968) |
| Activity in FHLB advances: | | |
| Calls and maturities | (6,000,000) | (9,000,000) |
| Net change in short-term and overnight advances | (25,000,000) | 64,900,000 |
| Prepayments | - | (10,524,197) |
| Activity in other borrowings: | | |
| Calls, maturities and scheduled principal payments | (8,000,000) | - |
| Prepayments | - | (10,759,000) |
| Retirement of junior subordinated debentures | - | (3,955,000) |
| Payment of cash dividends on common stock | (1,179,146) | (939,456) |
| Net proceeds from the common stock offering, 1,215,000 shares issued | - | 29,828,916 |
| Proceeds from issuance of common stock, net | 1,053,300 | 914,099 |
| Net cash provided by financing activities | \$ 140,161,195 | \$ 60,285,214 |
| Net increase in cash and due from banks | 6,591,360 | 7,838,833 |
| Cash and due from banks, beginning | 70,569,993 | 41,742,321 |
| Cash and due from banks, ending | \$ 77,161,353 | \$ 49,581,154 |

(Continued)

**QCR HOLDINGS,
INC. AND
SUBSIDIARIES
CONSOLIDATED
STATEMENTS
OF CASH
FLOWS
(UNAUDITED) -
continued
Six Months Ended
June 30, 2017 and
2016**

| | 2017 | 2016 |
|---|---------------|---------------|
| Supplemental disclosure of cash flow information, cash payments for: | | |
| Interest | \$7,876,668 | \$5,852,789 |
| Income/franchise taxes, net | \$7,450,738 | \$4,869,300 |
| Supplemental schedule of noncash investing activities: | | |
| Change in accumulated other comprehensive income, unrealized gains on securities available for sale and derivative instruments, net | \$1,112,478 | \$3,706,044 |
| Exchange of shares of common stock in connection with payroll taxes for restricted stock and in connection with stock options exercised | \$(317,614) | \$(451,434) |
| Tax benefit of nonqualified stock options exercised | \$N/A | \$110,366 |
| Transfers of loans to other real estate owned | \$141,828 | \$51,000 |
| Due to broker for purchases of securities | \$(4,662,631) | \$(1,500,000) |
| Dividends payable | \$657,003 | \$520,701 |
| Tax basis adjustment related to the acquisition of noncontrolling interest in m2 Lease Funds | \$- | \$2,132,415 |
| Decrease (increase) in the fair market value of interest rate swap assets and liabilities | \$(209,185) | \$6,823,332 |

See Notes to
Consolidated
Financial
Statements
(Unaudited)

Part I

Item 1

QCR HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2017

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, 2016, included in the Company's Annual Report on Form 10-K filed with the SEC on March 10, 2017. 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. GAAP 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, 2017, are not necessarily indicative of the results expected for the year ending December 31, 2017, or for any other period.

The acronyms and abbreviations identified below are used throughout this Quarterly Report on Form 10-Q. It may be helpful to refer back to this page as you read this report.

| | |
|---|--|
| Allowance: Allowance for estimated losses on loans/leases | Guaranty Bank: Guaranty Bank and Trust Company |
| AOCI: Accumulated other comprehensive income (loss) | HTM: Held to maturity |
| AFS: Available for sale | m2: m2 Lease Funds, LLC |
| ASC: Accounting Standards Codification | NIM: Net interest margin |
| ASU: Accounting Standards Update | NPA: Nonperforming asset |
| BOLI: Bank-owned life insurance | NPL: Nonperforming loan |
| Caps: Interest rate cap derivatives | OREO: Other real estate owned |
| Community National: Community National Bancorporation | OTTI: Other-than-temporary impairment |
| CRBT: Cedar Rapids Bank & Trust Company | PCI: Purchased credit impaired |
| CRE: Commercial real estate | Provision: Provision for loan/lease losses |
| CSB: Community State Bank | QCBT: Quad City Bank & Trust Company |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | |
|---|---|
| C&I: Commercial and industrial | RB&T: Rockford Bank & Trust Company |
| Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act | ROAA: Return on Average Assets |
| EPS: Earnings per share | SBA: U.S. Small Business Administration |
| Exchange Act: Securities Exchange Act of 1934, as amended | SEC: Securities and Exchange Commission |
| FASB: Financial Accounting Standards Board | TA: Tangible assets |
| FDIC: Federal Deposit Insurance Corporation | TCE: Tangible common equity |
| FHLB: Federal Home Loan Bank | TDRs: Troubled debt restructurings |
| FRB: Federal Reserve Bank of Chicago | TEY: Tax equivalent yield |
| GAAP: Generally Accepted Accounting Principles | The Company: QCR Holdings, Inc. |
| Guaranty: Guaranty Bankshares, Ltd. | USDA: U.S. Department of Agriculture |

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries which include four commercial banks: QCBT, CRBT, CSB and RB&T. All are state-chartered commercial banks. The Company also engages in direct financing lease contracts through m2, a wholly-owned subsidiary of QCBT. All material intercompany transactions and balances have been eliminated in consolidation.

The acquisition of CSB occurred on August 31, 2016; therefore, the Consolidated Balance Sheets included herein for both June 30, 2017 and December 31, 2016 include CSB. The Consolidated Statements of Income included herein include CSB for the quarter and six months ended June 30, 2017, however, do not include CSB for the comparative periods ending June 30, 2016.

On June 8, 2017, the Company announced the signing of a definitive agreement to acquire Guaranty Bank, headquartered in Cedar Rapids, Iowa, from Guaranty. The transaction is expected to be completed late in the third quarter or early in the fourth quarter of 2017, subject to certain customary closing conditions. The financial results of Guaranty are not recognized in this Report. See Note 8 to the Consolidated Financial Statements for additional information about the planned acquisition.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Recent accounting developments: 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 was originally effective for the Company on January 1, 2017, however, FASB issued ASU 2015-14 which defers the effective date in order to provide additional time for both public and private entities to evaluate the impact. ASU 2014-09 will now be effective for the Company on January 1, 2018 and it is not expected to have a significant impact on the Company's consolidated financial statements.

In January 2016, FASB issued ASU 2016-01, *Financial Instruments – Overall*. ASU 2016-01 makes targeted adjustments to GAAP by eliminating the AFS classification for equity securities and requiring equity investments to be measured at fair value with changes in fair value recognized in net income. The standard also requires public business entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes. The standard clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to AFS securities in combination with the entity's other deferred tax assets. It also requires an entity to present separately (within other comprehensive income) the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. Additionally, the standard eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years and it is not expected to have a significant impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. Under ASU 2016-02, lessees will be required to recognize a lease liability measured on a discounted basis and a right-of-use asset for all leases (with the exception of short-term leases). Lessor accounting is largely unchanged under ASU 2016-02. However, the definition of initial direct costs was updated to include only initial direct costs that are considered incremental. This change in definition will change the manner in which the Company recognizes the costs associated with originating leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted for all entities. The Company is in the process of analyzing the impact of adoption on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses*. Under the standard, assets measured at amortized costs (including loans, leases and AFS securities) will be presented at the net amount expected to be collected. Rather than the “incurred” model that is currently being utilized, the standard will require the use of a forward-looking approach to recognizing all expected credit losses at the beginning of an asset’s life. For public companies, ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Companies may choose to early adopt for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is in the process of analyzing the impact of adoption on the Company’s consolidated financial statements.

Effective January 1, 2017, the Company adopted ASU 2016-09, *Compensation – Stock Compensation*. Under the standard, the excess tax benefit (deficiency) related to stock options exercised and restricted stock awards vested is recorded as an adjustment to income tax expense. In the past, this tax benefit (deficiency) was recorded directly to equity. This change in accounting resulted in \$90 thousand of reduced income tax in the second quarter of 2017 and \$623 thousand of reduced income tax expense in the first six months of 2017.

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, 2017 and December 31, 2016 are summarized as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value |
|--|-------------------|------------------------------|---------------------------------|---------------|
| June 30, 2017: | | | | |
| Securities HTM: | | | | |
| Municipal securities | \$323,153,634 | \$2,027,969 | \$(3,242,226) | \$321,939,377 |
| Other securities | 1,050,000 | - | - | 1,050,000 |
| | \$324,203,634 | \$2,027,969 | \$(3,242,226) | \$322,989,377 |
| Securities AFS: | | | | |
| U.S. govt. sponsored agency securities | \$42,037,160 | \$96,651 | \$(189,347) | \$41,944,464 |
| Residential mortgage-backed and related securities | 166,063,973 | 245,551 | (1,894,691) | 164,414,833 |
| Municipal securities | 57,881,338 | 471,713 | (252,541) | 58,100,510 |
| Other securities | 4,065,468 | 778,988 | (22,550) | 4,821,906 |
| | \$270,047,939 | \$1,592,903 | \$(2,359,129) | \$269,281,713 |
| December 31, 2016: | | | | |
| Securities HTM: | | | | |
| Municipal securities | \$321,859,056 | \$2,200,577 | \$(4,694,734) | \$319,364,899 |
| Other securities | 1,050,000 | - | - | 1,050,000 |
| | \$322,909,056 | \$2,200,577 | \$(4,694,734) | \$320,414,899 |
| Securities AFS: | | | | |
| U.S. govt. sponsored agency securities | \$46,281,306 | \$132,886 | \$(330,585) | \$46,083,607 |
| Residential mortgage-backed and related securities | 150,465,222 | 174,993 | (2,938,088) | 147,702,127 |
| Municipal securities | 52,816,541 | 425,801 | (637,916) | 52,604,426 |
| Other securities | 4,046,332 | 703,978 | (27,331) | 4,722,979 |
| | \$253,609,401 | \$1,437,658 | \$(3,933,920) | \$251,113,139 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

The Company's HTM municipal securities consist largely of private issues of municipal debt. The large majority of the municipalities are located within the Midwest. 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 private mortgage-backed securities or pooled trust preferred securities.

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, 2017 and December 31, 2016, 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, 2017: | | | | | | |
| Securities HTM: | | | | | | |
| Municipal securities | \$64,001,034 | \$(1,792,524) | \$30,641,106 | \$(1,449,702) | \$94,642,140 | \$(3,242,226) |
| Securities AFS: | | | | | | |
| U.S. govt. sponsored agency securities | \$27,793,290 | \$(184,702) | \$4,775,235 | \$(4,645) | \$32,568,525 | \$(189,347) |
| Residential mortgage-backed and related securities | 129,347,074 | (1,614,041) | 8,839,471 | (280,650) | 138,186,545 | (1,894,691) |
| Municipal securities | 25,578,044 | (234,044) | 336,441 | (18,497) | 25,914,485 | (252,541) |
| Other securities | 926,800 | (22,550) | - | - | 926,800 | (22,550) |
| | \$183,645,208 | \$(2,055,337) | \$13,951,147 | \$(303,792) | \$197,596,355 | \$(2,359,129) |

December 31, 2016:

Securities HTM:

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | |
|--|---------------|---------------|--------------|-------------|---|---------------|---------------|
| Municipal securities | \$122,271,533 | \$(4,076,647) | \$13,010,803 | \$(618,087) |) | \$135,282,336 | \$(4,694,734) |
| Securities AFS: | | | | | | | |
| U.S. govt. sponsored agency securities | \$21,788,139 | \$(257,640) | \$5,499,012 | \$(72,945) |) | \$27,287,151 | \$(330,585) |
| Residential mortgage-backed and related securities | 121,506,582 | (2,641,664) | 7,437,615 | (296,424) |) | 128,944,197 | (2,938,088) |
| Municipal securities | 34,152,822 | (618,462) | 338,099 | (19,454) |) | 34,490,921 | (637,916) |
| Other securities | 3,177,414 | (27,331) | - | - |) | 3,177,414 | (27,331) |
| | \$180,624,957 | \$(3,545,097) | \$13,274,726 | \$(388,823) |) | \$193,899,683 | \$(3,933,920) |

At June 30, 2017, the investment portfolio included 568 securities. Of this number, 212 securities were in an unrealized loss position. The aggregate losses of these securities totaled approximately 0.9% of the total amortized cost of the portfolio. Of these 212 securities, 30 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 lacks the intent 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, 2017 and December 31, 2016, equity securities represented less than 1% of the total portfolio.

The Company did not recognize OTTI on any debt or equity securities for the three or six months ended June 30, 2017 and 2016.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

All sales of securities for the three and six months ended June 30, 2017 and 2016 were from securities identified as AFS. Information on proceeds received, as well as pre-tax gross gains and losses from sales on those securities are as follows:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 30, 2017 | June 30, 2016 | June 30, 2017 | June 30, 2016 |
| Proceeds from sales of securities | \$13,554,075 | \$5,548,294 | \$13,554,075 | \$61,075,145 |
| Pre-tax gross gains from sales of securities | 59,568 | 18,030 | 59,568 | 533,545 |
| Pre-tax gross losses from sales of securities | (21,104) | - | (21,104) | (157,035) |

The amortized cost and fair value of securities as of June 30, 2017 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 prepaid without any penalties. Therefore, these securities are not included in the maturity categories in the following table. "Other securities" AFS are excluded from the maturity categories as there is no fixed maturity date for those securities.

| | Amortized Cost | Fair Value |
|--|-------------------|---------------|
| Securities HTM: | | |
| Due in one year or less | \$7,479,990 | \$7,478,528 |
| Due after one year through five years | 18,040,753 | 18,137,483 |
| Due after five years | 298,682,891 | 297,373,366 |
| | \$324,203,634 | \$322,989,377 |
| Securities AFS: | | |
| Due in one year or less | \$3,498,188 | \$3,504,089 |
| Due after one year through five years | 31,550,278 | 31,700,139 |
| Due after five years | 64,870,032 | 64,840,746 |
| | \$99,918,498 | \$100,044,974 |
| Residential mortgage-backed and related securities | 166,063,973 | 164,414,833 |
| Other securities | 4,065,468 | 4,821,906 |
| | \$270,047,939 | \$269,281,713 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

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. These callable securities are summarized as follows:

| | Amortized Cost | Fair Value |
|--|-------------------|----------------|
| Securities HTM: | | |
| Municipal securities | \$ 170,556,294 | \$ 170,715,228 |
| Securities AFS: | | |
| U.S. govt. sponsored agency securities | 5,048,597 | 5,040,134 |
| Municipal securities | 41,135,349 | 41,095,251 |
| | \$ 46,183,946 | \$ 46,135,385 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

As of June 30, 2017, the Company's municipal securities portfolios were comprised of general obligation bonds issued by 124 issuers with fair values totaling \$107.9 million and revenue bonds issued by 126 issuers, primarily consisting of states, counties, towns, villages and school districts with fair values totaling \$272.2 million. The Company held investments in general obligation bonds in 21 states, including six states in which the aggregate fair value exceeded \$5.0 million. The Company held investments in revenue bonds in 13 states, including six states in which the aggregate fair value exceeded \$5.0 million.

As of December 31, 2016, the Company's municipal securities portfolios were comprised of general obligation bonds issued by 116 issuers with fair values totaling \$116.5 million and revenue bonds issued by 120 issuers, primarily consisting of states, counties, towns, villages and school districts with fair values totaling \$255.5 million. The Company held investments in general obligation bonds in 21 states, including five states in which the aggregate fair value exceeded \$5.0 million. The Company held investments in revenue bonds in twelve states, including six states in which the aggregate fair value exceeded \$5.0 million.

The amortized cost and fair values of the Company's portfolio of general obligation bonds are summarized in the following tables by the issuer's state:

June 30, 2017:

| U.S. State: | Number of Issuers | Amortized Cost | Fair Value | Average Exposure Per Issuer (Fair Value) |
|--------------|-------------------------|-------------------|--------------|---|
| Iowa | 26 | \$31,131,484 | \$31,242,925 | \$1,201,651 |
| North Dakota | 7 | 21,619,812 | 21,514,855 | 3,073,551 |
| Illinois | 19 | 14,872,773 | 15,051,806 | 792,200 |
| Missouri | 16 | 9,078,540 | 9,123,733 | 570,233 |
| Ohio | 10 | 8,716,542 | 8,588,019 | 858,802 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | |
|--------------------------------|-----|---------------|---------------|-----------|
| Texas | 8 | 5,347,075 | 5,336,188 | 667,024 |
| Other | 38 | 16,886,554 | 16,997,159 | 447,294 |
| Total general obligation bonds | 124 | \$107,652,780 | \$107,854,685 | \$869,796 |

December 31, 2016:

| U.S. State: | Number of Issuers | Amortized Cost | Fair Value | Average Exposure Per Issuer (Fair Value) |
|--------------------------------|-------------------------|-------------------|---------------|---|
| Iowa | 27 | \$32,258,612 | \$32,231,936 | \$1,193,775 |
| Illinois | 19 | 29,214,559 | 29,308,438 | 1,542,549 |
| North Dakota | 7 | 22,169,050 | 21,499,075 | 3,071,296 |
| Missouri | 14 | 8,291,192 | 8,323,245 | 594,518 |
| Ohio | 8 | 6,790,398 | 6,651,897 | 831,487 |
| Other | 41 | 18,481,496 | 18,458,044 | 450,196 |
| Total general obligation bonds | 116 | \$117,205,307 | \$116,472,635 | \$1,004,074 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

The amortized cost and fair values of the Company's portfolio of revenue bonds are summarized in the following tables by the issuer's state:

June 30, 2017:

| U.S. State: | Number of Issuers | Amortized Cost | Fair Value | Average Exposure Per Issuer (Fair Value) |
|---------------------|-------------------------|-------------------|----------------|---|
| Missouri | 54 | \$ 107,360,504 | \$ 106,983,845 | \$ 1,981,182 |
| Iowa | 27 | 57,862,675 | 57,834,419 | 2,142,016 |
| Indiana | 21 | 50,114,290 | 49,578,767 | 2,360,894 |
| Ohio | 5 | 19,691,358 | 19,493,348 | 3,898,670 |
| Kansas | 6 | 13,178,963 | 13,179,104 | 2,196,517 |
| North Dakota | 5 | 11,729,782 | 11,676,766 | 2,335,353 |
| Other | 8 | 13,444,620 | 13,438,953 | 1,679,869 |
| Total revenue bonds | 126 | \$ 273,382,192 | \$ 272,185,202 | \$ 2,160,200 |

December 31, 2016:

| U.S. State: | Number of Issuers | Amortized Cost | Fair Value | Average Exposure Per Issuer |
|-------------|-------------------------|-------------------|------------|--------------------------------------|
|-------------|-------------------------|-------------------|------------|--------------------------------------|

(Fair
Value)

| | | | | |
|---------------------|-----|---------------|---------------|-------------|
| Missouri | 47 | \$90,784,441 | \$89,664,013 | \$1,907,745 |
| Iowa | 31 | 70,788,393 | 71,142,393 | 2,294,916 |
| Indiana | 22 | 47,994,737 | 47,582,138 | 2,162,824 |
| Kansas | 6 | 13,476,366 | 13,427,491 | 2,237,915 |
| North Dakota | 4 | 8,089,067 | 7,796,381 | 1,949,095 |
| Ohio | 3 | 13,650,000 | 13,405,222 | 4,468,407 |
| Other | 7 | 12,687,286 | 12,479,052 | 1,782,722 |
| Total revenue bonds | 120 | \$257,470,290 | \$255,496,690 | \$2,129,139 |

Both general obligation and revenue bonds are diversified across many issuers. As of June 30, 2017 and December 31, 2016, the Company did not hold general obligation or revenue bonds of any single issuer, the aggregate book or market value of which exceeded 5% of the Company's stockholders' equity. Of the general obligation and revenue bonds in the Company's portfolio, the majority are unrated bonds that represent small, private issuances. All unrated bonds were underwritten according to loan underwriting standards and have an average loan risk rating of 2, indicating very high quality. Additionally, many of these bonds are funding essential municipal services such as water, sewer, education, and medical facilities.

The Company's municipal securities are owned by each of the four charters, whose investment policies set forth limits for various subcategories within the municipal securities portfolio. Each charter is monitored individually, and as of June 30, 2017, all were well within policy limitations approved by the board of directors. Policy limits are calculated as a percentage of each charter's total risk-based capital.

As of June 30, 2017, the Company's standard monitoring of its municipal securities portfolio had not uncovered any facts or circumstances resulting in significantly different credit ratings than those assigned by a nationally recognized statistical rating organization, or in the case of unrated bonds, the rating assigned using the credit underwriting standards.

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, 2017 and December 31, 2016 is presented as follows:

| | As of June 30, 2017 | As of December 31, 2016 |
|---|------------------------|-------------------------------|
| C&I loans | \$942,538,419 | \$827,637,263 |
| CRE loans | | |
| Owner-occupied CRE | 317,225,055 | 332,387,621 |
| Commercial construction, land development, and other land | 179,316,027 | 165,149,491 |
| Other non owner-occupied CRE | 635,365,041 | 595,921,748 |
| | 1,131,906,123 | 1,093,458,860 |
| Direct financing leases * | 153,336,548 | 165,419,360 |
| Residential real estate loans ** | 233,870,678 | 229,233,104 |
| Installment and other consumer loans | 84,047,403 | 81,665,695 |
| | 2,545,699,171 | 2,397,414,282 |
| Plus deferred loan/lease origination costs, net of fees | 7,866,437 | 8,072,703 |
| | 2,553,565,608 | 2,405,486,985 |
| Less allowance | (33,356,632) | (30,757,448) |
| | \$2,520,208,976 | \$2,374,729,537 |
| | | |
| * Direct financing leases: | | |
| Net minimum lease payments to be received | \$170,143,561 | \$184,274,802 |
| Estimated unguaranteed residual values of leased assets | 1,085,154 | 1,085,154 |
| Unearned lease/residual income | (17,892,167) | (19,940,596) |
| | 153,336,548 | 165,419,360 |
| Plus deferred lease origination costs, net of fees | 5,216,015 | 5,881,778 |
| | 158,552,563 | 171,301,138 |
| Less allowance | (2,638,301) | (3,111,898) |
| | \$155,914,262 | \$168,189,240 |

*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, which is combined with 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, 2017 and 2016.

**Includes residential real estate loans held for sale totaling \$705,800 and \$1,135,500 as of June 30, 2017, and December 31, 2016, respectively.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Changes in accretable yield for acquired loans were as follows:

| | Three months ended June 30, 2017 | | | Six months ended June 30, 2017 | | |
|--|----------------------------------|---------------------|---------------|--------------------------------|---------------------|---------------|
| | PCI Loans | Performing Loans | Total | PCI Loans | Performing Loans | Total |
| Balance at the beginning of the period | \$(127,616) | \$(6,944,074) | \$(7,071,690) | \$(194,306) | \$(9,115,614) | \$(9,309,920) |
| Accretion recognized | 43,756 | 1,618,603 | 1,662,359 | 110,446 | 3,790,143 | 3,900,589 |
| Balance at the end of the period | \$(83,860) | \$(5,325,471) | \$(5,409,331) | \$(83,860) | \$(5,325,471) | \$(5,409,331) |

The aging of the loan/lease portfolio by classes of loans/leases as of June 30, 2017 and December 31, 2016 is presented as follows:

| Classes of Loans/Leases | As of June 30, 2017 | | | | | Total |
|--|---------------------|------------------------|------------------------|--|----------------------------|---------------|
| | Current | 30-59 Days Past Due | 60-89 Days Past Due | Accruing Past Due 90 Days or More | Nonaccrual Loans/Leases | |
| C&I CRE | \$937,716,988 | \$271,248 | \$430,367 | \$45,812 | \$4,074,004 | \$942,538,419 |
| Owner-Occupied CRE | 316,555,536 | 514,499 | - | - | 155,020 | 317,225,055 |
| Commercial Construction, Land Development, and Other Land | 174,851,763 | 117,247 | - | - | 4,347,017 | 179,316,027 |
| Other Non Owner-Occupied CRE | 632,539,426 | 1,503,560 | - | - | 1,322,055 | 635,365,041 |
| | 151,027,116 | 155,553 | 106,185 | - | 2,047,694 | 153,336,548 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | |
|--------------------------------|-----------------|-------------|-------------|-----------|--------------|-----------------|
| Direct Financing Leases | | | | | | |
| Residential Real Estate | 232,076,296 | 92,966 | 395,734 | 257,771 | 1,047,911 | 233,870,678 |
| Installment and Other Consumer | 83,377,699 | 253,751 | 71,882 | 120,363 | 223,708 | 84,047,403 |
| | \$2,528,144,824 | \$2,908,824 | \$1,004,168 | \$423,946 | \$13,217,409 | \$2,545,699,171 |

| | | | | | | | | | | | | |
|---|-------|---|------|---|------|---|------|---|------|---|--------|---|
| As a percentage of total loan/lease portfolio | 99.31 | % | 0.11 | % | 0.04 | % | 0.02 | % | 0.52 | % | 100.00 | % |
|---|-------|---|------|---|------|---|------|---|------|---|--------|---|

As of December 31, 2016

| Classes of Loans/Leases | Current | 30-59 Days Past Due | 60-89 Days Past Due | Accruing Past Due 90 Days or More | Nonaccrual Loans/Leases | Total |
|---|-----------------|---------------------|---------------------|-----------------------------------|-------------------------|-----------------|
| C&I CRE | \$821,637,507 | \$1,455,185 | \$10,551 | \$346,234 | \$4,187,786 | \$827,637,263 |
| Owner-Occupied CRE | 331,812,571 | - | 242,902 | - | 332,148 | 332,387,621 |
| Commercial Construction, Land Development, and Other Land | 160,760,034 | 35,638 | - | - | 4,353,819 | 165,149,491 |
| Other Non Owner-Occupied CRE | 594,384,926 | 100,673 | - | - | 1,436,149 | 595,921,748 |
| Direct Financing Leases | 161,452,627 | 730,627 | 574,700 | 215,225 | 2,446,181 | 165,419,360 |
| Residential Real Estate | 227,023,552 | 473,478 | 365,581 | 294,854 | 1,075,639 | 229,233,104 |
| Installment and Other Consumer | 81,199,766 | 204,973 | 63,111 | 110,501 | 87,344 | 81,665,695 |
| | \$2,378,270,983 | \$3,000,574 | \$1,256,845 | \$966,814 | \$13,919,066 | \$2,397,414,282 |

| | | | | | | | | | | | | |
|---|-------|---|------|---|------|---|------|---|------|---|--------|---|
| As a percentage of total loan/lease portfolio | 99.20 | % | 0.13 | % | 0.05 | % | 0.04 | % | 0.58 | % | 100.00 | % |
|---|-------|---|------|---|------|---|------|---|------|---|--------|---|

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NPLs by classes of loans/leases as of June 30, 2017 and December 31, 2016 are presented as follows:

| Classes of Loans/Leases | As of June 30, 2017 | | | Total NPLs | Percentage of | |
|---|-----------------------------------|---------------------------|---------------|--------------|---------------|---|
| | Accruing Past Due 90 Days or More | Nonaccrual Loans/Leases * | Accruing TDRs | | Total NPLs | % |
| C&I | \$45,812 | \$4,074,004 | \$4,858,983 | \$8,978,799 | 43.68 | % |
| CRE | | | | | | |
| Owner-Occupied CRE | - | 155,020 | - | 155,020 | 0.75 | % |
| Commercial Construction, Land Development, and Other Land | - | 4,347,017 | - | 4,347,017 | 21.15 | % |
| Other Non Owner-Occupied CRE | - | 1,322,055 | - | 1,322,055 | 6.43 | % |
| Direct Financing Leases | - | 2,047,694 | 1,689,086 | 3,736,780 | 18.18 | % |
| Residential Real Estate | 257,771 | 1,047,911 | 350,704 | 1,656,386 | 8.06 | % |
| Installment and Other Consumer | 120,363 | 223,708 | 16,400 | 360,471 | 1.75 | % |
| | \$423,946 | \$13,217,409 | \$6,915,173 | \$20,556,528 | 100.00 | % |

*Nonaccrual loans/leases included \$2,167,863 of TDRs, including \$268,629 in C&I loans, \$1,148,818 in CRE loans, \$519,178 in direct financing leases, \$179,881 in construction loans, \$41,465 in residential real estate loans, and \$9,892 in installment loans.

| Classes of Loans/Leases | As of December 31, 2016 | | | Total NPLs | Percentage of | |
|-------------------------|------------------------------|----------------------------|---------------|------------|---------------|---|
| | Accruing Past Due 90 Days or | Nonaccrual Loans/Leases ** | Accruing TDRs | | Total NPLs | % |
| | | | | | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

More

| | | | | | | |
|--|-----------|--------------|-------------|--------------|--------|---|
| C&I CRE | \$346,234 | \$4,187,786 | \$4,733,997 | 9,268,017 | 43.65 | % |
| Owner-Occupied CRE | - | 332,148 | - | 332,148 | 1.56 | % |
| Commercial Construction, Land Development, and Other Land | - | 4,353,819 | - | 4,353,819 | 20.51 | % |
| Other Non Owner-Occupied CRE | - | 1,436,149 | - | 1,436,149 | 6.77 | % |
| Direct Financing Leases | 215,225 | 2,446,181 | 1,008,244 | 3,669,650 | 17.28 | % |
| Residential Real Estate | 294,854 | 1,075,639 | 585,541 | 1,956,034 | 9.21 | % |
| Installment and Other Consumer | 110,501 | 87,344 | 18,746 | 216,591 | 1.02 | % |
| | \$966,814 | \$13,919,066 | \$6,346,528 | \$21,232,408 | 100.00 | % |

**Nonaccrual loans/leases included \$2,300,479 of TDRs, including \$48,501 in C&I loans, \$1,380,047 in CRE loans, \$816,149 in direct financing leases, \$43,579 in residential real estate loans, and \$12,203 in installment loans.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Changes in the allowance by portfolio segment for the three and six months ended June 30, 2017 and 2016, respectively, are presented as follows:

| | Three Months Ended June 30, 2017 | | | | | |
|---|----------------------------------|---------------|-------------------------------|----------------------------|--------------------------------------|---------------|
| | C&I | CRE | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
| Balance, beginning | \$ 12,954,090 | \$ 12,643,266 | \$ 2,978,260 | \$ 2,375,864 | \$ 1,107,670 | \$ 32,059,150 |
| Provisions (credits) charged to expense | 1,281,786 | 339,857 | 297,672 | 116,151 | (12,473) | 2,022,993 |
| Loans/leases charged off | (74,071) | (10,375) | (684,079) | (61,561) | (21,518) | (851,604) |
| Recoveries on loans/leases previously charged off | 45,928 | 26,485 | 46,448 | - | 7,232 | 126,093 |
| Balance, ending | \$ 14,207,733 | \$ 12,999,233 | \$ 2,638,301 | \$ 2,430,454 | \$ 1,080,911 | \$ 33,356,632 |
| | Three Months Ended June 30, 2016 | | | | | |
| | C&I | CRE | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
| Balance, beginning | \$ 10,991,979 | \$ 10,090,567 | \$ 3,287,231 | \$ 1,836,622 | \$ 1,189,043 | \$ 27,395,442 |
| Provisions (credits) charged to expense | (241,600) | 919,596 | 460,997 | 194,988 | (136,131) | 1,197,850 |
| Loans/leases charged off | (48,983) | (23,101) | (534,716) | (17,523) | (9,892) | (634,215) |
| Recoveries on loans/leases previously charged off | 23,110 | - | 12,682 | 900 | 101,721 | 138,413 |
| Balance, ending | \$ 10,724,506 | \$ 10,987,062 | \$ 3,226,194 | \$ 2,014,987 | \$ 1,144,741 | \$ 28,097,490 |

Six Months Ended June 30, 2017

Total

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | |
|--|---------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|---------------|
| Balance, beginning | \$ 12,545,110 | \$ 11,670,609 | \$ 3,111,898 | \$ 2,342,344 | \$ 1,087,487 | \$ 30,757,448 |
| Provisions (credits) charged to expense | 1,875,144 | 1,306,128 | 802,687 | 159,671 | (15,528) | 4,128,102 |
| Loans/leases charged off | (292,344) | (10,375) | (1,342,763) | (75,184) | (23,564) | (1,744,230) |
| Recoveries on loans/leases previously charged off | 79,823 | 32,871 | 66,479 | 3,623 | 32,516 | 215,312 |
| Balance, ending | \$ 14,207,733 | \$ 12,999,233 | \$ 2,638,301 | \$ 2,430,454 | \$ 1,080,911 | \$ 33,356,632 |

Six Months Ended June 30, 2016

| | Commercial and Industrial | Commercial Real Estate | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total |
|--|---------------------------------|---------------------------|-------------------------------|----------------------------|--------------------------------------|---------------|
| Balance, beginning | \$ 10,484,080 | \$ 9,375,117 | \$ 3,395,088 | \$ 1,790,150 | \$ 1,096,471 | \$ 26,140,906 |
| Provisions (credits) charged to expense | 498,231 | 1,635,046 | 939,242 | 257,644 | (59,328) | 3,270,835 |
| Loans/leases charged off | (292,549) | (23,101) | (1,135,654) | (33,707) | (17,488) | (1,502,499) |
| Recoveries on loans/leases previously charged off | 34,744 | - | 27,518 | 900 | 125,086 | 188,248 |
| Balance, ending | \$ 10,724,506 | \$ 10,987,062 | \$ 3,226,194 | \$ 2,014,987 | \$ 1,144,741 | \$ 28,097,490 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

The allowance by impairment evaluation and by portfolio segment as of June 30, 2017 and December 31, 2016 is presented as follows:

| | As of June 30, 2017 | | | | | | |
|---|---------------------|------------------|-------------------------------|----------------------------|--------------------------------------|------------------|---|
| | C&I | CRE | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total | |
| Allowance for impaired loans/leases | \$ 1,580,113 | \$ 938,450 | \$ 550,575 | \$ 266,217 | \$ 20,365 | \$ 3,355,720 | |
| Allowance for nonimpaired loans/leases | 12,627,620 | 12,060,783 | 2,087,726 | 2,164,237 | 1,060,546 | 30,000,912 | |
| | \$ 14,207,733 | \$ 12,999,233 | \$ 2,638,301 | \$ 2,430,454 | \$ 1,080,911 | \$ 33,356,632 | |
| Impaired loans/leases | \$ 8,985,913 | \$ 5,727,375 | \$ 3,553,173 | \$ 1,398,615 | \$ 240,107 | \$ 19,905,183 | |
| Nonimpaired loans/leases | 933,552,506 | 1,126,178,748 | 149,783,375 | 232,472,063 | 83,807,296 | 2,525,793,988 | |
| | \$ 942,538,419 | \$ 1,131,906,123 | \$ 153,336,548 | \$ 233,870,678 | \$ 84,047,403 | \$ 2,545,699,171 | |
| Allowance as a percentage of impaired loans/leases | 17.58 | % 16.39 | % 15.50 | % 19.03 | % 8.48 | % 16.86 | % |
| Allowance as a percentage of nonimpaired loans/leases | 1.35 | % 1.07 | % 1.39 | % 0.93 | % 1.27 | % 1.19 | % |
| Total allowance as | 1.51 | % 1.15 | % 1.72 | % 1.04 | % 1.29 | % 1.31 | % |

a percentage
of total
loans/leases

| | As of December 31, 2016 | | | | | | |
|--|-------------------------|------------------|-------------------------------|----------------------------|--------------------------------------|------------------|---|
| | C&I | CRE | Direct Financing Leases | Residential Real Estate | Installment and Other Consumer | Total | |
| Allowance for impaired loans/leases | \$ 1,771,537 | \$ 693,919 | \$ 848,919 | \$ 289,112 | \$ 39,481 | \$ 3,642,968 | |
| Allowance for nonimpaired loans/leases | 10,773,573 | 10,976,690 | 2,262,979 | 2,053,232 | 1,048,006 | 27,114,480 | |
| | \$ 12,545,110 | \$ 11,670,609 | \$ 3,111,898 | \$ 2,342,344 | \$ 1,087,487 | \$ 30,757,448 | |
| Impaired loans/leases | \$ 8,936,451 | \$ 6,112,114 | \$ 3,256,264 | \$ 1,661,180 | \$ 106,090 | \$ 20,072,099 | |
| Nonimpaired loans/leases | 818,700,812 | 1,087,346,746 | 162,163,096 | 227,571,924 | 81,559,605 | 2,377,342,183 | |
| | \$ 827,637,263 | \$ 1,093,458,860 | \$ 165,419,360 | \$ 229,233,104 | \$ 81,665,695 | \$ 2,397,414,282 | |
| Allowance as a percentage of impaired loans/leases | 19.82 | % 11.35 | % 26.07 | % 17.40 | % 37.21 | % 18.15 | % |
| Allowance as a percentage of nonimpaired loans/leases | 1.32 | % 1.01 | % 1.40 | % 0.90 | % 1.28 | % 1.14 | % |
| Total allowance as a percentage of total loans/leases | 1.52 | % 1.07 | % 1.88 | % 1.02 | % 1.33 | % 1.28 | % |

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, 2017 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: | | | | | | |
| C&I | \$993,551 | \$1,003,988 | \$- | \$802,367 | \$ 16,751 | \$ 16,751 |
| CRE | | | | | | |
| Owner-Occupied CRE | - | - | - | - | - | - |
| Commercial Construction, Land Development, and Other Land | - | - | - | - | - | - |
| Other Non Owner-Occupied CRE | 1,148,818 | 1,148,818 | - | 1,171,229 | - | - |
| Direct Financing Leases | 2,739,319 | 2,739,319 | - | 2,557,608 | 57,844 | 57,844 |
| Residential Real Estate | 710,118 | 784,896 | - | 628,555 | 1,161 | 1,161 |
| Installment and Other Consumer | 189,018 | 189,019 | - | 144,838 | 218 | 218 |
| | \$5,780,824 | \$5,866,040 | \$- | \$5,304,597 | \$ 75,974 | \$ 75,974 |
| Impaired Loans/Leases with Specific Allowance Recorded: | | | | | | |
| C&I | \$7,992,362 | \$7,996,201 | \$1,580,113 | \$7,930,142 | \$ 97,721 | \$ 97,721 |
| CRE | | | | | | |
| Owner-Occupied CRE | 155,020 | 155,020 | 111,520 | 266,439 | - | - |
| | 4,347,017 | 4,347,017 | 820,811 | 4,350,034 | - | - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | |
|--|--------------|---------------|-------------|--------------|-----------|-----------|
| Commercial Construction, Land Development, and Other Land Other Non Owner-Occupied CRE | 76,519 | 76,519 | 6,119 | 25,506 | - | - |
| Direct Financing Leases | 813,854 | 813,854 | 550,575 | 739,561 | - | - |
| Residential Real Estate | 688,497 | 688,497 | 266,217 | 604,450 | 7,229 | 7,229 |
| Installment and Other Consumer | 51,090 | 51,090 | 20,365 | 29,137 | - | - |
| | \$14,124,359 | \$14,128,198 | \$3,355,720 | \$13,945,269 | \$104,950 | \$104,950 |
| Total Impaired Loans/Leases: | | | | | | |
| C&I | \$8,985,913 | \$9,000,189 | \$1,580,113 | \$8,732,509 | \$114,472 | \$114,472 |
| CRE | | | | | | |
| Owner-Occupied CRE | 155,020 | 155,020 | 111,520 | 266,439 | - | - |
| Commercial Construction, Land Development, and Other Land | 4,347,017 | 4,347,017 | 820,811 | 4,350,033 | - | - |
| Other Non Owner-Occupied CRE | 1,225,337 | 1,225,337 | 6,119 | 1,196,735 | - | - |
| Direct Financing Leases | 3,553,173 | 3,553,173 | 550,575 | 3,297,169 | 57,844 | 57,844 |
| Residential Real Estate | 1,398,615 | 1,473,393 | 266,217 | 1,233,005 | 8,390 | 8,390 |
| Installment and Other Consumer | 240,108 | 240,109 | 20,365 | 173,975 | 218 | 218 |
| | \$19,905,183 | \$19,994,2388 | \$3,355,720 | \$19,249,865 | \$180,924 | \$180,924 |

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, 2017 and 2016, respectively, are presented as follows:

| Classes of Loans/Leases | Three Months Ended June 30, 2017 | | | Three Months Ended June 30, 2016 | | |
|--|----------------------------------|----------------------------|---|----------------------------------|----------------------------|---|
| | 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: | | | | | | |
| C&I | \$ 805,309 | \$ 9,399 | \$ 9,399 | \$ 2,524,056 | \$ 3,519 | \$ 3,519 |
| CRE | | | | | | |
| Owner-Occupied CRE | - | - | - | 121,444 | - | - |
| Commercial Construction, Land Development, and Other Land | - | - | - | - | - | - |
| Other Non Owner-Occupied CRE | 1,160,161 | - | - | 1,311,540 | - | - |
| Direct Financing Leases | 2,560,019 | 38,949 | 38,949 | 1,510,987 | 19,897 | 19,897 |
| Residential Real Estate | 712,793 | - | - | 621,354 | 1,013 | 1,013 |
| Installment and Other Consumer | 173,585 | 218 | 218 | 229,207 | - | - |
| | \$ 5,411,867 | \$ 48,566 | \$ 48,566 | \$ 6,318,588 | \$ 24,429 | \$ 24,429 |
| Impaired Loans/Leases with Specific Allowance Recorded: | | | | | | |
| C&I | \$ 8,066,702 | \$ 35,055 | \$ 35,055 | \$ 2,292,483 | \$ - | \$ - |
| CRE | | | | | | |
| Owner-Occupied CRE | 238,584 | - | - | - | - | - |
| Commercial Construction, Land Development, and Other Land | 4,348,142 | - | - | 190,174 | - | - |
| Other Non Owner-Occupied CRE | 38,260 | - | - | 658,220 | - | - |
| Direct Financing Leases | 757,602 | - | - | 995,446 | - | - |
| Residential Real Estate | 624,641 | 2,989 | 2,989 | 919,271 | 1,948 | 1,948 |
| Installment and Other Consumer | 34,333 | - | - | 218,742 | 1,468 | 1,468 |
| | \$ 14,108,264 | \$ 38,044 | \$ 38,044 | \$ 5,274,336 | \$ 3,416 | \$ 3,416 |
| Total Impaired Loans/Leases: | | | | | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | |
|--|--------------|-----------|-----------|--------------|-----------|-----------|
| C&I | \$8,872,011 | \$ 44,454 | \$ 44,454 | \$4,816,539 | \$ 3,519 | \$ 3,519 |
| CRE | | | | | | |
| Owner-Occupied CRE | 238,584 | - | - | 121,444 | - | - |
| Commercial Construction, Land Development, and Other Land | 4,348,142 | - | - | 190,174 | - | - |
| Other Non Owner-Occupied CRE | 1,198,421 | - | - | 1,969,760 | - | - |
| Direct Financing Leases | 3,317,621 | 38,949 | 38,949 | 2,506,433 | 19,897 | 19,897 |
| Residential Real Estate | 1,337,434 | 2,989 | 2,989 | 1,540,625 | 2,961 | 2,961 |
| Installment and Other Consumer | 207,918 | 218 | 218 | 447,949 | 1,468 | 1,468 |
| | \$19,520,131 | \$ 86,610 | \$ 86,610 | \$11,592,924 | \$ 27,845 | \$ 27,845 |

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, 2016 are presented as follows:

| Classes of Loans/Leases | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|--|------------------------|--------------------------------|----------------------|
| Impaired Loans/Leases with No Specific Allowance Recorded: | | | |
| C&I | \$841,895 | \$951,600 | \$- |
| CRE | | | |
| Owner-Occupied CRE | - | 93,774 | - |
| Commercial Construction, Land Development, and Other Land | - | - | - |
| Other Non Owner-Occupied CRE | 1,196,549 | 1,196,549 | - |
| Direct Financing Leases | 1,690,121 | 1,690,121 | - |
| Residential Real Estate | 853,294 | 892,495 | - |
| Installment and Other Consumer | 55,734 | 55,734 | - |
| | \$4,637,593 | \$4,880,273 | \$- |
| Impaired Loans/Leases with Specific Allowance Recorded: | | | |
| C&I | \$8,094,556 | \$8,098,395 | \$1,771,537 |
| CRE | | | |
| Owner-Occupied CRE | 322,148 | 322,148 | 57,398 |
| Commercial Construction, Land Development, and Other Land | 4,353,819 | 4,353,817 | 577,611 |
| Other Non Owner-Occupied CRE | 239,600 | 239,600 | 58,910 |
| Direct Financing Leases | 1,566,141 | 1,566,143 | 848,919 |
| Residential Real Estate | 807,886 | 882,018 | 289,112 |
| Installment and Other Consumer | 50,356 | 50,356 | 39,481 |
| | \$15,434,506 | \$15,512,477 | \$3,642,968 |
| Total Impaired Loans/Leases: | | | |
| C&I | \$8,936,451 | \$9,049,995 | \$1,771,537 |
| CRE | | | |
| Owner-Occupied CRE | 322,148 | 415,922 | 57,398 |
| Commercial Construction, Land Development, and Other Land | 4,353,819 | 4,353,817 | 577,611 |
| Other Non Owner-Occupied CRE | 1,436,149 | 1,436,149 | 58,910 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | |
|--------------------------------|--------------|--------------|-------------|
| Direct Financing Leases | 3,256,262 | 3,256,264 | 848,919 |
| Residential Real Estate | 1,661,180 | 1,774,513 | 289,112 |
| Installment and Other Consumer | 106,090 | 106,090 | 39,481 |
| | \$20,072,099 | \$20,392,750 | \$3,642,968 |

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 C&I and CRE loans, the Company's credit quality indicator consists of 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, 2017 and December 31, 2016:

| Internally Assigned Risk Rating | As of June 30, 2017 | | | | | As a % of Total |
|---------------------------------|---------------------|--------------------|--|---------------|-----------------|-----------------|
| | C&I | Owner-Occupied CRE | Non Owner-Occupied Commercial Construction, Land Development, and Other Land | Other CRE | Total | |
| Pass (Ratings 1 through 5) | \$904,511,211 | \$301,874,401 | \$172,442,816 | \$622,588,629 | \$2,001,417,057 | 96.48 % |
| Special Mention (Rating 6) | 10,814,298 | 10,448,915 | 1,780,000 | 4,693,909 | 27,737,122 | 1.34 % |
| Substandard (Rating 7) | 27,212,910 | 4,901,739 | 5,093,211 | 8,082,503 | 45,290,363 | 2.18 % |
| Doubtful (Rating 8) | - | - | - | - | - | 0.00 % |
| | \$942,538,419 | \$317,225,055 | \$179,316,027 | \$635,365,041 | \$2,074,444,542 | 100.00 % |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

As of June 30, 2017

| Delinquency Status * | Direct | Residential | Installment | Total | As a % of Total |
|----------------------|---------------------|----------------|--------------------------|----------------|-----------------------|
| | Financing Leases | Real Estate | and Other Consumer | | |
| Performing | \$ 149,599,768 | \$ 232,214,292 | \$ 83,686,932 | \$ 465,500,992 | 98.78 % |
| Nonperforming | 3,736,780 | 1,656,386 | 360,471 | 5,753,637 | 1.22 % |
| | \$ 153,336,548 | \$ 233,870,678 | \$ 84,047,403 | \$ 471,254,629 | 100.00 % |

As of December 31, 2016

| Internally Assigned Risk Rating | CRE | | | | Total | As a % of Total |
|------------------------------------|----------------|-----------------------|---|--|------------------|-----------------------|
| | C&I | Owner-Occupied CRE | Land Development, and Other Land | Non Owner-Occupied Commercial Construction, Other CRE | | |
| Pass (Ratings 1 through 5) | \$ 796,568,451 | \$ 314,447,662 | \$ 158,108,465 | \$ 582,854,048 | \$ 1,851,978,626 | 96.40 % |
| Special Mention (Rating 6) | 6,305,772 | 7,559,380 | 1,780,000 | 4,437,122 | 20,082,274 | 1.05 % |
| Substandard (Rating 7) | 24,763,040 | 10,380,369 | 5,261,026 | 8,630,578 | 49,035,013 | 2.55 % |
| Doubtful (Rating 8) | - | 210 | - | - | 210 | 0.00 % |
| | \$ 827,637,263 | \$ 332,387,621 | \$ 165,149,491 | \$ 595,921,748 | \$ 1,921,096,123 | 100.00 % |

As of December 31, 2016

| Delinquency Status * | Direct | Residential | Installment | Total | As a % of Total |
|----------------------|---------------------|----------------|-----------------------|----------------|-----------------------|
| | Financing Leases | Real Estate | and Other Consumer | | |
| Performing | \$ 161,749,710 | \$ 227,277,070 | \$ 81,449,104 | \$ 470,475,884 | 98.77 % |
| Nonperforming | 3,669,650 | 1,956,034 | 216,591 | 5,842,275 | 1.23 % |
| | \$ 165,419,360 | \$ 229,233,104 | \$ 81,665,695 | \$ 476,318,159 | 100.00 % |

*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 TDRs.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

As of June 30, 2017 and December 31, 2016, TDRs totaled \$9,083,036 and \$8,647,007, respectively.

For each class of financing receivable, the following presents the number and recorded investment of TDRs, by type of concession, that were restructured during the three and six months ended June 30, 2017 and 2016. 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, 2017 | | | | For the three months ended June 30, 2016 | | | |
|---|---|---------------------------------------|--------------------|-------------|---|---------------------------------------|---------------------|-------------|
| | Number of Pre-Modification Recorded Investment / Leases | Post-Modification Recorded Investment | Specific Allowance | | Number of Pre-Modification Recorded Investment / Leases | Post-Modification Recorded Investment | Specific Allowance | |
| CONCESSION - Extension of Maturity | | | | | | | | |
| C&I | - | - | - | - | 1 | \$ 52,286 | \$ 52,286 | \$ - |
| Direct Financing Leases | 1 | \$ 98,119 | \$ 98,119 | \$ - | - | \$ - | \$ - | \$ - |
| | 1 | \$ 98,119 | \$ 98,119 | \$ - | 1 | \$ 52,286 | \$ 52,286 | \$ - |
| CONCESSION - Significant Payment Delay | | | | | | | | |
| C&I | 1 | \$ 47,509 | \$ 47,509 | \$ - | 1 | \$ 62,140 | \$ 62,140 | \$ - |
| Direct Financing Leases | 15 | 802,542 | 802,542 | - | 4 | 494,692 | 494,692 | - |
| | 16 | \$ 850,051 | \$ 850,051 | \$ - | 5 | \$ 556,832 | \$ 556,832 | \$ - |
| CONCESSION - Significant Payment Delay | | | | | | | | |
| C&I | - | \$ - | \$ - | \$ - | 1 | \$ 1,233,740 | \$ 1,233,740 | \$ - |
| | - | \$ - | \$ - | \$ - | 1 | \$ 1,233,740 | \$ 1,233,740 | \$ - |
| TOTAL | 17 | \$ 948,170 | \$ 948,170 | \$ - | 7 | \$ 1,842,858 | \$ 1,842,858 | \$ - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| Classes of Loans/Leases | For the six months ended June 30, 2017 | | | | For the six months ended June 30, 2016 | | | | |
|---|--|---------------------------------------|--------------------|--|--|--------------------|--|---------------------------------------|--------------------|
| | Number of Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Specific Allowance | Number of Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Specific Allowance | Number of Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Specific Allowance |
| CONCESSION - Extension of Maturity | | | | | | | | | |
| C&I | - | \$- | \$- | \$- | 1 | \$52,286 | \$52,286 | \$- | \$- |
| Direct Financing Leases | 2 | 104,382 | 104,382 | - | 4 | 410,653 | 410,653 | - | - |
| | 2 | \$104,382 | \$104,382 | \$- | 5 | \$462,939 | \$462,939 | \$- | \$- |
| CONCESSION - Significant Payment Delay | | | | | | | | | |
| C&I | 3 | \$181,198 | \$181,198 | \$- | 1 | \$62,140 | \$62,140 | \$- | \$- |
| Direct Financing Leases | 23 | 1,472,403 | 1,472,403 | - | 5 | 540,631 | 540,631 | - | - |
| | 26 | \$1,653,601 | \$1,653,601 | \$- | 6 | \$602,771 | \$602,771 | \$- | \$- |
| CONCESSION - Interest Rate Adjusted Below Market | | | | | | | | | |
| CRE - Other | - | \$- | \$- | \$- | 1 | \$1,233,740 | \$1,233,740 | \$- | \$- |
| | - | \$- | \$- | \$- | 1 | 1,233,740 | 1,233,740 | - | - |
| TOTAL | 28 | \$1,757,983 | \$1,757,983 | \$- | 12 | \$2,299,450 | \$2,299,450 | \$- | \$- |

Of the TDRs reported above, none were on nonaccrual as of June 30, 2017. One with a post-modification recorded balance of \$1,233,740 was on nonaccrual as of June 30, 2016.

For the three and six months ended June 30, 2017, two of the Company's TDRs redefaulted within 12 months subsequent to restructure where default is defined as delinquency of 90 days or more and/or placement on nonaccrual status. These two TDRs were related to the same customer and were restructured in the fourth quarter of 2016 with pre-modification balances totaling \$195 thousand.

For the three and six months ended June 30, 2016, none of the Company's TDRs had redefaulted within 12 months subsequent to restructure.

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 EPS on a basic and diluted basis:

| | Three months ended | | Six months ended | |
|---|--------------------|-------------|------------------|--------------|
| | June 30, 2017 | 2016 | June 30, 2017 | 2016 |
| Net income | \$8,766,017 | \$6,676,467 | \$17,950,982 | \$13,049,956 |
| Basic EPS | \$0.67 | \$0.54 | \$1.36 | \$1.08 |
| Diluted EPS | \$0.65 | \$0.53 | \$1.33 | \$1.07 |
| Weighted average common shares outstanding | 13,170,283 | 12,335,077 | 13,151,833 | 12,064,349 |
| Weighted average common shares issuable upon exercise of stock options and under the employee stock purchase plan | 346,309 | 181,397 | 350,672 | 170,863 |
| Weighted average common and common equivalent shares outstanding | 13,516,592 | 12,516,474 | 13,502,505 | 12,235,212 |

The increase in weighted average common shares outstanding from June 30, 2016 to June 30, 2017 was primarily due to the common stock issuance discussed in Note 2 of the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

NOTE 5 – 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.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

Assets and liabilities measured at fair value on a recurring basis comprise the following at June 30, 2017 and December 31, 2016:

| | Fair Value | 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) |
| <u>June 30, 2017:</u> | | | | |
| Securities AFS: | | | | |
| U.S. govt. sponsored agency securities | \$41,944,464 | \$- | \$41,944,464 | \$ - |
| Residential mortgage-backed and related securities | 164,414,833 | - | 164,414,833 | - |
| Municipal securities | 58,100,510 | - | 58,100,510 | - |
| Other securities | 4,821,906 | 1,050 | 4,820,856 | - |
| Interest rate caps | 398,973 | - | 398,973 | - |
| Interest rate swaps - assets | 2,547,466 | - | 2,547,466 | - |
| Total assets measured at fair value | \$272,228,152 | \$1,050 | \$272,227,102 | \$ - |
| Interest rate swaps - liabilities | \$2,547,466 | \$- | \$2,547,466 | \$ - |
| Total liabilities measured at fair value | \$2,547,466 | \$- | \$2,547,466 | \$ - |
| <u>December 31, 2016:</u> | | | | |
| Securities AFS: | | | | |
| U.S. govt. sponsored agency securities | \$46,083,607 | \$- | \$46,083,607 | \$ - |
| Residential mortgage-backed and related securities | 147,702,127 | - | 147,702,127 | - |
| Municipal securities | 52,604,426 | - | 52,604,426 | - |
| Other securities | 4,722,979 | 1,361 | 4,721,618 | - |
| Interest rate caps | 576,527 | - | 576,527 | - |
| Interest rate swaps - assets | 2,338,281 | - | 2,338,281 | - |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | |
|--|---------------|---------|---------------|----|---|
| Total assets measured at fair value | \$254,027,947 | \$1,361 | \$254,026,586 | \$ | - |
| Interest rate swaps - liabilities | \$2,338,281 | \$- | \$2,338,281 | \$ | - |
| Total liabilities measured at fair value | \$2,338,281 | \$- | \$2,338,281 | \$ | - |

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, 2017 or 2016.

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).

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

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).

Interest rate caps are used for the purpose of hedging interest rate risk. The fair values are determined by pricing models that consider observable market data for derivative instruments with similar structures (Level 2 inputs).

Interest rate swaps are executed for select commercial customers. The interest rate swaps are further described in Note 1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2016. The fair values are determined by comparing the contract rate on the swap with the then-current market rate for the remaining term of the transaction (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, 2017 and December 31, 2016:

| | Fair Value | Fair Value Measurements at Reporting Date Using | | |
|-----------------------|--------------|---|---------|--------------|
| | | Level 1 | Level 2 | Level 3 |
| <u>June 30, 2017:</u> | | | | |
| Impaired loans/leases | \$11,760,878 | \$- | \$- | \$11,760,878 |
| OREO | 5,587,403 | - | - | 5,587,403 |
| | \$17,348,281 | \$- | \$- | \$17,348,281 |

December 31, 2016:

| | | | | |
|-----------------------|--------------|-----|-----|--------------|
| Impaired loans/leases | \$12,823,121 | \$- | \$- | \$12,823,121 |
| OREO | 5,964,952 | - | - | 5,964,952 |
| | \$18,788,073 | \$- | \$- | \$18,788,073 |

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 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 client and client's business.

OREO 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 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.

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

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 June 30, 2017 | Fair Value December 31, 2016 | Valuation Technique | Unobservable Input | Range |
|-----------------------|---|---|----------------------------|---------------------------|--------------------|
| Impaired loans/leases | \$11,760,878 | \$12,823,121 | Appraisal of collateral | Appraisal adjustments | -10.00% to -50.00% |
| OREO | 5,587,403 | 5,964,952 | Appraisal of collateral | Appraisal adjustments | 0.00% to -35.00% |

For the impaired loans/leases and OREO, 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, 2017 and 2016.

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, 2017 | | As of December 31, 2016 | |
|---|---|----------------------------|---------------------------------|--------------------------------|---------------------------------|
| | | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Cash and due from banks | Level 1 | \$77,161,353 | \$77,161,353 | \$70,569,993 | \$70,569,993 |
| Federal funds sold | Level 2 | 19,183,000 | 19,183,000 | 22,257,000 | 22,257,000 |
| Interest-bearing deposits at financial institutions | Level 2 | 53,171,325 | 53,171,325 | 63,948,925 | 63,948,925 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | |
|-----------------------------------|--------------------|---------------|---------------|---------------|---------------|
| Investment securities: | | | | | |
| HTM | Level 2 | 324,203,634 | 322,989,377 | 322,909,056 | 320,414,899 |
| AFS | See Previous Table | 269,281,713 | 269,281,713 | 251,113,139 | 251,113,139 |
| Loans/leases receivable, net | Level 3 | 10,889,702 | 11,760,878 | 11,873,260 | 12,823,121 |
| Loans/leases receivable, net | Level 2 | 2,509,319,274 | 2,491,370,000 | 2,362,856,277 | 2,344,462,740 |
| Interest rate caps | Level 2 | 398,973 | 398,973 | 576,527 | 576,527 |
| Interest rate swaps - assets | Level 2 | 2,547,466 | 2,547,466 | 2,338,281 | 2,338,281 |
| Deposits: | | | | | |
| Nonmaturity deposits | Level 2 | 2,311,779,642 | 2,311,779,642 | 2,188,683,349 | 2,188,683,349 |
| Time deposits | Level 2 | 558,454,597 | 557,833,000 | 480,577,924 | 479,605,000 |
| Short-term borrowings | Level 2 | 18,217,393 | 18,217,393 | 39,971,387 | 39,971,387 |
| FHLB advances | Level 2 | 106,500,000 | 107,071,000 | 137,500,000 | 138,338,000 |
| Other borrowings | Level 2 | 72,000,000 | 73,041,000 | 80,000,000 | 81,282,000 |
| Junior subordinated debentures | Level 2 | 33,546,425 | 25,169,023 | 33,480,202 | 24,881,494 |
| Interest rate swaps - liabilities | Level 2 | 2,547,466 | 2,547,466 | 2,338,281 | 2,338,281 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 6 – 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 comprised of the four subsidiary banks wholly owned by the Company: QCBT, CRBT, CSB and RB&T. Each of these secondary segments offers similar products and services, but is managed separately due to different pricing, product demand, and consumer markets. Each offers commercial, consumer, and mortgage loans and deposit services.

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

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 as of and for the three and six months ended June 30, 2017 and 2016.

Commercial Banking

Wealth

Intercompany Co

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | QCBT | CRBT | CSB | RB&T | Management | All Other | Eliminations | Total |
|---|------------------|----------------|----------------|----------------|--------------|----------------|-----------------|------------------|
| Three Months Ended June 30, 2017 | | | | | | | | |
| Total revenue | \$ 14,210,040 | \$ 10,149,769 | \$ 8,171,307 | \$ 4,241,431 | \$ 2,560,836 | \$ 10,181,814 | \$(10,279,411) | \$ 39,033,766 |
| Net interest income | \$ 11,414,818 | \$ 7,230,425 | \$ 6,920,820 | \$ 3,095,512 | \$ - | \$(614,878) | \$ - | \$ 28,656,697 |
| Provision for loan/lease losses | \$ 552,993 | \$ 300,000 | \$ 861,000 | \$ 309,000 | \$ - | \$ - | \$ - | \$ 2,022,993 |
| Net income | \$ 4,073,777 | \$ 2,870,582 | \$ 1,920,040 | \$ 834,842 | \$ 454,465 | \$ 8,766,014 | \$(10,153,703) | \$ 8,933,915 |
| Goodwill | \$ 3,222,688 | \$ - | \$ 9,888,225 | \$ - | \$ - | \$ - | \$ - | \$ 13,110,913 |
| Core deposit intangible | \$ - | \$ 1,172,141 | \$ 5,747,339 | \$ - | \$ - | \$ - | \$ - | \$ 6,919,480 |
| Total assets | \$ 1,400,307,827 | \$ 993,768,912 | \$ 642,761,140 | \$ 426,159,677 | \$ - | \$ 382,407,292 | \$(388,218,153) | \$ 3,464,355,795 |
| Three Months Ended June 30, 2016 | | | | | | | | |
| Total revenue | \$ 14,162,914 | \$ 10,438,092 | \$ - | \$ 3,918,629 | \$ 2,204,821 | \$ 8,244,495 | \$(8,293,266) | \$ 30,430,685 |
| Net interest income | \$ 11,207,759 | \$ 7,135,725 | \$ - | \$ 2,945,417 | \$ - | \$(280,088) | \$ - | \$ 21,008,813 |
| Provision for loan/lease losses | \$ 747,850 | \$ 150,000 | \$ - | \$ 300,000 | \$ - | \$ - | \$ - | \$ 1,197,850 |
| Net income | \$ 3,898,343 | \$ 3,144,986 | \$ - | \$ 772,169 | \$ 386,202 | \$ 6,676,467 | \$(8,201,700) | \$ 6,872,467 |
| Goodwill | \$ 3,222,688 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 3,222,688 |
| Core deposit intangible | \$ - | \$ 1,371,653 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 1,371,653 |
| Total assets | \$ 1,390,025,232 | \$ 904,367,275 | \$ - | \$ 402,157,473 | \$ - | \$ 328,099,700 | \$(341,215,392) | \$ 2,763,374,388 |
| Six Months Ended June 30, | | | | | | | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

2017

| | | | | | | | | |
|---------------------------------|-----------------|---------------|---------------|---------------|-------------|---------------|-----------------|-----------------|
| Total revenue | \$27,745,981 | \$20,536,314 | \$16,303,013 | \$8,189,230 | \$5,262,642 | \$20,057,957 | \$(20,230,498) | \$77,000,000 |
| Net interest income | \$22,716,300 | \$14,204,472 | \$13,947,328 | \$6,063,586 | \$- | \$(1,216,106) | \$- | \$55,000,000 |
| Provision for loan/lease losses | \$1,484,102 | \$550,000 | \$1,635,000 | \$459,000 | \$- | \$- | \$- | \$4,000,000 |
| Net income | \$7,728,783 | \$5,763,142 | \$3,815,174 | \$1,679,411 | \$1,015,527 | \$17,950,982 | \$(20,002,037) | \$17,000,000 |
| Goodwill | \$3,222,688 | \$- | \$9,888,225 | \$- | \$- | \$- | \$- | \$13,000,000 |
| Core deposit intangible | \$- | \$1,172,141 | \$5,747,339 | \$- | \$- | \$- | \$- | \$6,000,000 |
| Total assets | \$1,400,307,827 | \$993,768,912 | \$642,761,140 | \$426,159,677 | \$- | \$382,407,292 | \$(388,218,153) | \$3,000,000,000 |

Six Months Ended June 30, 2016

| | | | | | | | | |
|---------------------------------|-----------------|---------------|-----|---------------|-------------|---------------|-----------------|-----------------|
| Total revenue | \$27,679,846 | \$21,277,313 | \$- | \$7,712,876 | \$4,439,113 | \$15,104,270 | \$(15,213,201) | \$61,000,000 |
| Net interest income | \$22,169,206 | \$14,160,713 | \$- | \$5,857,391 | \$- | \$(580,975) | \$- | \$41,000,000 |
| Provision for loan/lease losses | \$1,970,835 | \$700,000 | \$- | \$600,000 | \$- | \$- | \$- | \$3,000,000 |
| Net income | \$6,730,039 | \$6,079,717 | \$- | \$1,389,954 | \$833,972 | \$13,049,955 | \$(15,033,681) | \$13,000,000 |
| Goodwill | \$3,222,688 | \$- | \$- | \$- | \$- | \$- | \$- | \$3,000,000 |
| Core deposit intangible | \$- | \$1,371,653 | \$- | \$- | \$- | \$- | \$- | \$1,000,000 |
| Total assets | \$1,390,025,232 | \$904,367,275 | \$- | \$402,157,473 | \$- | \$328,099,700 | \$(341,215,392) | \$2,000,000,000 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 7 – REGULATORY CAPITAL REQUIREMENTS

The Company (on a consolidated basis) and the subsidiary banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and subsidiary banks' financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the subsidiary banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Quantitative measures established by regulation to ensure capital adequacy require the Company and the subsidiary banks to maintain minimum amounts and ratios (set forth in the following table) of total common equity Tier 1 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, 2017 and December 31, 2016, that the Company and the subsidiary banks met all capital adequacy requirements to which they are subject.

Under the regulatory framework for prompt corrective action, to be categorized as "well capitalized," an institution must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 leverage and common equity Tier 1 ratios as set forth in the following tables. The Company and the subsidiary banks' actual capital amounts and ratios as of June 30, 2017 and December 31, 2016 are also presented in the following table (dollars in thousands). As of June 30, 2017 and December 31, 2016, each of the subsidiary banks met the requirements to be "well capitalized".

| | | For Capital | | For Capital | | For Capital | | To Be Well | |
|----------------------|-------|-------------|-------|-------------|-------|--------------|-------|-------------------|-------|
| | | | | Adequacy | | With Capital | | Capitalized Under | |
| | | | | Purposes | | Conservation | | Prompt Corrective | |
| | | | | Buffer* | | | | Action Provisions | |
| Actual | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of June 30, 2017: | | | | | | | | | |
| Company: | | | | | | | | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | | | | | | |
|----------------------------|-----------|--------|-----------|---|--------|-----------|---|-------|-----------|---|-------|
| Total risk-based capital | \$347,033 | 11.65% | \$238,402 | ≥ | 8.000% | \$275,652 | ≥ | 9.25% | \$298,003 | ≥ | 10.0% |
| Tier 1 risk-based capital | 313,333 | 10.51% | 178,802 | ≥ | 6.000 | 216,052 | ≥ | 7.25 | 238,402 | ≥ | 8.0 |
| Tier 1 leverage | 313,333 | 9.34% | 134,142 | ≥ | 4.000 | 134,142 | ≥ | 4.00 | 167,677 | ≥ | 5.0 |
| Common equity Tier 1 | 281,774 | 9.46% | 134,101 | ≥ | 4.500 | 171,352 | ≥ | 5.75 | 193,702 | ≥ | 6.5 |
| Quad City Bank & Trust: | | | | | | | | | | | |
| Total risk-based capital | \$149,008 | 12.59% | \$94,717 | ≥ | 8.000% | \$109,516 | ≥ | 9.25% | \$118,396 | ≥ | 10.0% |
| Tier 1 risk-based capital | 135,628 | 11.46% | 71,038 | ≥ | 6.000 | 85,837 | ≥ | 7.25 | 94,717 | ≥ | 8.0 |
| Tier 1 leverage | 135,628 | 9.56% | 56,719 | ≥ | 4.000 | 56,719 | ≥ | 4.00 | 70,898 | ≥ | 5.0 |
| Common equity Tier 1 | 135,628 | 11.46% | 53,278 | ≥ | 4.500 | 68,078 | ≥ | 5.75 | 76,957 | ≥ | 6.5 |
| Cedar Rapids Bank & Trust: | | | | | | | | | | | |
| Total risk-based capital | \$110,561 | 12.19% | \$72,578 | ≥ | 8.000% | \$83,918 | ≥ | 9.25% | \$90,722 | ≥ | 10.0% |
| Tier 1 risk-based capital | 99,216 | 10.94% | 54,434 | ≥ | 6.000 | 65,774 | ≥ | 7.25 | 72,578 | ≥ | 8.0 |
| Tier 1 leverage | 99,216 | 10.43% | 38,044 | ≥ | 4.000 | 38,044 | ≥ | 4.00 | 47,555 | ≥ | 5.0 |
| Common equity Tier 1 | 99,216 | 10.94% | 40,825 | ≥ | 4.500 | 52,165 | ≥ | 5.75 | 58,969 | ≥ | 6.5 |
| Community State Bank: | | | | | | | | | | | |
| Total risk-based capital | \$69,222 | 13.32% | \$41,577 | ≥ | 8.000% | \$48,074 | ≥ | 9.25% | \$51,972 | ≥ | 10.0% |
| Tier 1 risk-based capital | 66,089 | 12.72% | 31,183 | ≥ | 6.000 | 37,679 | ≥ | 7.25 | 41,577 | ≥ | 8.0 |
| Tier 1 leverage | 66,089 | 10.91% | 24,231 | ≥ | 4.000 | 24,231 | ≥ | 4.00 | 30,289 | ≥ | 5.0 |
| Common equity Tier 1 | 66,089 | 12.72% | 23,387 | ≥ | 4.500 | 29,884 | ≥ | 5.75 | 33,782 | ≥ | 6.5 |
| Rockford Bank & Trust | | | | | | | | | | | |
| Total risk-based capital | \$44,068 | 11.78% | \$29,922 | ≥ | 8.000% | \$34,598 | ≥ | 9.25% | \$37,403 | ≥ | 10.0% |
| Tier 1 risk-based capital | 39,384 | 10.53% | 22,442 | ≥ | 6.000 | 27,117 | ≥ | 7.25 | 29,922 | ≥ | 8.0 |
| Tier 1 leverage | 39,384 | 9.63% | 16,354 | ≥ | 4.000 | 16,354 | ≥ | 4.00 | 20,442 | ≥ | 5.0 |
| Common equity Tier 1 | 39,384 | 10.53% | 16,831 | ≥ | 4.500 | 21,507 | ≥ | 5.75 | 24,312 | ≥ | 6.5 |

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

| | Actual | | For Capital Adequacy Purposes | | For Capital Adequacy Purposes With Capital | | To Be Well Capitalized Under Prompt Corrective | |
|----------------------------|-----------|--------|-------------------------------|----------|--|----------|--|---------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2016: | | | | | | | | |
| Company: | | | | | | | | |
| Total risk-based capital | \$327,440 | 11.56% | \$226,587 | ≥ 8.000% | \$244,289 | ≥ 8.625% | \$283,233 | ≥ 10.0% |
| Tier 1 risk-based capital | 296,366 | 10.46% | 169,940 | ≥ 6.000 | 187,642 | ≥ 6.625 | 226,587 | ≥ 8.0 |
| Tier 1 leverage | 296,366 | 9.10 % | 130,229 | ≥ 4.000 | 130,229 | ≥ 4.000 | 162,787 | ≥ 5.0 |
| Common equity Tier 1 | 266,419 | 9.41 % | 127,455 | ≥ 4.500 | 145,157 | ≥ 5.125 | 184,102 | ≥ 6.5 |
| Quad City Bank & Trust: | | | | | | | | |
| Total risk-based capital | \$142,990 | 12.27% | \$93,212 | ≥ 8.000% | \$100,494 | ≥ 8.625% | \$116,515 | ≥ 10.0% |
| Tier 1 risk-based capital | 129,524 | 11.12% | 69,909 | ≥ 6.000 | 77,191 | ≥ 6.625 | 93,212 | ≥ 8.0 |
| Tier 1 leverage | 129,524 | 9.18 % | 56,445 | ≥ 4.000 | 56,445 | ≥ 4.000 | 70,556 | ≥ 5.0 |
| Common equity Tier 1 | 129,524 | 11.12% | 52,432 | ≥ 4.500 | 59,714 | ≥ 5.125 | 75,735 | ≥ 6.5 |
| Cedar Rapids Bank & Trust: | | | | | | | | |
| Total risk-based capital | \$106,791 | 12.82% | \$66,623 | ≥ 8.000% | \$71,828 | ≥ 8.625% | \$83,279 | ≥ 10.0% |
| Tier 1 risk-based capital | 96,369 | 11.57% | 49,968 | ≥ 6.000 | 55,173 | ≥ 6.625 | 66,623 | ≥ 8.0 |
| Tier 1 leverage | 96,369 | 10.69% | 36,061 | ≥ 4.000 | 36,061 | ≥ 4.000 | 45,076 | ≥ 5.0 |
| Common equity Tier 1 | 96,369 | 11.57% | 37,476 | ≥ 4.500 | 42,681 | ≥ 5.125 | 54,132 | ≥ 6.5 |
| Community State Bank: | | | | | | | | |
| Total risk-based capital | \$68,216 | 13.81% | \$39,521 | ≥ 8.000% | \$42,609 | ≥ 8.625% | \$49,402 | ≥ 10.0% |
| Tier 1 risk-based capital | 66,746 | 13.51% | 29,641 | ≥ 6.000 | 32,729 | ≥ 6.625 | 39,522 | ≥ 8.0 |
| Tier 1 leverage | 66,746 | 11.75% | 22,726 | ≥ 4.000 | 22,726 | ≥ 4.000 | 28,408 | ≥ 5.0 |
| Common equity Tier 1 | 66,746 | 13.51% | 22,231 | ≥ 4.500 | 25,319 | ≥ 5.125 | 32,111 | ≥ 6.5 |
| Rockford Bank & Trust: | | | | | | | | |
| Total risk-based capital | \$42,007 | 12.26% | \$27,410 | ≥ 8.000% | \$29,551 | ≥ 8.625% | \$34,262 | ≥ 10.0% |
| Tier 1 risk-based capital | 37,716 | 11.01% | 20,558 | ≥ 6.000 | 22,699 | ≥ 6.625 | 27,410 | ≥ 8.0 |
| Tier 1 leverage | 37,716 | 9.57 % | 15,772 | ≥ 4.000 | 15,772 | ≥ 4.000 | 19,716 | ≥ 5.0 |
| Common equity Tier 1 | 37,716 | 11.01% | 15,418 | ≥ 4.500 | 17,559 | ≥ 5.125 | 22,270 | ≥ 6.5 |

*The minimums under Basel III increase by .625% (the capital conservation buffer) annually until 2019. The fully phased-in minimums are 10.5% (Total risk-based capital), 8.5% (Tier 1 risk-based capital), and 7.0% (Common equity Tier 1).

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-continued

NOTE 8 – ACQUISITION OF GUARANTY BANK AND TRUST COMPANY

On June 8, 2017, the Company announced the signing of a definitive agreement to acquire Guaranty Bank and Trust Company (Guaranty Bank), headquartered in Cedar Rapids, Iowa, from Guaranty Bankshares, Ltd. (Guaranty). Guaranty Bank is an Iowa-chartered bank that operates five banking locations throughout the Cedar Rapids metropolitan area. As of June 30, 2017, Guaranty Bank had \$264 million in assets and \$212 million in deposits.

The Company filed a registration statement on Form S-4 with the SEC on July 27, 2017 for 881,631 shares of common stock in connection with its proposed acquisition of Guaranty Bank.

The purchase and assumption agreement provides for the sale by Guaranty of substantially all of its assets, including all of the capital stock of Guaranty Bank, and the assumption by the Company of certain of Guaranty's assets and liabilities. The sale is anticipated to be completed late in the third quarter or early fourth quarter of 2017. At a date following the completion of the sale, the Company intends to merge Guaranty Bank with and into CRBT, with CRBT as the surviving bank. At such time, Guaranty Bank's banking offices will become banking offices of CRBT. Until the banks are merged, the Company will own and operate Guaranty Bank as a separate bank subsidiary.

The total consideration to be paid to Guaranty by the Company at the closing of the sale pursuant to the purchase and assumption agreement, subject to adjustment, is equal to: (1) Guaranty's adjusted tangible equity as of the end of the month immediately preceding the closing date up to an amount equal to \$24,286,985 multiplied by 1.53; plus (2) Guaranty's adjusted tangible equity as of the end of the month immediately preceding the closing date in excess of the core capital. Guaranty intends to pay a special dividend to its shareholders in an amount equal to the excess capital immediately prior to the closing of the sale. Therefore, the total consideration to be paid to Guaranty at the closing of the sale is expected to be an amount equal to 1.53 multiplied by the core capital, or approximately \$37.2 million. The cash portion of the sale consideration is expected to be approximately \$7.8 million. Based on a closing price of the Company's common stock of \$46.05 as of the end of day August 3, 2017, the stock portion of the sale consideration would equal approximately 638,400 shares of the Company's common stock with an aggregate market value of approximately \$29.4 million. The cash and stock portions of the sale consideration will be paid directly to Guaranty, and not to Guaranty's shareholders. No fractional shares of the Company's common stock will be issued in the sale.

In June 2017, the Company executed a \$7.0 million term note commitment with a four-year term with interest calculated at the effective LIBOR rate plus 3.00% per annum (4.16% at June 30, 2017). This \$7.0 million term note commitment may be drawn upon at closing of the acquisition of Guaranty Bank to help fund the cash portion of the purchase price. Any additional cash consideration paid to Guaranty beyond this \$7.0 million would come from operating cash.

Part I

Item 2

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

INTRODUCTION

This section reviews the financial condition and results of operations of the Company and its subsidiaries for the three and six months ending June 30, 2017. Some tables may include additional periods to comply with disclosure requirements or to illustrate trends. When reading this discussion, also refer to the Consolidated Financial Statements and related notes in this report. The page locations and specific sections and notes that are referred to are presented in the table of contents.

Additionally, a comprehensive list of the acronyms and abbreviations used throughout this discussion is included in Note 1 to the Consolidated Financial Statements.

GENERAL

QCR Holdings, Inc. is a financial holding company and the parent company of QCBT, CRBT, CSB and RB&T.

QCBT, CRBT and CSB 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 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, 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.

Cedar Falls and Waterloo, Iowa and adjacent communities are served through three additional CRBT offices (two in Waterloo and one in Cedar Falls).

CSB was acquired in 2016, as further described in Note 2 of the Annual Report on Form 10-K for the year ended December 31, 2016. CSB provides full-service commercial and consumer banking to the Des Moines, Iowa area and adjacent communities through its 10 branch locations, including its main office located on North Ankeny Boulevard in Ankeny, Iowa.

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.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

EXECUTIVE OVERVIEW

The Company reported net income of \$8.8 million and diluted EPS of \$0.65 for the quarter ended June 30, 2017. By comparison, for the quarter ended March 31, 2017, the Company reported net income of \$9.2 million and diluted EPS of \$0.68. For the quarter ended June 30, 2016, the Company reported net income of \$6.7 million and diluted EPS of \$0.53.

For the six months ended June 30, 2017, the Company reported net income of \$18.0 million, and diluted EPS of \$1.33. By comparison, for the six months ended June 30, 2016, the Company reported net income of \$13.0 million, and diluted EPS of \$1.07.

The second quarter of 2017 was highlighted by several significant items:

Loan and lease growth totaled \$117.7 million for the quarter, or an annualized growth rate of 19.2%;
 Nonperforming assets decreased \$1.4 million in the current quarter. The ratio of nonperforming assets to total assets was 0.75% at June 30, 2017, which was down from 0.81% at March 31, 2017;
 Return on average assets (annualized) increased to 1.08% for the six months ended June 30, 2017 as compared to 1.00% for the six months ended June 30, 2016;
 The Company announced the signing of a definitive agreement to acquire Guaranty Bank.

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, 2017 | March 31, 2017 | June 30, 2016 | June 30, 2017 | June 30, 2016 |
| Net income | \$8,766,017 | \$9,184,965 | \$6,676,467 | \$17,950,982 | \$13,049,956 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | |
|--|------------|------------|------------|------------|------------|
| Diluted earnings per common share | \$0.65 | \$0.68 | \$0.53 | \$1.33 | \$1.07 |
| Weighted average common and common equivalent shares outstanding | 13,516,592 | 13,488,417 | 12,516,474 | 13,502,505 | 12,235,212 |

The increase in weighted average common shares outstanding from June 30, 2016 to June 30, 2017 was primarily due to the common stock issuance discussed in Note 2 of the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

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, 2017 | March 31, 2017 | June 30, 2016 | June 30, 2017 | June 30, 2016 |
| Net interest income | \$28,046,697 | \$27,668,883 | \$21,008,813 | \$55,715,580 | \$41,606,335 |
| Provision expense | 2,022,993 | 2,105,109 | 1,197,850 | 4,128,102 | 3,270,835 |
| Noninterest income | 6,782,518 | 7,283,754 | 6,762,401 | 14,066,272 | 13,584,874 |
| Noninterest expense | 21,404,629 | 21,273,117 | 17,743,753 | 42,677,746 | 34,698,251 |
| Federal and state income tax expense | 2,635,576 | 2,389,446 | 2,153,144 | 5,025,022 | 4,172,167 |
| Net income | \$8,766,017 | \$9,184,965 | \$6,676,467 | \$17,950,982 | \$13,049,956 |

Part I

Item 2

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

Following are some noteworthy changes in the Company's financial results:

Net interest income in the second quarter of 2017 was up 1% compared to the first quarter of 2017. Net interest income increased 33% compared to the second quarter of 2016 and 34% when comparing the first six months of 2017 to the same period in the prior year primarily due to the addition of CSB.

Provision expense in the second quarter of 2017 decreased 4% compared to the first quarter of 2017. Provision expense increased 69% from the same period of 2016. The increase from the second quarter of 2016 to the second quarter of 2017 was primarily attributable to CSB. As acquired loans renew, the discount associated with those loans is eliminated and the Company must establish an allowance. This resulted in \$861 thousand of provision expense in the second quarter of 2017.

Noninterest income in the second quarter of 2017 decreased 7% compared to the first quarter of 2017, primarily due to smaller gains on the sale of government guaranteed portions of loans. Noninterest income in the second quarter of 2017 was flat from the second quarter of 2016.

Noninterest expense was flat from the first quarter of 2017. Noninterest expense increased 21% from the second quarter of 2016 due to the addition of CSB's cost structure.

Federal and state income tax expense in the second quarter of 2017 increased 10% compared to the first quarter of 2017. Federal and state income tax in the second quarter of 2017 increased 22% compared to the second quarter of 2016. See the Income Taxes section of this Report for additional details.

LONG-TERM FINANCIAL GOALS

As previously stated, the Company has established certain financial goals by which it manages its business and measures its performance. The goals are periodically updated to reflect changes in business developments. While the Company is determined to work prudently to achieve these goals, there is no assurance that they will be met. Moreover, the Company's ability to achieve these goals will be affected by the factors discussed under "Forward Looking Statements" as well as the factors detailed in the "Risk Factors" section included under Item 1A. of Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2016. The Company's long-term financial

goals are as follows:

Improve balance sheet efficiency by maintaining a gross loans and leases to total assets ratio in the range of 70 – 75%;

Improve profitability (measured by NIM and ROAA);

Continue to improve asset quality by reducing NPAs to total assets to below 0.75% and maintain charge-offs as a percentage of average loans/leases of under 0.25% annually;

Maintain reliance on wholesale funding at less than 15% of total assets;

Grow noninterest bearing deposits to more than 30% of total assets;

37

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Continue to focus on generating gains on sales of government guaranteed portions of loans and swap fee income to more than \$4 million annually; and

Grow wealth management segment net income by 10% annually.

The following table shows the evaluation of the Company's long-term financial goals.

| Goal | Key Metric | Target** | For the Quarter Ending | | |
|---|---|------------------------|------------------------|----------------|---------------|
| | | | June 30, 2017 | March 31, 2017 | June 30, 2016 |
| Balance sheet efficiency | Gross loans and leases to total assets | 70 - 75% | 74% | 72% | 72% |
| | NIM (TEY)(non-GAAP)* | > 3.85% | 3.81% | 3.90% | 3.62% |
| Profitability | ROAA | > 1.10% | 1.04% | 1.12% | 1.01% |
| | Core ROAA (non-GAAP)* | > 1.10% | 1.04% | 1.12% | 1.00% |
| Asset quality | NPAs to total assets | < 0.75% | 0.75% | 0.81% | 0.70% |
| | Net charge-offs to average loans and leases*** | < 0.25% annually | 0.13% | 0.13% | 0.12% |
| Reliance on wholesale funding | Wholesale funding to total assets**** | < 15% | 10% | 9% | 18% |
| Funding mix | Noninterest bearing deposits as a percentage of total assets | > 30% | 22% | 23% | 23% |
| Consistent, high quality noninterest income revenue streams | Gains on sales of government guaranteed portions of loans and swap fee income**** | > \$4 million annually | \$3.0 million | \$4.3 million | \$7.1 million |
| | Grow wealth management segment net income*** | > 10% annually | 22% | 25% | 2% |

* See GAAP to Non-GAAP reconciliations.

** Targets will be re-evaluated and adjusted as appropriate.

*** Ratios and amounts provided for these measurements represent year-to-date actual amounts for the respective period, that are then annualized for comparison.

**** Wholesale funding in total assets is calculated by dividing total borrowings and brokered deposits by total assets.

STRATEGIC DEVELOPMENTS

The Company took the following actions to support its corporate strategy and the long-term financial goals shown above.

The Company grew loans and leases in the second quarter of 2017 by 19% on an annualized basis. This growth exceeded the targeted organic growth of 10-12% for the full year. Strong loan and lease growth for the remainder of the year will help keep the Company's loan and leases to asset ratio within the top end of the targeted range of 70-75%.

The Company intends to continue to participate in a prudent manner as an acquirer in the consolidation taking place in our markets to further boost ROAA and improve the Company's efficiency ratio. In the third quarter of 2016, the Company acquired CSB, headquartered in Ankeny, Iowa. See Note 2 of the Company's 2016 Annual Report on Form 10-K for the year ended December 31, 2016 for additional details. The Company plans to close the acquisition of Guaranty Bank late in the third quarter of early in the fourth quarter of 2017, pending regulatory and shareholder approvals and certain customary closing conditions. See Note 8 to the Consolidated Financial Statements for additional details.

Part I

Item 2

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

The Company continues to focus on reducing the NPAs to total assets ratio. This ratio improved by 6 basis points to 0.75%, as compared to the first quarter 2017. The Company remains committed to improving asset quality ratios in 2017.

Management continues to focus on reducing the Company's reliance on wholesale funding. The strong core deposit growth in the first half of 2017 allowed the Company to further reduce wholesale borrowings and also provides liquidity for future loan and lease growth. Management also continues to evaluate opportunities for continued reduction in wholesale funding.

Correspondent banking continues to be a core line of business for the Company. The Company is competitively positioned with experienced staff, software systems and processes to continue growing in the three states currently served – Iowa, Illinois and Wisconsin. The Company acts as the correspondent bank for 181 downstream banks with average total noninterest bearing deposits of \$288.6 million during the second quarter of 2017. This line of business provides a strong source of noninterest bearing and interest bearing deposits, fee income, high-quality loan participations and bank stock loans.

SBA and USDA lending is a specialty lending area on which the Company has focused. Once these loans are originated, the government-guaranteed portion of the loan can be sold to the secondary market for premiums. The Company aims to continue to make this a more consistent source of noninterest income.

As a result of the low interest rate environment, the Company is focused on executing interest rate swaps on select commercial loans. The interest rate swaps allow the commercial borrowers to pay a fixed interest rate while the Company receives a variable interest rate as well as an upfront fee dependent on the pricing. Management believes that these swaps help position the Company more favorably for rising rate environments. The Company 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.

Wealth management is another core line of business for the Company and includes a full range of products, including trust services, brokerage and investment advisory services, asset management, estate planning and financial planning. As of June 30, 2017 the Company had \$2.11 billion of total financial assets in trust (and related) accounts and \$954 million of total financial assets in brokerage (and related) accounts. Continued growth in assets under management will help to drive trust and investment advisory fees. The Company offers trust and investment advisory services to the correspondent banks that it serves. As management continues to focus on growing wealth management fee income, expanding market share will continue to be a primary strategy.

Part I

Item 2

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

GAAP TO NON-GAAP RECONCILIATIONS

The following table presents certain non-GAAP financial measures related to the “TCE/TA ratio”, “core net income”, “core net income attributable to QCR Holdings, Inc. common stockholders”, “core EPS”, “core ROAA”, “NIM (TEY)”, “efficiency ratio” and “Texas ratio”. In compliance with applicable rules of the SEC, all non-GAAP measures are reconciled to the most directly comparable GAAP measure, as follows:

TCE/TA ratio (non-GAAP) is reconciled to stockholders' equity and total assets;

Core net income, core net income attributable to QCR Holdings, Inc. common stockholders, core EPS and core ROAA (all non-GAAP measures) are reconciled to net income;

NIM (TEY) (non-GAAP) is reconciled to NIM;

Efficiency ratio (non-GAAP) is reconciled to noninterest expense, net interest income and noninterest income; and

Texas ratio (non-GAAP) is reconciled to nonperforming loans and stockholders' equity.

The TCE/TA non-GAAP ratio has been a focus for investors and management believes that this ratio may assist investors in analyzing the Company's capital position without regard to the effects of intangible assets.

Part I

Item 2

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

The table following also includes several “core” non-GAAP measurements of financial performance. The Company's management believes that these measures are important to investors as they exclude non-recurring income and expense items; therefore, they provide a better comparison for analysis and may provide a better indicator of future run-rates.

NIM (TEY) is a financial measure that the Company's management utilizes to take into account the tax benefit associated with certain tax-exempt loans and securities. It is standard industry practice to measure net interest margin using tax-equivalent measures.

The efficiency ratio and Texas ratio are both ratios that management utilizes to compare the Company to peers. Both are also standard in the banking industry and widely utilized by investors.

Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied, and are not audited. Although these non-GAAP financial measures are frequently used by investors to evaluate a company, they have limitations as analytical tools and should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP.

| | As of | | |
|---|--|--------------|--------------|
| | June 30, | March 31, | December |
| GAAP TO NON-GAAP RECONCILIATIONS | 2017 | 2017 | 31, 2016 |
| | <i>(dollars in thousands, except per share data)</i> | | |
| TCE / TA RATIO | | | |
| Stockholders' equity (GAAP) | \$ 305,083 | \$ 295,840 | \$ 286,041 |
| Less: Intangible assets | 20,030 | 20,261 | 22,522 |
| TCE (non-GAAP) | \$ 285,053 | \$ 275,579 | \$ 263,519 |
| Total assets (GAAP) | \$ 3,457,187 | \$ 3,381,013 | \$ 3,301,944 |
| Less: Intangible assets | 20,030 | 20,261 | 22,522 |
| TA (non-GAAP) | \$ 3,437,157 | \$ 3,360,752 | \$ 3,279,422 |

| TCE / TA ratio (non-GAAP) | 8.29 | % | 8.20 | % | 8.04 | % |
|--|-----------------------|----------------|----------------|--------------------------|-----------------|----------|
| | For the Quarter Ended | | | For the Six Months Ended | | |
| | June 30, | March 31, | December | June 30, | June 30, | |
| | 2017 | 2017 | 31, | 2017 | 2016 | |
| | | | 2016 | | | |
| CORE NET INCOME | | | | | | |
| Net income (GAAP) | \$8,766 | \$9,185 | \$8,529 | \$17,951 | \$13,050 | |
| Less nonrecurring items (post-tax) (*): | | | | | | |
| Income: | | | | | | |
| Securities gains, net | \$25 | \$- | \$(23) | \$25 | \$245 | |
| Total nonrecurring income (non-GAAP) | \$25 | \$- | \$(23) | \$25 | \$497 | |
| Expense: | | | | | | |
| Losses on debt extinguishment | \$- | \$- | \$232 | \$- | \$54 | |
| Acquisition costs | - | - | 26 | - | 231 | |
| Total nonrecurring expense (non-GAAP) | \$- | \$- | \$258 | \$- | \$285 | |
| Core net income (non-GAAP) | \$8,741 | \$9,185 | \$8,810 | \$17,926 | \$13,090 | |
| CORE EPS | | | | | | |
| Core net income (non-GAAP) (from above) | \$8,741 | \$9,185 | \$8,810 | \$17,926 | \$13,090 | |
| Weighted average common shares outstanding | 13,170,283 | 13,133,382 | 13,087,592 | 13,151,833 | 12,064,349 | |
| Weighted average common and common equivalent shares outstanding | 13,516,592 | 13,488,417 | 13,323,883 | 13,502,505 | 12,235,212 | |
| Core EPS (non-GAAP): | | | | | | |
| Basic | \$0.66 | \$0.70 | \$0.67 | \$1.36 | \$1.09 | |
| Diluted | \$0.65 | \$0.68 | \$0.66 | \$1.33 | \$1.07 | |
| CORE ROAA | | | | | | |
| Core net income (non-GAAP) (from above) | \$8,741 | \$9,185 | \$8,810 | \$17,926 | \$13,090 | |
| Average Assets | \$3,378,195 | \$3,274,713 | \$3,277,814 | \$3,326,454 | \$2,621,514 | |
| Core ROAA (annualized) (non-GAAP) | 1.04 | % 1.12 | % 1.08 | % 1.08 | % 1.00 | % |

* Nonrecurring items (after-tax) are calculated using an estimated effective tax rate of 35%.

41

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

| | For the Quarter Ended | | | For the Six Months Ended | |
|--|-----------------------|-------------------|-------------------------|--------------------------|------------------|
| | June 30, 2017 | March 31, 2017 | December 31, 2016 | June 30, 2017 | June 30, 2016 |
| GAAP TO NON-GAAP RECONCILIATIONS (CONTINUED) | | | | | |
| <i>(dollars in thousands)</i> | | | | | |
| NIM (TEY) | | | | | |
| Net interest income (GAAP) | \$28,047 | \$27,669 | \$29,280 | \$55,716 | \$41,606 |
| Plus: Tax equivalent adjustment | 2,201 | 1,950 | 1,727 | 4,218 | 2,706 |
| Net interest income - tax equivalent (Non-GAAP) | \$30,248 | \$29,619 | \$31,007 | \$59,934 | \$44,312 |
| Average earning assets | \$3,180,779 | \$3,076,356 | \$3,069,122 | \$3,128,569 | \$2,470,525 |
| NIM (GAAP) | 3.54 | % 3.65 | % 3.80 | % 3.59 | % 3.39 |
| NIM (TEY) (Non-GAAP) | 3.81 | % 3.90 | % 4.02 | % 3.86 | % 3.61 |
| EFFICIENCY RATIO | | | | | |
| Noninterest expense (GAAP) | \$21,405 | \$21,273 | \$22,308 | \$42,678 | \$34,698 |
| Net interest income (GAAP) | \$28,047 | \$27,669 | \$29,280 | \$55,716 | \$41,606 |
| Noninterest income (GAAP) | 6,782 | 7,284 | 7,029 | 14,066 | 13,585 |
| Total income | \$34,829 | \$34,953 | \$36,309 | \$69,782 | \$55,191 |
| Efficiency ratio (noninterest expense/total income) (Non-GAAP) | 61.46 | % 60.86 | % 61.44 | % 61.16 | % 62.87 |
| TEXAS RATIO | | | | | |
| Nonaccrual loans/leases | \$13,217 | \$14,205 | \$13,919 | | |
| Accruing loans/leases past due 90 days or more | 424 | 955 | 967 | | |
| TDRs - accruing | 6,915 | 6,229 | 6,347 | | |
| OREO | 5,174 | 5,625 | 5,523 | | |
| NPLs (excluding other repossessed assets) | \$25,730 | \$27,014 | \$26,756 | | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | |
|-----------------------------------|-----------|-----------|-----------|
| Total stockholders' equity (GAAP) | \$305,083 | \$295,840 | \$286,041 |
| Less: Intangible assets | 20,030 | 20,261 | 22,522 |
| Plus: Allowance (GAAP) | 33,357 | 32,059 | 30,757 |
| Tangible equity plus allowance | \$318,410 | \$307,638 | \$294,276 |
| Texas Ratio (Non-GAAP) | 8.08 | % 8.78 | % 9.09 % |

42

Part I

Item 2

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

NET INTEREST INCOME - (TAX EQUIVALENT BASIS)

Net interest income, on a tax equivalent basis, increased 35% to \$30.2 million for the quarter ended June 30, 2017, compared to the same quarter of the prior year. For the six months ended June 30, 2017, net interest income, on a tax equivalent basis, increased 35% to \$59.9 million, compared to the same period of 2016. Net interest income improved due to several factors:

The acquisition of CSB, whose strong net interest margin has significantly contributed to the Company's results. The Company's continued strategy to redeploy funds from the taxable securities portfolio into higher yielding loans and leases.

Organic loan and lease growth has been strong over the past twelve months, as evidenced by average gross loan/lease growth of 10% in that period (excluding loans/leases in CSB acquisition).

A comparison of yields, spread and margin from the second quarter of 2017 to the second quarter of 2016 is as follows (on a tax equivalent basis):

The average yield on interest-earning assets increased 28 basis points.
The average cost of interest-bearing liabilities increased 7 basis points.
The net interest spread increased 21 basis points from 3.39% to 3.60%.
NIM improved 19 basis points from 3.62% to 3.81%.

A comparison of yields, spread and margin from the first half of 2017 to the first half of 2016 is as follows (on a tax equivalent basis):

The average yield on interest-earning assets increased 30 basis points.
The average cost of interest-bearing liabilities increased 3 basis points.
The net interest spread increased 27 basis points from 3.38% to 3.65%.
NIM improved 25 basis points from 3.61% to 3.86%.

The Company's management closely monitors and manages NIM. From a profitability standpoint, an important challenge for the Company's subsidiary banks and leasing company is the improvement of their net interest margins. Management continually addresses this issue with pricing and other balance sheet management strategies.

The improvement in net interest margin was primarily the result of the acquisition of CSB. CSB's margin will fluctuate based on the amortization and accretion of purchase accounting adjustments, most notably, the discount accretion on the loan portfolio. This benefit can fluctuate based on prepayments of both PCI and performing loans. As loans prepay, the associated discount is accelerated.

The Company continues to place an emphasis on shifting its balance sheet mix. With a stated goal of maintaining loans/leases as a percentage of assets in a range of 70%-75%, the Company funded its loan/lease growth with a mixture of core deposits and cash from calls/maturities/redemptions in the investment securities portfolio. In 2015 and 2016, cash from called securities and the targeted sales of securities was redeployed into the loan portfolio, resulting in a significant increase in yield, while minimizing any extension of duration. Additionally, the Company recognized net gains on these sales due to the previous rate environment. As rates rise, the Company should also have less market volatility in the investment securities portfolio, as this is a smaller portion of the balance sheet.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Although the Company's wholesale borrowings portfolio has declined significantly, there still exists some higher cost legacy borrowings and the Company continues to monitor and evaluate both prepayment and debt restructuring opportunities, as executing on such a strategy could potentially increase NIM at a much quicker pace than holding the debt until maturity.

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, | | | | | |
|---|--|-------------------------------|--------------------------------|--------------------|-------------------------------|--------------------------------|
| | 2017 | | | 2016 | | |
| | 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 | \$18,742 | \$38 | 0.81 % | \$14,174 | \$11 | 0.31 % |
| Interest-bearing deposits at financial institutions | 86,236 | 220 | 1.02 % | 50,747 | 62 | 0.49 % |
| Investment securities (1) | 573,747 | 5,384 | 3.76 % | 505,697 | 4,573 | 3.64 % |
| Restricted investment securities | 13,226 | 132 | 4.00 % | 14,171 | 134 | 3.80 % |
| Gross loans/leases receivable (1) (2) (3) | 2,488,828 | 28,881 | 4.65 % | 1,899,932 | 20,497 | 4.34 % |
| Total interest earning assets | \$3,180,779 | \$34,655 | 4.37 % | \$2,484,721 | \$25,277 | 4.09 % |
| Noninterest-earning assets: | | | | | | |
| Cash and due from banks | \$63,526 | | | \$50,461 | | |
| Premises and equipment | 61,327 | | | 38,178 | | |
| Less allowance | (32,361) | | | (27,811) | | |
| Other | 104,924 | | | 95,129 | | |
| Total assets | \$3,378,195 | | | \$2,640,678 | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing deposits | \$1,566,106 | 1,835 | 0.47 % | \$941,856 | 600 | 0.26 % |
| Time deposits | 527,719 | 1,156 | 0.88 % | 425,216 | 744 | 0.70 % |
| Short-term borrowings | 17,936 | 19 | 0.42 % | 50,122 | 18 | 0.14 % |
| FHLB advances | 76,739 | 354 | 1.85 % | 128,956 | 416 | 1.30 % |
| Other borrowings | 72,000 | 696 | 3.88 % | 100,008 | 824 | 3.31 % |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | |
|--|-------------|----------|--------|-------------|----------|--------|
| Junior subordinated debentures | 33,530 | 347 | 4.15 % | 33,396 | 302 | 3.64 % |
| Total interest-bearing liabilities | \$2,294,030 | \$4,407 | 0.77 % | \$1,679,554 | \$2,904 | 0.70 % |
| Noninterest-bearing demand deposits | \$741,886 | | | \$666,044 | | |
| Other noninterest-bearing liabilities | 41,411 | | | 39,689 | | |
| Total liabilities | \$3,077,327 | | | \$2,385,287 | | |
| Stockholders' equity | 300,868 | | | 255,391 | | |
| Total liabilities and stockholders' equity | \$3,378,195 | | | \$2,640,678 | | |
| Net interest income | | \$30,248 | | | \$22,373 | |
| Net interest spread | | | 3.60 % | | | 3.39 % |
| Net interest margin | | | 3.81 % | | | 3.62 % |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 138.65 % | | | 147.94 % | | |

(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, 2017**

| | Inc./Decomponents from of Change (1) | | |
|---|---|-------------|---------------|
| | Prior Period 2017 vs. 2016 | Rate | Volume |
| | (dollars in thousands) | | |
| INTEREST INCOME | | | |
| Federal funds sold | \$27 | \$23 | \$4 |
| Interest-bearing deposits at financial institutions | 158 | 96 | 62 |
| Investment securities (2) | 811 | 167 | 644 |
| Restricted investment securities | (2) | 31 | (33) |
| Gross loans/leases receivable (2) (3) (4) | 8,384 | 1,593 | 6,791 |
| Total change in interest income | \$9,378 | \$1,910 | \$7,468 |
| INTEREST EXPENSE | | | |
| Interest-bearing deposits | \$1,235 | \$688 | \$547 |
| Time deposits | 412 | 209 | 203 |
| Short-term borrowings | 1 | 70 | (69) |
| Federal Home Loan Bank advances | (62) | 663 | (725) |
| Other borrowings | (128) | 652 | (780) |
| Junior subordinated debentures | 45 | 44 | 1 |
| Total change in interest expense | \$1,503 | \$2,326 | \$(823) |
| Total change in net interest income | \$7,875 | \$(416) | \$8,291 |

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, 2017 | | | 2016 | | |
|---|--|-------------------------------|--------------------------------|--------------------|-------------------------------|--------------------------------|
| | 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 | \$ 14,917 | \$ 53 | 0.72 % | \$ 15,703 | \$ 23 | 0.29 % |
| Interest-bearing deposits at financial institutions | 89,394 | 418 | 0.94 % | 45,691 | 123 | 0.54 % |
| Investment securities (1) | 567,101 | 10,543 | 3.75 % | 528,034 | 9,257 | 3.53 % |
| Restricted investment securities | 13,549 | 262 | 3.90 % | 14,156 | 264 | 3.75 % |
| Gross loans/leases receivable (1) (2) (3) | 2,443,608 | 56,741 | 4.68 % | 1,866,941 | 40,454 | 4.36 % |
| Total interest earning assets | \$ 3,128,569 | \$ 68,017 | 4.38 % | \$ 2,470,525 | \$ 50,121 | 4.08 % |
| Noninterest-earning assets: | | | | | | |
| Cash and due from banks | \$ 64,409 | | | \$ 48,176 | | |
| Premises and equipment | 61,152 | | | 37,963 | | |
| Less allowance | (31,930) | | | (27,256) | | |
| Other | 104,256 | | | 92,107 | | |
| Total assets | \$ 3,326,456 | | | \$ 2,621,514 | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing deposits | \$ 1,486,876 | 2,974 | 0.40 % | \$ 933,551 | 1,214 | 0.26 % |
| Time deposits | 519,419 | 2,249 | 0.87 % | 412,410 | 1,420 | 0.69 % |
| Short-term borrowings | 21,562 | 43 | 0.40 % | 68,331 | 61 | 0.18 % |
| FHLB advances | 95,548 | 758 | 1.60 % | 128,696 | 858 | 1.34 % |
| Other borrowings | 73,381 | 1,379 | 3.79 % | 100,873 | 1,650 | 3.29 % |
| Junior subordinated debentures | 33,514 | 680 | 4.09 % | 34,023 | 606 | 3.58 % |
| Total interest-bearing liabilities | \$ 2,230,300 | \$ 8,083 | 0.73 % | \$ 1,677,884 | \$ 5,809 | 0.70 % |
| Noninterest-bearing demand deposits | \$ 757,566 | | | \$ 660,625 | | |
| Other noninterest-bearing liabilities | 42,704 | | | 39,687 | | |
| Total liabilities | \$ 3,030,569 | | | \$ 2,378,195 | | |
| Stockholders' equity | 295,887 | | | 243,319 | | |
| Total liabilities and stockholders' equity | \$ 3,326,456 | | | \$ 2,621,514 | | |
| Net interest income | | \$ 59,934 | | | \$ 44,312 | |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | |
|---|----------|--------|----------|--------|
| Net interest spread | | 3.65 % | | 3.38 % |
| Net interest margin | | 3.86 % | | 3.61 % |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 140.28 % | | 147.24 % | |

- (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, 2017**

| | Inc./ (Dec.) Components from of Change (1) Prior Rate Volume Period 2017 vs. 2016 (dollars in thousands) | | |
|---|---|----------------|-----------------|
| INTEREST INCOME | | | |
| Federal funds sold | \$30 | \$33 | \$(3) |
| Interest-bearing deposits at financial institutions | 295 | 129 | 166 |
| Investment securities (2) | 1,286 | 593 | 693 |
| Restricted investment securities | (2) | 21 | (23) |
| Gross loans/leases receivable (2) (3) (4) | 16,287 | 3,168 | 13,119 |
| Total change in interest income | \$17,896 | \$3,944 | \$13,952 |
| INTEREST EXPENSE | | | |
| Interest-bearing deposits | \$1,760 | \$841 | \$919 |
| Time deposits | 829 | 416 | 413 |
| Short-term borrowings | (18) | 97 | (115) |
| Federal Home Loan Bank advances | (100) | 338 | (438) |
| Other borrowings | (271) | 551 | (822) |
| Junior subordinated debentures | 74 | 100 | (26) |
| Total change in interest expense | \$2,274 | \$2,343 | \$(69) |
| Total change in net interest income | \$15,622 | \$1,601 | \$14,021 |

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

CRITICAL ACCOUNTING POLICIES

The Company's financial statements are prepared in accordance with GAAP. 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. Certain critical accounting policies are described below.

ALLOWANCE FOR LOAN AND LEASE LOSSES

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.

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 NPLs, and other factors. Quantitative factors also incorporate known information about individual loans/leases, including borrowers' sensitivity to interest rate movements.

Qualitative factors include management's view regarding 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 structures, existing loan/lease policies and pace of portfolio growth are other qualitative factors that are considered in the methodology.

Management may report a materially different amount for the provision in the statement of income to change the allowance if its assessment of the above factors were different. This discussion and analysis should be read in conjunction with the Company's financial statements and the accompanying notes presented elsewhere herein, as well as the 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, 2017 was adequate to absorb losses 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.

OTHER-THAN-TEMPORARY IMPAIRMENT

The Company's assessment of OTTI of its investment securities portfolio is another critical accounting policy due to the level of judgment required by management. Investment securities are evaluated to determine whether declines in fair value below their cost are other-than-temporary.

In estimating OTTI 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 Company's lack of intent to 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 OTTI 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 increased 36%, comparing the second quarter of 2017 to the same period of 2016 and increased 34%, comparing the first half of 2017 to the same period of 2016. Most of this increase was the result of the CSB acquisition during the third quarter of 2016.

Overall, the Company's average earning assets increased 28%, comparing the second quarter of 2017 to the second quarter of 2016. During the same time period, average gross loans and leases increased 31%, while average investment securities increased 13%. Average earning assets increased 27%, comparing the first half of 2017 to the same period of 2016. Average gross loans and leases increased 31% and average investment securities increased 7%, comparing the first half of 2017 to the same period of 2016. These increases were also primarily the result of the acquisition of CSB.

Additionally, the Company continued to diversify its securities portfolio, including increasing its portfolio of tax exempt municipal securities. The large majority of these are privately placed debt issuances by municipalities located in the Midwest and require a thorough underwriting process before investment. Execution of this strategy has led to increased interest income on a tax equivalent basis over the past several years. Management understands that this strategy has 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 intends to continue to grow quality loans and leases as well as diversify its securities portfolio to maximize yield while minimizing credit and interest rate risk.

INTEREST EXPENSE

Interest expense for the second quarter of 2017 increased 52% from the second quarter of 2016. For the first six months of 2017, interest expense increased 39% compared to the first six months of 2016. The acquisition of CSB primarily contributed to this increase. Additionally, the Company has rate sensitive deposits with select major customers that have repriced with the increase in certain market interest rates.

Management has placed a strong focus on reducing the reliance on long-term wholesale funding as it tends to be higher in cost than deposits. Several balance sheet restructuring strategies were executed in 2016. Refer to Notes 10 and 11 of the Company's Annual Report on Form 10-K for the year ended December 31, 2016 for additional details.

The Company's management intends to continue to shift the mix of funding from wholesale funds to core deposits, including noninterest-bearing deposits. Continuing this trend is expected to strengthen the Company's franchise value, reduce funding costs, and increase fee income opportunities through deposit service charges.

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 Company's provision totaled \$2.0 million for the second quarter of 2017, which was an increase of \$825 thousand or 69% from the same quarter of the prior year. Provision for the first half of the year totaled \$4.1 million, which was up \$857 thousand, or 26%, compared to the first half of 2016. This provision, when coupled with net charge-offs of \$1.5 million for the first six months of 2017, increased the Company's allowance to \$33.4 million at June 30, 2017. As of June 30, 2017, the Company's allowance to total loans/leases was 1.31%, which was down from 1.32% at March 31, 2017 and down from 1.46% at June 30, 2016, respectively.

In accordance with GAAP for business combination accounting, the loans acquired through the acquisition of CSB were recorded at market value; therefore, there was no allowance associated with CSB's loans at acquisition. Management continues to evaluate the allowance needed on the acquired CSB loans factoring in the net remaining discount (\$6.3 million at June 30, 2017). When factoring this remaining discount into the Company's allowance to total loans and leases calculation, the Company's allowance as a percentage of total loans and leases increases from 1.31% to 1.55%.

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

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

NONINTEREST INCOME

The following tables set forth the various categories of noninterest income for the three and six months ended June 30, 2017 and 2016.

| | Three Months Ended | | \$ Change | % Change | |
|---|--------------------|---------------|-------------|----------|---|
| | June 30, 2017 | June 30, 2016 | | | |
| Trust department fees | \$ 1,692,001 | \$ 1,512,083 | \$ 179,918 | 11.9 | % |
| Investment advisory and management fees | 868,835 | 692,738 | 176,097 | 25.4 | |
| Deposit service fees | 1,458,359 | 946,810 | 511,549 | 54.0 | |
| Gains on sales of residential real estate loans | 112,628 | 84,413 | 28,215 | 33.4 | |
| Gains on sales of government guaranteed portions of loans | 87,053 | 1,603,890 | (1,516,837) | (94.6) |) |
| Swap fee income | 327,577 | 167,582 | 159,995 | 95.5 | |
| Securities gains, net | 38,464 | 18,030 | 20,434 | 113.3 | |
| Earnings on bank-owned life insurance | 459,359 | 480,520 | (21,161) | (4.4) |) |
| Debit card fees | 743,521 | 343,748 | 399,773 | 116.3 | |
| Correspondent banking fees | 200,057 | 244,939 | (44,882) | (18.3) |) |
| Other | 794,664 | 667,648 | 127,016 | 19.0 | |
| Total noninterest income | \$ 6,782,518 | \$ 6,762,401 | \$ 20,117 | 0.3 | % |

| | Six Months Ended | | \$ Change | % Change | |
|---|------------------|---------------|-------------|----------|---|
| | June 30, 2017 | June 30, 2016 | | | |
| Trust department fees | \$ 3,432,208 | \$ 3,087,990 | \$ 344,218 | 11.1 | % |
| Investment advisory and management fees | 1,830,434 | 1,351,123 | 479,311 | 35.5 | |
| Deposit service fees | 2,774,749 | 1,877,889 | 896,860 | 47.8 | |
| Gains on sales of residential real estate loans | 208,951 | 144,799 | 64,152 | 44.3 | |
| Gains on sales of government guaranteed portions of loans | 1,037,694 | 2,482,418 | (1,444,724) | (58.2) |) |
| Swap fee income | 441,097 | 1,024,540 | (583,443) | (56.9) |) |
| Securities gains, net | 38,464 | 376,510 | (338,046) | (89.8) |) |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | |
|---------------------------------------|---------------|---------------|------------|--------|
| Earnings on bank-owned life insurance | 929,046 | 874,129 | 54,917 | 6.3 |
| Debit card fees | 1,446,322 | 651,399 | 794,923 | 122.0 |
| Correspondent banking fees | 445,246 | 547,069 | (101,823) | (18.6) |
| Other | 1,482,061 | 1,167,008 | 315,053 | 27.0 |
| Total noninterest income | \$ 14,066,272 | \$ 13,584,874 | \$ 481,398 | 3.5 % |

In recent years, the Company has been successful in expanding its wealth management customer base. Trust department fees continue to be a significant contributor to noninterest income and, due to favorable market conditions in early 2017 coupled with strong growth in assets under management, trust department fees increased 12%, comparing the second quarter of 2017 to the same period of the prior year. Trust department fees increased 11% when comparing the first half of 2017 to the same period of the prior year. Income is generated primarily from fees charged based on assets under administration for corporate and personal trusts and for custodial services. The majority of the trust department fees are determined based on the value of the investments within the fully managed trusts. Additionally, the Company recently started offering trust operations services to correspondent banks. Management 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 leverage of and collaboration among existing resources (including the aforementioned trust department). Similar to trust department fees, these fees are largely determined based on the value of the investments managed. And, similar to the trust department, the Company has had some success in expanding its customer base. Due to this growth and favorable market conditions in 2017, investment advisory and management fees increased 25%, comparing the second quarter of 2017 to the same period of the prior year and they increased 36% when comparing the first half of 2017 to the first half of 2016. The acquisition of CSB also contributed to this increase, as it had an established investment advisory and management services department at acquisition.

Part I

Item 2

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

Deposit service fees expanded 54% comparing the second quarter of 2017 to the same period of the prior year and expanded 48% when comparing the first half of 2017 to the same period of the prior year. This increase was primarily the result of the acquisition of CSB. 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 continuing 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 increased 33% when comparing the second quarter of 2017 to the same period of the prior year and increased 44% when comparing the first half of 2017 to the same period of the prior year. The increase was primarily attributable to the acquisition of CSB. Overall, with the continued low interest rate environment, refinancing activity has slowed, as many of the Company's existing and prospective customers have already executed a refinancing. Therefore, this area has generally become a smaller contributor to overall noninterest income.

The Company's gains on the sale of government-guaranteed portions of loans for the second quarter of 2017 decreased 95% compared to the second quarter of 2016 and decreased 58% when comparing the first half of 2017 to the same period of the prior year. Given the nature of these gains, large fluctuations can happen from quarter-to-quarter and year-to-year. As one of its core strategies, the Company continues to leverage its expertise by taking advantage of programs offered by the SBA and the USDA. The Company's portfolio of government-guaranteed loans has grown as a direct result of the Company's strong expertise in SBA and USDA lending. In some cases, it is more beneficial for the Company to sell the government-guaranteed portion on the secondary market for a premium rather than retain the loans in the Company's portfolio. Sales activity for government-guaranteed portions of loans tends to fluctuate depending on the demand for loans that fit the criteria for the government guarantee. Further, the size of the transactions can vary and, as the gain is determined as a percentage of the guaranteed amount, the resulting gain on sale can vary. 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.

As a result of the continued low interest rate environment, the Company was able to execute numerous interest rate swaps on select commercial loans over the past two years. The interest rate swaps allow the commercial borrowers to pay a fixed interest rate while the Company receives a variable interest rate as well as an upfront fee dependent upon the pricing. Management believes that these swaps help position the Company 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. A good interest rate swap candidate must be

of a certain size and sophistication which leads to volatility in activity from quarter to quarter. Swap fee income totaled \$328 thousand for the second quarter of 2017, compared to \$168 thousand for the second quarter of 2016. Swap fee income totaled \$441 thousand for the first half of 2017 compared to \$1.0 million in the first half of 2016. Future levels of swap fee income are dependent upon prevailing interest rates.

Part I

Item 2

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

Securities gains were \$38 thousand for the second quarter of 2017. Securities gains were \$18 thousand for the second quarter of 2016. Securities gains totaled \$38 thousand for the first six months of 2017, compared to \$377 thousand for the first six months of 2016. The Company took advantage of market opportunities by selling low-yielding investments and using the proceeds to purchase higher-yielding bonds with a moderate duration extension and to fund loan and lease growth.

Earnings on BOLI decreased 4% comparing the second quarter of 2017 to the second quarter of 2016 and increased 6% comparing the first half of 2017 to the first half of 2016. There were no purchases of BOLI within the last twelve months. Notably, a small portion of the Company's BOLI is variable rate whereby the returns are determined by the performance of the equity market. Equity market performance accounted for the majority of the volatility.

Management intends to continue to review its BOLI investments to be consistent with policy and regulatory limits in conjunction with the rest of its earning assets in an effort to maximize returns while minimizing risk.

Debit card fees are the interchange fees paid on certain debit card customer transactions. Debit card fees increased 116% comparing the second quarter of 2017 to the second quarter of the prior year and increased 122% comparing the first half of 2017 to the first half of 2016. The primary reason for the increase was the addition of CSB. CSB has a large retail customer base and, therefore generates significant interchange revenue. Additionally, these fees can vary based on customer debit card usage, so fluctuations from period to period may occur. As an opportunity to maximize fees, the Company offers a retail deposit product with a higher interest rate that incentivizes debit card activity.

Correspondent banking fees decreased 18% comparing the second quarter of 2017 to the second quarter of the prior year and decreased 19% when comparing the first half of 2017 to the first half of 2016. As interest rates rise, the correspondent bank deposit accounts receive a higher earnings credit, which then reduces the direct fees that the Company receives. Management will continue to evaluate earnings credit rates and the resulting impact on deposit balances and fees while balancing the ability to grow market share. 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 loan growth as well as a steady source of fee income. The Company now serves approximately 181 banks in Iowa, Illinois and Wisconsin.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

NONINTEREST EXPENSE

The following tables set forth the various categories of noninterest expense for the three and six months ended June 30, 2017 and 2016.

| | Three Months Ended | | | |
|---|--------------------|------------------|-------------|-------------|
| | June 30, 2017 | June 30, 2016 | \$ Change | % Change |
| Salaries and employee benefits | \$12,930,944 | 10,917,473 | \$2,013,471 | 18.4 % |
| Occupancy and equipment expense | 2,698,336 | 1,884,556 | 813,780 | 43.2 |
| Professional and data processing fees | 2,340,699 | 1,542,322 | 798,377 | 51.8 |
| Acquisition costs | - | 354,969 | (354,969) | (100.0) |
| FDIC insurance, other insurance and regulatory fees | 645,277 | 649,604 | (4,327) | (0.7) |
| Loan/lease expense | 260,284 | 154,349 | 105,935 | 68.6 |
| Net cost of operations of other real estate | 27,957 | 277,911 | (249,954) | (89.9) |
| Advertising and marketing | 567,588 | 433,451 | 134,137 | 30.9 |
| Bank service charges | 447,445 | 415,350 | 32,095 | 7.7 |
| Correspondent banking expense | 201,693 | 181,776 | 19,917 | 11.0 |
| Other | 1,284,406 | 931,992 | 352,414 | 37.8 |
| Total noninterest expense | \$21,404,629 | \$17,743,753 | \$3,660,876 | 20.6 % |

| | Six Months Ended | | | |
|---|------------------|------------------|-------------|-------------|
| | June 30, 2017 | June 30, 2016 | \$ Change | % Change |
| Salaries and employee benefits | \$26,238,275 | \$21,718,380 | \$4,519,895 | 20.8 % |
| Occupancy and equipment expense | 5,200,555 | 3,711,544 | 1,489,011 | 40.1 |
| Professional and data processing fees | 4,424,091 | 2,989,735 | 1,434,356 | 48.0 |
| Acquisition costs | - | 354,969 | (354,969) | (100.0) |
| FDIC insurance, other insurance and regulatory fees | 1,266,519 | 1,283,969 | (17,450) | (1.4) |
| Loan/lease expense | 553,822 | 317,168 | 236,654 | 74.6 |
| Net cost of operations of other real estate | 42,187 | 380,094 | (337,907) | (88.9) |
| Advertising and marketing | 1,177,019 | 819,710 | 357,309 | 43.6 |
| Bank service charges | 871,346 | 831,281 | 40,065 | 4.8 |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | |
|------------------------------------|--------------|--------------|-------------|----------|
| Losses on debt extinguishment, net | - | 83,197 | (83,197) | (100.0) |
| Correspondent banking expense | 400,044 | 358,765 | 41,279 | 11.5 |
| Other | 2,503,888 | 1,849,439 | 654,449 | 35.4 |
| Total noninterest expense | \$42,677,746 | \$34,698,251 | \$7,979,495 | 23.0 % |

Management places a strong emphasis on overall cost containment and is committed to improving the Company's general efficiency. Most expenses were higher in the second quarter of 2017 compared to 2016 as a result of acquiring CSB as the Company's fourth bank charter in the third quarter of 2016. Noninterest expense, excluding CSB, decreased 3.8% comparing the second quarter of 2017 to the same period of the prior year and decreased 2.4% comparing the first half of 2017 to the first half of 2016.

Salaries and employee benefits, which is the largest component of noninterest expense, increased from the second quarter of 2016 to the second quarter of 2017 by 18%. This line item also increased 21% when comparing the first half of 2017 to the first half of 2016. This increase was primarily related to the acquisition of CSB.

Occupancy and equipment expense increased 43%, comparing the second quarter of 2017 to the same period of the prior year and increased 40% comparing the first half of 2017 to the same period of the prior year. The increased expense was mostly due to the addition of CSB.

Part I

Item 2

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

Professional and data processing fees increased 52%, comparing the second quarter of 2017 to the same period in 2016 and increased 48% comparing the first half of 2017 to the same period in 2016. This increased expense was primarily due to the addition of CSB. Generally, professional and data processing fees can fluctuate depending on certain one-time project costs. Management will continue to focus on minimizing such one-time costs and driving recurring costs down through contract renegotiation or managed reduction in activity where costs are determined on a usage basis.

FDIC and other insurance expense decreased 1%, comparing the second quarter of 2017 to the second quarter of 2016, and decreased 1% comparing the first half of 2017 to the same period of 2016. The decrease in expense was due to a decrease in the assessment rate designated by the FDIC partially offset by the acquisition of CSB.

Loan/lease expense increased 69%, comparing the second quarter of 2017 to the same quarter of 2016, and increased 75% when comparing the first half of 2017 to the same period of 2016. The Company incurred elevated levels of expense in the first six months of 2017 for certain existing NPLs in connection with the work-out of these loans. Generally, loan/lease expense has a direct relationship with the level of NPLs; however, it may deviate depending upon the individual NPLs.

Net cost of operations of other real estate includes gains/losses on the sale of OREO, write-downs of OREO and all income/expenses associated with OREO. Net costs of operations of other real estate totaled \$28 thousand for the second quarter of 2017, compared to \$278 thousand for the second quarter of 2016. Net costs of operations of other real estate totaled \$42 thousand for the first six months of 2017, compared to \$380 thousand for the first six months of 2016. Occupancy rates for one of the OREO properties managed by the Company have improved over the past year, increasing cash flow from that property and reducing net operating costs.

Bank service charges, a large portion of which includes indirect costs incurred to provide services to QCBT's correspondent banking customer portfolio, increased 8% from the second quarter of 2016 to the second quarter of 2017 and increased 5% from the first half of 2016 to the first half of 2017. The increase was due, in large part, to the success QCBT has had in growing its correspondent banking customer portfolio. As transactions volumes continue to increase and the number of correspondent banking clients increases, the associated expenses will also increase.

In the first half of 2016, the Company incurred \$83 thousand of losses on debt extinguishment, net. This amount included \$1.3 million of losses related to the prepayment of certain FHLB advances and wholesale structured repurchase agreements, as well as a \$1.2 million gain recognized through the repurchase of trust preferred securities, at a discount.

Correspondent banking expense was up 11% when comparing the second quarter of 2017 to the second quarter of 2016 and up 12% when comparing the first six months of 2017 to the same period of 2016 due to both increases in volume and in the number of correspondent banking clients. These are direct costs incurred to provide services to QCBT's correspondent banking customer portfolio, including safekeeping and cash management services.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

INCOME TAXES

In the second quarter of 2017, the Company incurred income tax expense of \$2.6 million. During the first half of the year, the Company incurred income tax expense of \$5.0 million. Following is a reconciliation of the expected income tax expense to the income tax expense included in the consolidated statements of income for the three and six months ended June 30, 2017 and 2016.

| | For the Three Months Ended June 30, | | | | For the Six Months Ended June 30, | | | |
|--|-------------------------------------|--------------------------|-------------|--------------------------|-----------------------------------|--------------------------|-------------|--------------------------|
| | 2017 | % of Pretax Income | 2016 | % of Pretax Income | 2017 | % of Pretax Income | 2016 | % of Pretax Income |
| | Amount | | Amount | | Amount | | Amount | |
| Computed "expected" tax expense | \$3,990,557 | 35.0 % | \$3,090,364 | 35.0 % | \$8,041,601 | 35.0 % | \$6,027,743 | 35.0 % |
| Tax exempt interest income | (1,433,903) | (12.6) | (988,488) | (11.2) | (2,739,330) | (11.9) | (1,954,806) | (11.4) |
| Bank-owned life insurance | (160,775) | (1.4) | (168,182) | (1.9) | (325,166) | (1.4) | (305,945) | (1.8) |
| State income taxes, net of federal benefit, current year | 394,410 | 3.5 | 297,130 | 3.4 | 802,735 | 3.5 | 564,038 | 3.3 |
| Excess tax benefit on stock options exercised and restricted stock awards vested * | (89,545) | (0.8) | - | - | (622,867) | (2.7) | - | - |
| Other | (65,168) | (0.6) | (77,680) | (0.9) | (131,951) | (0.6) | (158,863) | (0.9) |
| Federal and state income tax expense | \$2,635,576 | 23.1 % | \$2,153,144 | 24.4 % | \$5,025,022 | 21.9 % | \$4,172,167 | 24.2 % |

* As a result of the implementation of ASU 2016-09 effective January 1, 2017, the excess tax benefit on stock options exercised and restricted stock awards vested is now recorded as an adjustment to income tax expense in the income statement. Previously, the excess tax benefit was recorded as an adjustment to equity.

The effective tax rate for the quarter ended June 30, 2017 was 23.1% which was a decrease from the effective tax rate of 24.4% for the quarter ended June 30, 2016. The effective tax rate for the six months ended June 30, 2017 was 21.9%, which was a decrease over the effective tax rate of 24.2% for the six months ended June 30, 2016. This shift was primarily due to the implementation of ASU 2016-09, which resulted in a tax benefit of \$90 thousand for the second quarter of 2017 and \$623 thousand for the first six months of 2017. The effective rate for the three months ended June 30, 2017 was also impacted by higher tax exempt interest income.

FINANCIAL CONDITION

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

| | As of | | June 30, 2017 | | March 31, 2017 | | December 31, 2016 | | June 30, 2016 | |
|--|-------------------------------|------|---------------|------|----------------|------|-------------------|------|---------------|---|
| | <i>(dollars in thousands)</i> | | Amount | % | Amount | % | Amount | % | Amount | % |
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Cash and due from banks | \$77,161 | 2 % | \$56,326 | 2 % | \$70,570 | 2 % | \$49,581 | 2 % | | |
| Federal funds sold and interest-bearing deposits | 72,354 | 2 % | 173,219 | 5 % | 86,206 | 3 % | 68,432 | 3 % | | |
| Securities | 593,485 | 17 % | 557,646 | 16 % | 574,022 | 19 % | 510,959 | 19 % | | |
| Net loans/leases | 2,520,209 | 73 % | 2,403,791 | 71 % | 2,374,730 | 70 % | 1,894,676 | 71 % | | |
| Other assets | 193,978 | 6 % | 190,031 | 6 % | 196,416 | 6 % | 159,786 | 6 % | | |
| Total assets | \$3,457,187 | 100% | \$3,381,013 | 100% | \$3,301,944 | 100% | \$2,683,434 | 100% | | |
| Total deposits | \$2,870,234 | 83 % | \$2,805,931 | 83 % | \$2,669,261 | 74 % | \$1,973,594 | 74 % | | |
| Total borrowings | 230,264 | 7 % | 231,534 | 7 % | 290,952 | 14 % | 381,875 | 14 % | | |
| Other liabilities | 51,606 | 1 % | 47,708 | 1 % | 55,690 | 2 % | 52,848 | 2 % | | |
| Total stockholders' equity | 305,083 | 9 % | 295,840 | 9 % | 286,041 | 10 % | 275,117 | 10 % | | |
| Total liabilities and stockholders' equity | \$3,457,187 | 100% | \$3,381,013 | 100% | \$3,301,944 | 100% | \$2,683,434 | 100% | | |

During the second quarter of 2017, the Company's total assets increased \$76.2 million, or 2%, to a total of \$3.5 billion. Total gross loans and leases grew \$117.7 million. This loan and lease growth was funded by deposits, which increased \$64.3 million in the second quarter of 2017, and excess cash from strong deposit growth from the first quarter of 2017. Stockholders' equity increased \$9.2 million, or 3%, in the current quarter due to net retained income.

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 interest rate risk and maximizing return, while minimizing credit risk. The Company has further diversified the portfolio by decreasing U.S government sponsored agency securities, while increasing residential mortgage-backed and related securities and tax-exempt municipal securities. Of the latter, the large majority are privately placed tax-exempt debt issuances by municipalities located in the Midwest (with some in or near the Company's existing markets) and require a thorough underwriting process before investment.

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 | | As of | | December 31, | | As of | |
|--|-------------------------------|-------|----------------|-------|--------------|-------|---------------|-------|
| | June 30, 2017 | | March 31, 2017 | | 2016 | | June 30, 2016 | |
| | Amount | % | Amount | % | Amount | % | Amount | % |
| | <i>(dollars in thousands)</i> | | | | | | | |
| U.S. govt. sponsored agency securities | \$41,944 | 7 % | \$47,556 | 9 % | \$46,084 | 8 % | \$88,321 | 17 % |
| Municipal securities | 381,254 | 64 % | 356,776 | 64 % | 374,463 | 65 % | 302,689 | 59 % |
| Residential mortgage-backed and related securities | 164,415 | 28 % | 147,504 | 26 % | 147,702 | 26 % | 116,765 | 23 % |
| Other securities | 5,872 | 1 % | 5,810 | 1 % | 5,773 | 1 % | 3,184 | 1 % |
| | \$593,485 | 100 % | \$557,646 | 100 % | \$574,022 | 100 % | \$510,959 | 100 % |
| Securities as a % of total assets | 17.17 | % | 16.49 | % | 17.38 | % | 19.04 | % |
| Net unrealized gains (losses) as a % of amortized cost | (0.33) |)% | (0.79) |)% | (0.87) |)% | 1.95 | % |
| Duration (in years) | 6.3 | | 6.1 | | 6.0 | | 5.1 | |
| Yield on investment securities (tax equivalent) | 3.76 | % | 3.73 | % | 3.56 | % | 3.64 | % |

Management monitors the level of unrealized gains/losses including performing quarterly reviews of individual securities for evidence of OTTI. Management identified no OTTI in any of the periods presented.

The duration of the securities portfolio extended modestly with the TEY on the portfolio improving 20 bps over the first half of 2017.

The Company has not invested in private 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 Act).

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

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

LOANS/LEASES

Total loans/leases grew 19.2% on an annualized basis during the second quarter of 2017. The mix of the loan/lease types within the Company's loan/lease portfolio is presented in the following table.

| | As of | | | | December 31, | | June 30, 2016 | |
|---|-------------------------------|-------|----------------|-------|--------------|-------|---------------|-------|
| | June 30, 2017 | | March 31, 2017 | | 2016 | | | |
| | Amount | % | Amount | % | Amount | % | Amount | % |
| | <i>(dollars in thousands)</i> | | | | | | | |
| C&I loans | \$942,538 | 37 % | \$851,578 | 35 % | \$827,637 | 34 % | \$706,261 | 37 % |
| CRE loans | 1,131,906 | 45 % | 1,106,842 | 46 % | 1,093,459 | 46 % | 784,379 | 41 % |
| Direct financing leases | 153,337 | 6 % | 159,368 | 7 % | 165,419 | 7 % | 169,928 | 9 % |
| Residential real estate loans | 233,871 | 9 % | 231,326 | 9 % | 229,233 | 10 % | 180,482 | 9 % |
| Installment and other consumer loans | 84,047 | 3 % | 78,771 | 3 % | 81,666 | 3 % | 73,658 | 4 % |
| Total loans/leases | \$2,545,699 | 100 % | \$2,427,885 | 100 % | \$2,397,414 | 100 % | \$1,914,708 | 100 % |
| Plus deferred loan/lease origination costs, net of fees | 7,867 | | 7,965 | | 8,073 | | 8,065 | |
| Less allowance | (33,357) | | (32,059) | | (30,757) | | (28,097) | |
| Net loans/leases | \$2,520,209 | | \$2,403,791 | | \$2,374,730 | | \$1,894,676 | |

As CRE loans have historically been the Company's largest portfolio segment, management places a strong emphasis on monitoring the composition of the Company's CRE loan portfolio. For example, management tracks the level of owner-occupied CRE loans relative to non owner-occupied loans. Owner-occupied loans are generally considered to have less risk. As of June 30, 2017 and March 31, 2017, respectively, approximately 28% and 29% of the CRE loan portfolio was owner-occupied.

Over the past several quarters, the Company has been successful in shifting the mix of its commercial loan portfolio by adding more C&I loans. C&I loans grew \$91.0 million in the current quarter, or an annualized rate of 43%.

A syndicated loan is a commercial loan provided by a group of lenders and is structured, arranged and administered by one or several commercial or investment banks known as arrangers. The nationally syndicated loans invested in by the Company consist of fully funded, highly liquid term loans for which there is a liquid secondary market. As of June 30, 2017 and December 31, 2016, the amount of nationally syndicated loans totaled \$44.3 million and \$46.5 million, respectively.

The Company also has several loans that are syndicated to borrowers in our existing markets or purchased from peer banks that we have a relationship with. These loans were immaterial as of June 30, 2017 and December 31, 2016.

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 CRE loan portfolio:

| | As of June 30, 2017 | | As of March 31, 2017 | | As of December 31, 2016 | | As of June 30, 2016 | |
|---------------------------------------|-------------------------------|-------|-------------------------|-------|-------------------------------|-------|------------------------|-------|
| | Amount | % | Amount | % | Amount | % | Amount | % |
| | <i>(dollars in thousands)</i> | | | | | | | |
| Lessors of Nonresidential Buildings | \$344,747 | 30 % | \$327,077 | 30 % | \$322,337 | 30 % | \$285,522 | 36 % |
| Lessors of Residential Buildings | 159,370 | 14 % | 147,335 | 13 % | 141,321 | 13 % | 104,395 | 13 % |
| New Housing For-Sale Builders | 52,277 | 5 % | 57,733 | 5 % | 56,711 | 5 % | 5,430 | 1 % |
| Nonresidential Property Managers | 52,947 | 5 % | 57,112 | 5 % | 70,914 | 7 % | 17,517 | 2 % |
| Land Subdivision | 46,117 | 4 % | 47,254 | 4 % | 45,132 | 4 % | 18,034 | 2 % |
| Hotels | 39,881 | 4 % | 37,998 | 4 % | 35,006 | 3 % | 19,804 | 3 % |
| Nursing Care Facilities | 33,607 | 3 % | 34,611 | 3 % | 34,768 | 3 % | 15,070 | 2 % |
| New Multifamily Housing Construction | 26,583 | 2 % | 26,915 | 2 % | 24,146 | 2 % | 11,671 | 2 % |
| Lessors of Other Real Estate Property | 20,932 | 2 % | 20,989 | 2 % | 25,664 | 2 % | 21,803 | 3 % |
| Other * | 355,445 | 31 % | 349,818 | 32 % | 337,460 | 31 % | 285,133 | 36 % |
| Total CRE Loans | \$1,131,906 | 100 % | \$1,106,842 | 100 % | \$1,093,459 | 100 % | \$784,379 | 100 % |

* "Other" consists of all other industries. None of these had concentrations greater than \$22.6 million, or approximately 2% of total CRE loans in the most recent period presented.

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 meet 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.

Part I

Item 2

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

Following is a listing of significant equipment types within the m2 loan and lease portfolio:

| | As of June 30, 2017 | | As of March 31, 2017 | | As of December 31, 2016 | | As of June 30, 2016 | |
|---------------------------|-------------------------------|-------|----------------------------|-------|-------------------------------|-------|------------------------|-------|
| | Amount | % | Amount | % | Amount | % | Amount | % |
| | <i>(dollars in thousands)</i> | | | | | | | |
| Manufacturing - General | \$19,092 | 9 % | \$18,067 | 9 % | \$17,434 | 8 % | \$16,918 | 8 % |
| Trucks & Vans | 16,679 | 8 % | 14,657 | 7 % | 13,806 | 7 % | 12,897 | 6 % |
| Construction - General | 15,207 | 7 % | 17,914 | 9 % | 16,815 | 8 % | 17,116 | 8 % |
| Food Processing Equipment | 13,754 | 7 % | 14,102 | 7 % | 14,316 | 7 % | 14,241 | 7 % |
| Marine - Travelifts | 12,497 | 6 % | 8,132 | 4 % | 8,180 | 4 % | 7,601 | 4 % |
| Manufacturing - CNC | 10,083 | 5 % | 6,812 | 3 % | 7,164 | 3 % | 7,974 | 4 % |
| Computer Hardware | 9,821 | 5 % | 10,094 | 5 % | 10,443 | 5 % | 10,529 | 5 % |
| Trailers | 9,611 | 5 % | 9,465 | 5 % | 10,003 | 5 % | 10,300 | 5 % |
| Restaurant | 7,238 | 3 % | 7,841 | 4 % | 7,950 | 4 % | 8,053 | 4 % |
| Furniture | 6,305 | 3 % | 6,259 | 3 % | \$6,945 | 3 % | \$3,313 | 2 % |
| Other | 93,966 | 42 % | 95,116 | 46 % | 97,989 | 46 % | 96,941 | 47 % |
| Total m2 loans and leases | 214,253 | 100 % | 208,459 | 100 % | 211,045 | 100 % | 205,883 | 100 % |

* "Other" consists of all other equipment types. None of these had concentrations greater than 3% of total m2 loan and lease portfolio in the most recent period presented.

See Note 3 to the Consolidated Financial Statements for additional information regarding the Company's loan and 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, 2017 and 2016 are presented as follows:

| | Three Months Ended | | Six Months Ended | |
|---|-----------------------------------|------------------|-----------------------------------|------------------|
| | June 30, 2017 | June 30, 2016 | June 30, 2017 | June 30, 2016 |
| | <i>(dollars in thousands)</i> | | <i>(dollars in thousands)</i> | |
| Balance, beginning | \$32,059 | \$27,395 | \$30,757 | \$26,141 |
| Provisions charged to expense | 2,023 | 1,198 | 4,128 | 3,271 |
| Loans/leases charged off | (851) | (634) | (1,743) | (1,502) |
| Recoveries on loans/leases previously charged off | 126 | 138 | 215 | 187 |
| Balance, ending | \$33,357 | \$28,097 | \$33,357 | \$28,097 |

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" as described in Note 1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2016 and carrying aggregate exposure in excess of \$250 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.

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| Internally Assigned Risk Rating * | As of June 30, 2017 | March 31, 2017 | December 31, 2016 | June 30, 2016 |
|---|-------------------------------|----------------|-------------------|---------------|
| | <i>(dollars in thousands)</i> | | | |
| Special Mention (Rating 6) | \$27,737 | \$ 22,841 | \$ 20,082 | \$ 16,231 |
| Substandard (Rating 7) | 45,290 | 50,810 | 49,035 | 44,636 |
| Doubtful (Rating 8) | - | - | - | - |
| | \$73,027 | \$ 73,651 | \$ 69,117 | \$ 60,867 |
| Criticized Loans ** | \$73,027 | \$ 73,651 | \$ 69,117 | \$ 60,867 |
| Classified Loans *** | \$45,290 | \$ 50,810 | \$ 49,035 | \$ 44,636 |
| Criticized Loans as a % of Total Loans/Leases | 2.86 % | 3.02 % | 2.87 % | 3.17 % |
| Classified Loans as a % of Total Loans/Leases | 1.77 % | 2.09 % | 2.04 % | 2.32 % |

* Amounts above include the government guaranteed portion, if any. For the calculation of allowance, 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 a modest increase in criticized loans and a decrease in classified loans during the first half of 2017; as shown below, these changes did not translate to increased NPLs. The Company continues its strong focus on improving credit quality in an effort to limit NPLs.

The following table summarizes the trend in the allowance as a percentage of gross loans/leases and as a percentage of NPLs.

| | As of | | | | | | | |
|--------------------------------|--------|-------|----------|------|--------|---|--------|---|
| | June | March | December | June | | | | |
| | 30, | 31, | 31, 2016 | 30, | | | | |
| | 2017 | 2017 | | 2016 | | | | |
| Allowance / Gross Loans/Leases | 1.31 | % | 1.32 | % | 1.28 | % | 1.46 | % |
| Allowance / NPLs * | 162.27 | % | 149.89 | % | 144.85 | % | 223.42 | % |

*NPLs consist of nonaccrual loans/leases, accruing loans/leases past due 90 days or more, and accruing TDRs.

Although management believes that the allowance at June 30, 2017 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.

In accordance with GAAP for business combination accounting, the loans acquired through the acquisition of CSB were recorded at market value; therefore, there was no allowance associated with CSB's loans at acquisition. Management continues to evaluate the allowance needed on the acquired CSB loans factoring in the net remaining discount (\$6.3 million at June 30, 2017). When factoring this remaining discount into the Company's allowance to

total loans and leases calculation, the Company's allowance as a percentage of total loans and leases increases from 1.31% to 1.55%. This elimination of CSB's allowance also resulted in a decrease of the allowance to NPLs ratio, as CSB's NPLs no longer have an allowance allocated to them and instead, have a loan discount that is separate from the allowance.

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

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 NPAs and related ratios.

| | As of June 30, 2017 | As of March 31, 2017 | As of December 31, 2016 | As of June 30, 2016 |
|--|-------------------------------|-------------------------------|----------------------------------|---------------------------|
| | <i>(dollars in thousands)</i> | | | |
| Nonaccrual loans/leases (1) (2) | \$13,217 | \$14,205 | \$13,919 | \$10,737 |
| Accruing loans/leases past due 90 days or more | 424 | 955 | 967 | 86 |
| TDRs - accruing | 6,915 | 6,229 | 6,347 | 1,753 |
| Total NPLs | 20,556 | 21,389 | 21,233 | 12,576 |
| OREO | 5,174 | 5,625 | 5,523 | 6,179 |
| Other repossessed assets | 123 | 285 | 202 | 154 |
| Total NPAs | \$25,853 | \$27,299 | \$26,958 | \$18,909 |
| NPLs to total loans/leases | 0.80 | 0.88 | 0.88 | 0.65 |
| NPAs to total loans/leases plus repossessed property | 1.01 | 1.12 | 1.12 | 0.98 |
| NPAs to total assets | 0.75 | 0.81 | 0.82 | 0.70 |
| Texas ratio (3) | 8.08 | 8.78 | 9.09 | 6.28 |

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

(2) Includes TDRs of \$2.2 million at June 30, 2017, \$2.4 million at March 31, 2017, \$2.3 million at December 31, 2016, and \$2.4 million at June 30, 2016.

(3) Texas Ratio = Nonperforming Assets (excluding Other Repossessed Assets) / Tangible Equity plus Allowance.
Texas Ratio is a non-GAAP financial measure. See GAAP to Non-GAAP Reconciliations for more information.

NPAs at June 30, 2017 were \$25.9 million, which were down from March 31, 2017 and up \$6.9 million from June 30, 2016. This increase was the result of two large credits added in the fourth quarter of 2016.

The ratio of NPAs to total assets was 0.75% at June 30, 2017, which was down from 0.81% at March 31, 2017, and up from 0.70% at June 30, 2016.

The large majority of the NPAs consist of nonaccrual loans/leases, accruing TDRs, and OREO. For nonaccrual loans/leases and accruing TDRs, management has thoroughly reviewed these loans/leases and has provided specific allowances as appropriate.

OREO is carried at the lower of carrying amount or fair value less costs to sell.

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 increased \$64.3 million during the second quarter of 2017. The table below presents the composition of the Company's deposit portfolio.

| | As of | | | | December 31, | | | |
|-------------------------------------|-------------------------------|------|----------------|------|--------------|------|---------------|------|
| | June 30, 2017 | | March 31, 2017 | | 2016 | | June 30, 2016 | |
| | | | | | | | | |
| | <i>(dollars in thousands)</i> | | | | | | | |
| | Amount | % | Amount | % | Amount | % | Amount | % |
| Noninterest bearing demand deposits | \$760,625 | 27 % | \$777,150 | 28 % | \$797,415 | 30 % | \$615,764 | 31 % |
| Interest bearing demand deposits | 1,526,103 | 52 % | 1,486,047 | 53 % | 1,369,226 | 51 % | 918,036 | 47 % |
| Time deposits | 478,580 | 17 % | 458,170 | 16 % | 439,169 | 17 % | 337,584 | 17 % |
| Brokered deposits | 104,926 | 4 % | 84,564 | 3 % | 63,451 | 2 % | 102,210 | 5 % |
| | \$2,870,234 | 100% | \$2,805,931 | 100% | \$2,669,261 | 100% | \$1,973,594 | 100% |

In an effort to strengthen the relationship and maximize the liquidity potential of its correspondent banking clients, the Company introduced an interest-bearing money market deposit account to its correspondent banking clients and this generated strong deposit growth in the first six months of 2017.

Quarter-end balances can greatly fluctuate due to large customer and correspondent bank activity. Management will continue to focus on growing its noninterest bearing deposit portfolio, including its correspondent banking business at QCBT, as well as shifting the mix from brokered and other higher cost deposits to lower cost core deposits.

BORROWINGS

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

The subsidiary banks offer short-term repurchase agreements to a few of their significant customers. Also, the subsidiary banks purchase federal funds for short-term funding needs from the FRB or from their correspondent banks. The table below presents the composition of the Company's short-term borrowings.

As of
 June 30, 2017 March 31, 2017 December 31, 2016 June 30, 2016

(dollars in thousands)

| | | | | |
|--|----------|----------|----------|----------|
| Overnight repurchase agreements with customers | \$4,897 | \$7,170 | \$8,131 | \$21,441 |
| Federal funds purchased | 13,320 | 12,300 | 31,840 | 30,120 |
| | \$18,217 | \$19,470 | \$39,971 | \$51,561 |

The Company is nearing the completion of a process to transition its overnight repurchase agreements with customers into a comparable interest bearing demand deposit product that offers full FDIC insurance. This transition has freed up securities that were previously pledged as collateral to the overnight repurchase agreements with customers and has enhanced the Company's ability to further rotate its earning assets from securities to loans.

As a result of their memberships in either the 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.

Part I

Item 2

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

The table below presents the Company's term FHLB advances and overnight FHLB advances.

| | As of | | | |
|-------------------------|-------------------------------|-------------------|----------------------|------------------|
| | June 30, 2017 | March 31, 2017 | December 31, 2016 | June 30, 2016 |
| | <i>(dollars in thousands)</i> | | | |
| Term FHLB advances | \$57,000 | \$59,000 | \$63,000 | \$78,000 |
| Overnight FHLB advances | 49,500 | 47,550 | 74,500 | 118,900 |
| | \$106,500 | \$106,550 | \$137,500 | \$196,900 |

Term FHLB advances decreased in the current quarter due to a small maturity of \$2.0 million. Overnight FHLB advances have increased by \$2.0 million.

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

| | As of | | | |
|--|-------------------------------|----------------------|----------------------|------------------|
| | June 30, 2017 | March 31, 2017 | December 31, 2016 | June 30, 2016 |
| | <i>(dollars in thousands)</i> | | | |
| Wholesale structured repurchase agreements | \$45,000 | \$45,000 | \$45,000 | \$100,000 |
| Term note | 27,000 | 27,000 | 30,000 | - |
| Revolving line of credit | - | - | 5,000 | - |
| | \$72,000 | \$72,000 | \$80,000 | \$100,000 |

Other borrowings include structured repos which are utilized as an alternative funding source to FHLB advances and customer deposits. Structured repos are collateralized by certain U.S. government agency securities and residential mortgage backed and related securities.

As described in Note 11 of the Company's Annual Report on Form 10-K for the year ended December 31, 2016, the Company has an outstanding five-year term note and revolving line of credit. As of June 30, 2017, the term debt had been paid down to \$27.0 million as scheduled. Also, in the first quarter of 2017, the Company paid off the full outstanding amount of the revolving line of credit. The term note and revolving line of credit were used to help fund the acquisition of CSB. As of June 30, 2017, the full \$10.0 million line of credit was available. If the line of credit is used, interest is calculated at the effective LIBOR rate plus 2.50% per annum (3.66% at June 30, 2017). In addition, a \$7.0 million term note commitment with a four-year term was executed with interest calculated at the effective LIBOR rate plus 3.00% per annum (4.16% at June 30, 2017) to fund a portion of the cash consideration.. This \$7.0 million term note commitment may be drawn upon closing of the acquisition of Guaranty Bank in late third quarter or early fourth quarter of 2017.

The Company executed several balance sheet restructuring strategies in 2016. Refer to Note 11 of the Annual Report on Form 10-K for the year ended December 31, 2016 for addition information regarding these prepayments.

It is management's intention to continue to reduce its reliance on wholesale funding, including FHLB advances, structured repos, and brokered deposits. Replacement of this funding with core deposits helps to reduce interest expense as wholesale funding tends to be higher cost. However, the Company may choose to utilize advances and/or brokered deposits to supplement funding needs, as this is a way for the Company to effectively and efficiently manage interest rate risk.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

The table below presents the maturity schedule including weighted average interest cost for the Company's combined wholesale funding portfolio.

| Maturity: | June 30, 2017 | | | December 31, 2016 | | |
|--------------------------|-------------------------------|--------------------------------|--|-------------------|--------------------------------|--|
| | Amount Due | Weighted Average Interest Rate | | Amount Due | Weighted Average Interest Rate | |
| | <i>(dollars in thousands)</i> | | | | | |
| Year ending December 31: | | | | | | |
| 2017 | 176,017 | 1.16 % | | 165,543 | 0.91 % | |
| 2018 | 38,459 | 2.56 | | 38,459 | 2.56 | |
| 2019 | 16,950 | 2.72 | | 16,950 | 2.65 | |
| 2020 | 25,000 | 2.48 | | 25,000 | 2.48 | |
| Total Wholesale Funding | \$256,426 | 1.60 % | | \$245,952 | 1.45 % | |

During the first six months of 2017, wholesale funding modestly increased \$10.5 million. Year-to-date, the Company has repaid \$6 million of term borrowings at maturity, however this was more than offset by growth in short-term borrowings used to temporarily fund strong earning asset growth.

STOCKHOLDERS' EQUITY

The table below presents the composition of the Company's stockholders' equity.

| As of | As of | As of | As of |
|----------|----------|----------|----------|
| June 30, | March | December | June 30, |
| 2017 | 31, 2017 | 31, 2016 | 2016 |

(dollars in thousands)

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | |
|----------------------------|-----------|-----------|-----------|-----------|
| Common stock | \$13,175 | \$13,161 | \$13,107 | \$13,057 |
| Additional paid in capital | 158,001 | 157,582 | 156,777 | 155,454 |
| Retained earnings | 135,254 | 127,145 | 118,617 | 105,024 |
| AOCI (loss) | (1,347) | (2,048) | (2,460) | 1,582 |
| Total stockholders' equity | \$305,083 | \$295,840 | \$286,041 | \$275,117 |
| | | | | |
| TCE* / TA | 8.29 | % | 8.20 | % |
| | | | 8.04 | % |
| | | | 10.10 | % |

*TCE is defined as total common stockholders' equity excluding goodwill and other intangibles. This ratio is a non-GAAP financial measure. See GAAP to Non-GAAP Reconciliations.

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 \$168.5 million during the second quarter of 2017 and \$139.5 million during the full year of 2016. 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, wholesale structured repurchase agreements, brokered deposits, lines of credit, borrowing at the Federal Reserve Discount Window, sales of securities AFS, 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, 2017, the subsidiary banks had 34 lines of credit totaling \$365.0 million, of which \$3.0 million was secured and \$362.0 million was unsecured. At June 30, 2017, \$359.1 million was available as \$5.9 million was utilized for short-term borrowing needs at QCBT.

At December 31, 2016, the subsidiary banks had 33 lines of credit totaling \$381.4 million, of which \$34.4 million was secured and \$347.0 million was unsecured. At December 31, 2016, \$361.4 million was available as \$20.0 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 a \$10.0 million secured revolving credit note with a variable interest rate and a maturity of June 30, 2018. At June 30, 2017, the full \$10.0 was available.

As of June 30, 2017, the Company has \$427.7 million in correspondent banking deposits spread over 181 relationships. While the Company believes that these funds are very stable, there is the potential for large fluctuations that can impact liquidity. Seasonality and the liquidity needs of these correspondent banks can impact balances. Management closely monitors these fluctuations and runs stress scenarios to measure the impact on liquidity and interest rate risk with various levels of correspondent deposit run-off.

Investing activities used cash of \$157.1 million during the first six months of 2017, compared to \$67.2 million for the same period of 2016. The net decrease in interest-bearing deposits at financial institutions was \$10.8 million for the first six months of 2017, compared to a net increase of \$11.2 million for the same period of 2016. Proceeds from calls, maturities, paydowns, and sales of securities were \$68.2 million for the first six months of 2017, compared to \$171.1 million for the same period of 2016. Purchases of securities used cash of \$89.8 million for the first six months of 2017, compared to \$97.1 million for the same period of 2016. The net increase in loans/leases used cash of \$146.4 million for the first six months of 2017 compared to \$125.0 million for the same period of 2016.

Part I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS – continued

Financing activities provided cash of \$140.2 million for the first six months of 2017, compared to \$60.3 million for same period of 2016. Net increases in deposits totaled \$201.0 million for the first six months of 2017, compared to \$92.9 million for the same period of 2016. During the first six months of 2017, the Company's short-term borrowings decreased \$21.8 million, while they decreased \$93.1 million for the same period of 2016. In the first six months of 2017, the Company reduced FHLB advances and other borrowings by \$39.0 million through a mixture of maturities, scheduled payments and the net change in short-term borrowings. In the first six months of 2016, the Company reduced FHLB advances and borrowings by \$25.2 million through a mixture of maturities, prepayments, and debt retirement. In the same period, the Company received \$29.8 million of proceeds from the common stock offering of 1.2 million shares of common stock.

Total cash provided by operating activities was \$23.6 million for the first six months of 2017, compared to \$14.8 million for the same period of 2016.

Throughout its history, the Company has secured additional capital through various sources, including the issuance of common and preferred stock, as well as trust preferred securities.

The following table presents the details of the trust preferred securities outstanding as of June 30, 2017 and December 31, 2016.

| Name | Date Issued | Amount Outstanding June 30, 2017 | Amount Outstanding December 31, 2016 | Interest Rate | Interest Rate as of June 30, 2017 | Interest Rate as of December 31, 2016 |
|----------------------------------|---------------|----------------------------------|--------------------------------------|--------------------------|-----------------------------------|---------------------------------------|
| QCR Holdings Statutory Trust II | February 2004 | \$ 10,310,000 | \$ 10,310,000 | 2.85% over 3-month LIBOR | 4.15% | 3.85% |
| QCR Holdings Statutory Trust III | February 2004 | 8,248,000 | 8,248,000 | 2.85% over 3-month LIBOR | 4.15% | 3.85% |
| | February 2006 | 10,310,000 | 10,310,000 | | 2.71% | 2.43% |

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

| | | | | | | |
|--|----------------|--------------|--------------|--------------------------|-------|-------|
| QCR Holdings Statutory Trust V | | | | 1.55% over 3-month LIBOR | | |
| Community National Statutory Trust II | September 2004 | 3,093,000 | 3,093,000 | 2.17% over 3-month LIBOR | 3.44% | 3.17% |
| Community National Statutory Trust III | March 2007 | 3,609,000 | 3,609,000 | 1.75% over 3-month LIBOR | 3.00% | 2.71% |
| | | \$35,570,000 | \$35,570,000 | Weighted Average Rate | 3.55% | 3.265 |

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, 2017, the remaining discount was \$2.0 million.

The Company filed a universal shelf registration statement on Form S-3 with the SEC on October 27, 2016, as amended on January 11, 2017. Declared effective by the SEC on January 31, 2017, the registration statement allows the Company to offer and sell various types of securities, including common stock, preferred stock, debt securities and/or warrants, from time to time up to an aggregate amount of \$100 million. The Company utilized \$30.1 million of its \$100 million previous shelf registration filing through the offer and sale of its common stock in the second quarter of 2016 to help fund the acquisition of CSB. This Form S-3 filing replenished the amount available to the previous level of \$100 million. The specific terms and prices of any securities offered pursuant to the registration statement 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. There were no securities issued under this shelf registration statement during the six months ended June 30, 2017.

The Company (on a consolidated basis) and the subsidiary banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and subsidiary banks' financial statements. Refer to Note 7 of the Consolidated Financial Statements for additional information regarding regulatory capital.

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" sections included under Item 1A of Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2016 and Item 1A of Part II of this report. 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. One should not consider the risk factors to be a complete discussion of risks, uncertainties and assumptions.

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 an effective manner. Notwithstanding the Company's interest rate risk management activities, the potential for changing interest rates is an uncertainty that can have an adverse effect on net income.

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

One method used to quantify interest rate risk is a short-term earnings at risk summary, which is a detailed and dynamic simulation model used to quantify the estimated exposure of net interest income to sustained interest rate changes. This simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest sensitive assets and liabilities reflected on the Company's consolidated balance

sheet. This sensitivity analysis demonstrates net interest income exposure annually over a five-year horizon, assuming no balance sheet growth and various interest rate scenarios including no change in rates; 200, 300, 400, and 500 basis point upward shifts; and a 100 basis point downward shift in interest rates, where interest-bearing assets and liabilities reprice at their earliest possible repricing date.

The model assumes parallel and pro rata shifts in interest rates over a twelve-month period for the 200 basis point upward shift and 100 basis point downward shift. For the 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.

Part I

Item 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK– continued

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 June 30, | As of December 31, | As of December 31, |
| | 2017 | 2016 | 2015 |
| 100 basis point downward shift -10.0% | -0.8% | -1.7% | -2.1% |
| 200 basis point upward shift -10.0% | -2.4% | -1.2% | -2.7% |
| 300 basis point upward shock -25.0% | -5.5% | -1.4% | -7.1% |

The simulation is well 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 June 30, 2017 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).

In 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 interest rate caps purchased 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

CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Exchange Act of 1934) as of June 30, 2017. 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.

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 Annual Report on Form 10-K for the year ended December 31, 2016. 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

73

Part II

QCR HOLDINGS, INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION - continued

Item 6 Exhibits

Purchase and Assumption Agreement, dated June 8, 2017, between QCR Holdings, Inc. and Guaranty Bankshares, Ltd. (incorporated by reference to Exhibit 2.1 of the Company's Form 8-K filed with the SEC on June 8, 2017.

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

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

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

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

101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016; (ii) Consolidated Statements of Income for the three and six months ended June 30, 2017 and June 30, 2016; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2017 and June 30, 2016; (iv) Consolidated Statements of Changes in Stockholders' Equity for the three and six months ended June 30, 2017 and June 30, 2016; (v) Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and June 30, 2016; 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 8, 2017 | /s/ Douglas M. Hultquist Douglas M. Hultquist, President Chief Executive Officer |
|------|----------------|--|

| | | |
|------|----------------|---|
| Date | August 8, 2017 | /s/ Todd A. Gipple Todd A. Gipple, Executive Vice President Chief Operating Officer Chief Financial Officer |
|------|----------------|---|

| | | |
|------|----------------|--|
| Date | August 8, 2017 | /s/ Elizabeth A. Grabin Elizabeth A. Grabin, First Vice President Director of Financial Reporting Principal Accounting Officer |
|------|----------------|--|