

QCR HOLDINGS INC
Form 10-Q
August 08, 2018
Table of Contents

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, 2018

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 42-1397595
(State or other jurisdiction of incorporation or organization) (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)

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).

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

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	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>	Non-accelerated filer	<input type="checkbox"/>
Smaller reporting company	<input type="checkbox"/>	Emerging growth company	<input type="checkbox"/>		

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

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of August 1, 2018, the Registrant had outstanding 15,664,417 shares of common stock, \$1.00 par value per share.

Table of Contents

QCR HOLDINGS, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page Number(s)
Part I FINANCIAL INFORMATION	
Item 1 Consolidated Financial Statements (Unaudited)	
<u>Consolidated Balance Sheets</u> <u>As of June 30, 2018 and December 31, 2017</u>	4
<u>Consolidated Statements of Income</u> <u>For the Three Months Ended June 30, 2018 and 2017</u>	5
<u>Consolidated Statements of Income</u> <u>For the Six Months Ended June 30, 2018 and 2017</u>	6
<u>Consolidated Statements of Comprehensive Income</u> <u>For the Three and Six Months Ended June 30, 2018 and 2017</u>	7
<u>Consolidated Statements of Changes in Stockholders' Equity</u> <u>For the Three and Six Months Ended June 30, 2018 and 2017</u>	8
<u>Consolidated Statements of Cash Flows</u> <u>For the Six Months Ended June 30, 2018 and 2017</u>	9
<u>Notes to Consolidated Financial Statements</u>	11
<u>Note 1. Summary of Significant Accounting Policies</u>	11
<u>Note 2. Investment Securities</u>	13
<u>Note 3. Loans/Leases Receivable</u>	17
<u>Note 4. Derivatives</u>	26
<u>Note 5. Earnings Per Share</u>	27
<u>Note 6. Fair Value</u>	28
<u>Note 7. Business Segment Information</u>	30
<u>Note 8. Regulatory Capital Requirements</u>	32
<u>Note 9. Revenue Recognition</u>	33
<u>Note 10. Mergers and Acquisitions</u>	34
Item 2 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	35
<u>Introduction</u>	35
<u>General</u>	35
<u>Executive Overview</u>	36
<u>Long-Term Financial Goals</u>	37
<u>Strategic Developments</u>	38
<u>GAAP to Non-GAAP Reconciliations</u>	39

<u>Net Interest Income (Tax Equivalent Basis)</u>	41
<u>Critical Accounting Policies</u>	47
<u>Results of Operations</u>	48
<u>Interest Income</u>	48

Table of Contents

<u>Interest Expense</u>	48
<u>Provision for Loan/Lease Losses</u>	49
<u>Noninterest Income</u>	49
<u>Noninterest Expense</u>	52
<u>Income Taxes</u>	54
<u>Financial Condition</u>	54
<u>Investment Securities</u>	55
<u>Loans/Leases</u>	56
<u>Allowance for Estimated Losses on Loans/Leases</u>	57
<u>Nonperforming Assets</u>	59
<u>Deposits</u>	59
<u>Borrowings</u>	60
<u>Stockholders' Equity</u>	61
<u>Liquidity and Capital Resources</u>	62
<u>Special Note Concerning Forward-Looking Statements</u>	63
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	65
<u>Item 4 Controls and Procedures</u>	67
<u>Part II OTHER INFORMATION</u>	68
<u>Item 1 Legal Proceedings</u>	68
<u>Item 1A Risk Factors</u>	68
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	68
<u>Item 3 Defaults upon Senior Securities</u>	68
<u>Item 4 Mine Safety Disclosures</u>	68
<u>Item 5 Other Information</u>	68
<u>Item 6 Exhibits</u>	69
<u>Signatures</u>	70

Throughout this Quarterly Report on Form 10-Q, we use certain acronyms and abbreviations, as defined in Note 1.

Table of Contents

QCR HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

As of June 30, 2018 and December 31, 2017

	June 30, 2018	December 31, 2017
Assets		
Cash and due from banks	\$ 69,069,403	\$ 75,721,663
Federal funds sold	10,866,000	30,197,000
Interest-bearing deposits at financial institutions	40,801,388	55,765,012
Securities held to maturity, at amortized cost	400,052,344	379,474,205
Securities available for sale, at fair value	257,944,671	272,907,907
Total securities	657,997,015	652,382,112
Loans receivable held for sale	1,033,700	645,001
Loans/leases receivable held for investment	3,113,758,723	2,963,840,399
Gross loans/leases receivable	3,114,792,423	2,964,485,400
Less allowance for estimated losses on loans/leases	(37,545,076)	(34,355,728)
Net loans/leases receivable	3,077,247,347	2,930,129,672
Bank-owned life insurance	59,876,754	59,059,494
Premises and equipment, net	64,472,319	62,838,255
Restricted investment securities	23,888,600	19,782,525
Other real estate owned, net	12,750,023	13,558,308
Goodwill	28,090,897	28,334,092
Core deposit intangible	8,469,851	9,078,953
Other assets	53,353,108	45,817,687
Total assets	\$ 4,106,882,705	\$ 3,982,664,773
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 746,821,779	\$ 789,547,696
Interest-bearing	2,551,454,248	2,477,107,360
Total deposits	3,298,276,027	3,266,655,056
Short-term borrowings	17,585,605	13,993,122
Federal Home Loan Bank advances	254,100,000	192,000,000
Other borrowings	71,125,000	66,000,000
Junior subordinated debentures	37,580,881	37,486,487
Other liabilities	58,627,027	53,242,979
Total liabilities	3,737,294,540	3,629,377,644
Stockholders' Equity:		

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Preferred stock, \$1 par value; shares authorized 250,000 June 2018 and December 2017- No shares issued or outstanding	—	—
Common stock, \$1 par value; shares authorized 20,000,000 June 2018 - 13,973,940 shares issued and outstanding December 2017 - 13,918,168 shares issued and outstanding	13,973,940	13,918,168
Additional paid-in capital	190,533,240	189,077,550
Retained earnings	171,955,296	151,962,661
Accumulated other comprehensive loss:		
Securities available for sale	(6,058,893)	(866,223)
Derivatives	(815,418)	(805,027)
Total stockholders' equity	369,588,165	353,287,129
Total liabilities and stockholders' equity	\$ 4,106,882,705	\$ 3,982,664,773

See Notes to Consolidated Financial Statements (Unaudited)

Table of Contents

QCR HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Three Months Ended June 30,

	2018	2017
Interest and dividend income:		
Loans/leases, including fees	\$ 35,407,851	\$ 28,114,729
Securities:		
Taxable	1,593,660	1,260,575
Nontaxable	3,295,046	2,688,243
Interest-bearing deposits at financial institutions	228,314	219,714
Restricted investment securities	211,902	131,890
Federal funds sold	61,441	38,117
Total interest and dividend income	40,798,214	32,453,268
Interest expense:		
Deposits	6,528,340	2,990,603
Short-term borrowings	62,503	19,157
Federal Home Loan Bank advances	882,118	354,213
Other borrowings	732,881	695,669
Junior subordinated debentures	507,876	346,929
Total interest expense	8,713,718	4,406,571
Net interest income	32,084,496	28,046,697
Provision for loan/lease losses	2,300,735	2,022,993
Net interest income after provision for loan/lease losses	29,783,761	26,023,704
Noninterest income:		
Trust department fees	2,057,987	1,692,001
Investment advisory and management fees	1,057,666	868,835
Deposit service fees	1,610,403	1,458,359
Gains on sales of residential real estate loans, net	101,772	112,628
Gains on sales of government guaranteed portions of loans, net	—	87,053
Swap fee income	1,648,885	327,577
Securities gains, net	—	38,464
Earnings on bank-owned life insurance	399,273	459,359
Debit card fees	844,286	743,521
Correspondent banking fees	212,530	200,057
Other	979,464	794,664
Total noninterest income	8,912,266	6,782,518
Noninterest expense:		
Salaries and employee benefits	15,804,016	12,930,944
Occupancy and equipment expense	3,132,658	2,698,336
Professional and data processing fees	2,771,223	2,340,699
Acquisition costs	413,602	—
Post-acquisition compensation, transition and integration costs	165,314	—

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

FDIC insurance, other insurance and regulatory fees	840,458	645,277
Loan/lease expense	260,089	260,284
Net cost of (income from) operations of other real estate	(70,190)	27,957
Advertising and marketing	753,084	567,588
Bank service charges	466,091	447,445
Correspondent banking expense	204,337	201,693
CDI amortization	304,551	230,867
Other	1,324,590	1,053,539
Total noninterest expense	26,369,823	21,404,629
Net income before income taxes	12,326,204	11,401,593
Federal and state income tax expense	1,880,819	2,635,576
Net income	\$ 10,445,385	\$ 8,766,017
Basic earnings per common share	\$ 0.75	\$ 0.67
Diluted earnings per common share	\$ 0.73	\$ 0.65
Weighted average common shares outstanding	13,919,565	13,170,283
Weighted average common and common equivalent shares outstanding	14,232,423	13,516,592
Cash dividends declared per common share	\$ 0.06	\$ 0.05
See Notes to Consolidated Financial Statements (Unaudited)		

Table of Contents

QCR HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Six Months Ended June 30,

	2018	2017
Interest and dividend income:		
Loans/leases, including fees	\$ 69,621,583	\$ 55,326,146
Securities:		
Taxable	3,149,544	2,402,810
Nontaxable	6,584,048	5,335,965
Interest-bearing deposits at financial institutions	425,317	418,366
Restricted investment securities	446,246	262,320
Federal funds sold	117,772	52,760
Total interest and dividend income	80,344,510	63,798,367
Interest expense:		
Deposits	11,409,489	5,223,359
Short-term borrowings	95,416	43,117
Federal Home Loan Bank advances	1,946,231	757,682
Other borrowings	1,451,057	1,378,877
Junior subordinated debentures	954,903	679,752
Total interest expense	15,857,096	8,082,787
Net interest income	64,487,414	55,715,580
Provision for loan/lease losses	4,840,574	4,128,102
Net interest income after provision for loan/lease losses	59,646,840	51,587,478
Noninterest income:		
Trust department fees	4,295,068	3,432,208
Investment advisory and management fees	2,010,010	1,830,434
Deposit service fees	3,141,856	2,774,749
Gains on sales of residential real estate loans, net	202,587	208,951
Gains on sales of government guaranteed portions of loans, net	358,434	1,037,694
Swap fee income	2,607,579	441,097
Securities gains, net	—	38,464
Earnings on bank-owned life insurance	817,260	929,046
Debit card fees	1,610,394	1,446,322
Correspondent banking fees	477,357	445,246
Other	1,933,170	1,482,061
Total noninterest income	17,453,715	14,066,272
Noninterest expenses:		
Salaries and employee benefits	31,781,991	26,238,275
Occupancy and equipment expense	6,198,469	5,200,555
Professional and data processing fees	5,478,939	4,424,091
Acquisition costs	506,141	—
Post-acquisition compensation, transition and integration costs	165,314	—

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

FDIC insurance, other insurance and regulatory fees	1,596,669	1,266,519
Loan/lease expense	550,836	553,822
Net cost of (income from) operations of other real estate	61,552	42,187
Advertising and marketing	1,446,323	1,177,019
Bank service charges	906,662	871,346
Correspondent banking expense	409,091	400,044
CDI amortization	609,102	461,733
Other	2,522,231	2,042,155
Total noninterest expenses	52,233,320	42,677,746
Income before income taxes	24,867,235	22,976,004
Federal and state income tax expense	3,871,889	5,025,022
Net income	\$ 20,995,346	\$ 17,950,982
Basic earnings per common share	\$ 1.51	\$ 1.36
Diluted earnings per common share	\$ 1.48	\$ 1.33
Weighted average common shares outstanding	13,904,113	13,151,833
Weighted average common and common equivalent shares outstanding	14,219,003	13,502,505
Cash dividends declared per common share	\$ 0.12	\$ 0.10
See Notes to Consolidated Financial Statements (Unaudited)		

Table of Contents

QCR HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

Three and Six Months Ended June 30, 2018 and 2017

	Three Months Ended June 30,	
	2018	2017
Net income	\$ 10,445,385	\$ 8,766,017
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale:		
Unrealized holding gains (losses) arising during the period before tax	(1,512,488)	1,170,310
Less reclassification adjustment for gains included in net income before tax	—	38,464
	(1,512,488)	1,131,846
Unrealized gains (losses) on derivatives:		
Unrealized holding gains (losses) arising during the period before tax	(322,937)	(132,352)
Less reclassification adjustment for ineffectiveness and caplet amortization before tax	177,688	(136,639)
	(500,625)	4,287
Other comprehensive income (loss), before tax	(2,013,113)	1,136,133
Tax expense (benefit)	(678,492)	434,394
Other comprehensive income (loss), net of tax	(1,334,621)	701,739
Comprehensive income	\$ 9,110,764	\$ 9,467,756
	Six Months Ended June 30,	
	2018	2017
Net income	\$ 20,995,346	\$ 17,950,982
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale:		
Unrealized holding gains (losses) arising during the period before tax	(6,878,601)	1,768,500
Less reclassification adjustment for gains (losses) included in net income before tax	—	38,464
Less reclassification adjustment for adoption of ASU 2016-01	855,039	—
	(6,023,562)	1,730,036
Unrealized gains (losses) on derivatives:		
Unrealized holding gains (losses) arising during the period before tax	(172,459)	(177,554)
Less reclassification adjustment for ineffectiveness and caplet amortization before tax	97,173	(259,452)

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

	(269,632)	81,898
Other comprehensive income (loss), before tax	(6,293,194)	1,811,934
Tax expense (benefit)	(1,757,033)	699,456
Other comprehensive income (loss), net of tax	(4,536,161)	1,112,478
Comprehensive income	\$ 16,459,185	\$ 19,063,460

See Notes to Consolidated Financial Statements (Unaudited)

7

Table of Contents

QCR HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

Three and Six Months Ended June 30, 2018 and 2017

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Total
Balance					
December 31, 2017	\$ 13,918,168	\$ 189,077,550	\$ 151,962,661	\$ (1,671,250)	\$ 353,287,129
Net income	—	—	10,549,961	—	10,549,961
Other comprehensive loss, net of tax	—	—	—	(3,201,540)	(3,201,540)
Impact of adoption of ASU 2016-01	—	—	666,900	(666,900)	—
Common cash dividends declared, \$0.06 per share	—	—	(833,730)	—	(833,730)
Issuance of 2,669 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan	2,669	100,262	—	—	102,931
Issuance of 13,074 shares of common stock as a result of stock options exercised	13,074	192,522	—	—	205,596
Stock-based compensation expense	—	495,493	—	—	495,493
Restricted stock awards - 6,860 shares of common stock	6,860	(6,860)	—	—	—
Exchange of 3,814 shares of common stock in connection with stock options exercised and restricted stock vested	(3,814)	(174,109)	—	—	(177,923)
Balance, March 31, 2018	\$ 13,936,957	\$ 189,684,858	\$ 162,345,792	\$ (5,539,690)	\$ 360,427,917
Net income	—	—	10,445,385	—	10,445,385
Other comprehensive loss, net of tax	—	—	—	(1,334,621)	(1,334,621)
	—	—	(835,881)	—	(835,881)

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Common cash dividends declared, \$0.06 per share					
Issuance of 5,728 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan	5,728	215,173	—	—	220,901
Issuance of 26,641 shares of common stock as a result of stock options exercised	26,641	362,292	—	—	388,933
Stock-based compensation expense	—	291,912	—	—	291,912
Restricted stock awards - 3,972 shares of common stock	3,972	(3,972)	—	—	—
Exchange of 642 shares of common stock in connection with stock options exercised and restricted stock vested	642	(17,023)	—	—	(16,381)
Balance, June 30, 2018	\$ 13,973,940	\$ 190,533,240	\$ 171,955,296	\$ (6,874,311)	\$ 369,588,165

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (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 loss, net of tax	—	—	—	410,739	410,739
Common cash dividends declared, \$0.05 per share	—	—	(656,574)	—	(656,574)
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
Issuance of 44,284 shares of common stock as a result of	44,284	630,290	—	—	674,574

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

stock options exercised					
Stock-based 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 loss, net of tax	—	—	—	701,739	701,739
Common cash dividends declared, \$0.05 per share	—	—	(657,003)	—	(657,003)
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
Issuance of 8,027 shares of common stock as a result of stock options exercised	8,027	109,392	—	—	117,419
Stock-based 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 and restricted stock vested	(594)	(26,730)	—	—	(27,324)
Balance, June 30, 2017	\$ 13,175,234	\$ 158,001,006	\$ 135,254,306	\$ (1,347,111)	\$ 305,083,435

See Notes to Consolidated Financial Statements (Unaudited)

Table of Contents

QCR HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Six Months Ended June 30, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 20,995,346	\$ 17,950,982
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,074,618	1,847,963
Provision for loan/lease losses	4,840,574	4,128,102
Stock-based compensation expense	787,405	557,067
Deferred compensation expense accrued	1,004,010	724,422
Losses on other real estate owned, net	118,159	3,596
Amortization of premiums on securities, net	828,972	1,005,121
Securities gains, net	—	(38,464)
Loans originated for sale	(21,899,515)	(32,130,683)
Proceeds on sales of loans	22,071,837	33,807,027
Gains on sales of residential real estate loans	(202,587)	(208,951)
Gains on sales of government guaranteed portions of loans	(358,434)	(1,037,694)
Amortization of core deposit intangible	609,102	461,733
Accretion of acquisition fair value adjustments, net	(496,561)	(3,578,379)
Increase in cash value of bank-owned life insurance	(817,260)	(929,046)
Increase (decrease) in other assets	(5,878,796)	3,412,207
Decrease (increase) in other liabilities	5,688,375	(7,059,305)
Net cash provided by operating activities	\$ 29,365,245	\$ 18,915,698
CASH FLOWS FROM INVESTING ACTIVITIES		
Net decrease in federal funds sold	19,331,000	3,074,000
Net decrease in interest-bearing deposits at financial institutions	14,963,624	10,777,600
Proceeds from sales of other real estate owned	736,370	487,815
Activity in securities portfolio:		
Purchases	(54,950,828)	(85,169,891)
Calls, maturities and redemptions	12,618,640	33,079,683
Paydowns	27,187,398	21,606,220
Sales	—	13,554,075
Activity in restricted investment securities:		
Purchases	(4,215,275)	(2,407,600)
Redemptions	109,200	1,300,700
Net increase in loans/leases originated and held for investment	(150,992,827)	(146,365,255)
Purchase of premises and equipment	(2,666,098)	(2,422,880)
Net cash used in investing activities	\$ (137,878,796)	\$ (152,485,533)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposit accounts	31,652,051	201,041,035
Net increase (decrease) in short-term borrowings	3,592,483	(21,753,994)

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Activity in Federal Home Loan Bank advances:		
Calls and maturities	(10,000,000)	(6,000,000)
Net change in short-term and overnight advances	72,100,000	(25,000,000)
Activity in other borrowings:		
Proceeds from other borrowings	9,000,000	—
Calls, maturities and scheduled principal payments	(3,875,000)	(8,000,000)
Payment of cash dividends on common stock	(1,526,604)	(1,179,146)
Proceeds from issuance of common stock, net	918,361	1,053,300
Net cash provided by financing activities	\$ 101,861,291	\$ 140,161,195
Net decrease in cash and due from banks	(6,652,260)	6,591,360
Cash and due from banks, beginning	75,721,663	70,569,993
Cash and due from banks, ending	\$ 69,069,403	\$ 77,161,353

(Continued)

Table of Contents

QCR HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) - continued

Six Months Ended June 30, 2018 and 2017

	2018	2017
Supplemental disclosure of cash flow information, cash payments for:		
Interest	\$ 12,303,768	\$ 7,876,668
Income/franchise taxes	\$ 1,010,097	\$ 7,450,738
Supplemental schedule of noncash investing activities:		
Change in accumulated other comprehensive income, unrealized gains on securities available for sale and derivative instruments, net	\$ (4,536,161)	\$ 1,112,478
Exchange of shares of common stock in connection with payroll taxes for restricted stock and in connection with stock options exercised	\$ (194,304)	\$ (317,614)
Transfers of loans to other real estate owned	\$ 46,244	\$ 141,828
Due to broker for purchases of securities	\$ —	\$ (4,662,631)
Dividends payable	\$ 835,881	\$ 657,003
Decrease (increase) in the fair value of interest rate swap assets and liabilities	\$ 1,774,502	\$ (209,185)
Transfer of equity securities from securities available for sale to other assets at fair value	\$ 2,614,261	\$ —

See Notes to Consolidated Financial Statements (Unaudited)

Table of Contents

Part I

Item 1

QCR HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2018

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, 2017, included in the Company's Annual Report on Form 10-K filed with the SEC on March 12, 2018. 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 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, 2018 are not necessarily indicative of the results expected for the year ending December 31, 2018, 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: Guaranty Bankshares, Ltd.
AOCI: Accumulated other comprehensive income (loss)	Guaranty Bank: Guaranty Bank and Trust Company
AFS: Available for sale	HTM: Held to maturity
ASC: Accounting Standards Codification	m2: m2 Lease Funds, LLC
ASU: Accounting Standards Update	NIM: Net interest margin
Bates Companies: Bates Financial Advisors, Inc., Bates Financial Services, Inc., Bates Securities, Inc. and Bates Financial Group, Inc.	NPA: Nonperforming asset
BOLI: Bank-owned life insurance	NPL: Nonperforming loan
Caps: Interest rate cap derivatives	OREO: Other real estate owned
CDI: Core deposit intangible	OTTI: Other-than-temporary impairment
Community National: Community National Bancorporation	PCI: Purchased credit impaired
CRBT: Cedar Rapids Bank & Trust Company	Provision: Provision for loan/lease losses
CRE: Commercial real estate	QCBT: Quad City Bank & Trust Company
CSB: Community State Bank	RB&T: Rockford Bank & Trust Company
C&I: Commercial and industrial	ROAA: Return on Average Assets
Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act	SBA: U.S. Small Business Administration
EPS: Earnings per share	SEC: Securities and Exchange Commission
	SFC Bank: Springfield First Community Bank
	Springfield Bancshares: Springfield Bancshares, Inc.
	TA: Tangible assets

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Exchange Act: Securities Exchange Act of 1934, as amended	Tax Act: Tax Cuts and Jobs Act of 2017
FASB: Financial Accounting Standards Board	TCE: Tangible common equity
FDIC: Federal Deposit Insurance Corporation	TDRs: Troubled debt restructurings
FHLB: Federal Home Loan Bank	TEY: Tax equivalent yield
FRB: Federal Reserve Bank of Chicago	The Company: QCR Holdings, Inc.
GAAP: Generally Accepted Accounting Principles	USDA: U.S. Department of Agriculture

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, with the exception of SFC Bank which was acquired by merger on July 1, 2018, and include the accounts of four commercial banks: QCBT, CRBT, CSB and RB&T. All are state-chartered commercial banks and all are members of the Federal Reserve system. 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 Guaranty Bank, headquartered in Cedar Rapids, Iowa occurred on October 2, 2017 and Guaranty Bank was merged into CRBT on December 2, 2017. The financial results for the periods since acquisition are included in this report. See Note 2 of the Company's Annual Report on Form 10 K for the year ended December 31, 2017 for additional information about the acquisition.

On July 1, 2018, the Company completed its previously announced merger with Springfield Bancshares, the holding company of SFC Bank, headquartered in Springfield, Missouri. The financial results of Springfield Bancshares and SFC Bank are not included in this report because the closing was effective July 1, 2018. See Note 10 to the Consolidated Financial Statements for additional information about the merger.

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 was adopted by the Company on January 1, 2018 and did not 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. Upon adoption of ASU 2016 01 by the Company on January 1, 2018, the fair value of the Company's loan portfolio is now presented using an exit price method. Also, the Company is no longer required to disclose the methodologies used for estimating fair value of financial assets and liabilities that are not measured at fair value on a recurring or nonrecurring basis. The

remaining requirements of this update had no significant impact on the 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

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

permitted for all entities. The Company has analyzed the impact of adoption and has concluded that it will not have a significant impact on the 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.

In February 2018, the FASB issued ASU 2018 02, Income Statement – Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. Under the standard, entities are allowed to make a one-time reclassification from AOCI to retained earnings for the effect of remeasuring deferred tax liabilities and assets originally recorded in other comprehensive income as a result of the change in the federal tax rate as defined by the Tax Act. ASU 2018 02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Companies may choose to early adopt for fiscal years or interim periods that have not been issued or made available for issuance as of February 14, 2018. The Company chose to early adopt ASU 2018 02 and apply the guidance to the consolidated financial statements for the year ended December 31, 2017.

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

NOTE 2 – INVESTMENT SECURITIES

The amortized cost and fair value of investment securities as of June 30, 2018 and December 31, 2017 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
June 30, 2018:				
Securities HTM:				
Municipal securities	\$ 399,002,344	\$ 4,916,288	\$ (7,700,914)	\$ 396,217,718
Other securities	1,050,000	—	(15,350)	1,034,650
	\$ 400,052,344	\$ 4,916,288	\$ (7,716,264)	\$ 397,252,368
Securities AFS:				
U.S. govt. sponsored agency securities	\$ 36,767,888	\$ 7,872	\$ (1,109,224)	\$ 35,666,536
Residential mortgage-backed and related securities	164,791,715	49,915	(6,307,182)	158,534,448

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Municipal securities	60,160,248	221,112	(874,093)	59,507,267
Other securities	4,254,509	—	(18,089)	4,236,420
	\$ 265,974,360	\$ 278,899	\$ (8,308,588)	\$ 257,944,671

13

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
December 31, 2017:				
Securities HTM:				
Municipal securities	\$ 378,424,205	\$ 2,763,718	\$ (2,488,119)	\$ 378,699,804
Other securities	1,050,000	—	—	1,050,000
	\$ 379,474,205	\$ 2,763,718	\$ (2,488,119)	\$ 379,749,804
Securities AFS:				
U.S. govt. sponsored agency securities	\$ 38,409,157	\$ 37,344	\$ (349,967)	\$ 38,096,534
Residential mortgage-backed and related securities	165,459,470	155,363	(2,313,529)	163,301,304
Municipal securities	66,176,364	660,232	(211,100)	66,625,496
Other securities	4,014,004	896,384	(25,815)	4,884,573
	\$ 274,058,995	\$ 1,749,323	\$ (2,900,411)	\$ 272,907,907

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, 2018 and December 31, 2017, 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, 2018:						
Securities HTM:						
Municipal securities	\$ 140,257,617	\$ (3,873,043)	\$ 61,121,755	\$ (3,827,871)	\$ 201,379,372	\$ (7,700,914)
Other securities	1,034,649	(15,350)	—	—	1,034,649	(15,350)
	\$ 141,292,266	\$ (3,888,393)	\$ 61,121,755	\$ (3,827,871)	\$ 202,414,021	\$ (7,716,264)

Securities AFS:						
U.S. govt. sponsored agency securities	\$ 31,724,483	\$ (928,027)	\$ 3,532,286	\$ (181,197)	\$ 35,256,769	\$ (1,109,224)
Residential mortgage-backed and related securities	93,074,220	(3,402,034)	59,724,819	(2,905,148)	152,799,039	(6,307,182)
Municipal securities	36,033,296	(648,203)	7,706,943	(225,890)	43,740,239	(874,093)
Other securities	4,236,420	(18,089)	—	—	4,236,420	(18,089)
	\$ 165,068,419	\$ (4,996,353)	\$ 70,964,048	\$ (3,312,235)	\$ 236,032,467	\$ (8,308,588)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2017:						
Securities HTM:						
Municipal securities	\$ 23,750,826	\$ (354,460)	\$ 72,611,780	\$ (2,133,659)	\$ 96,362,606	\$ (2,488,119)
Securities AFS:						
U.S. govt. sponsored agency securities	\$ 28,576,258	\$ (200,022)	\$ 3,640,477	\$ (149,945)	\$ 32,216,735	\$ (349,967)
Residential mortgage-backed and related securities	88,927,779	(871,855)	57,931,731	(1,441,674)	146,859,510	(2,313,529)
Municipal securities	10,229,337	(41,151)	9,997,433	(169,949)	20,226,770	(211,100)
Other securities	923,535	(25,815)	—	—	923,535	(25,815)
	\$ 128,656,909	\$ (1,138,843)	\$ 71,569,641	\$ (1,761,568)	\$ 200,226,550	\$ (2,900,411)

At June 30, 2018, the investment portfolio included 602 securities. Of this number, 303 securities were in an unrealized loss position. The aggregate losses of these securities totaled approximately 2.4% of the total amortized cost of the portfolio. Of these 303 securities, 42 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,

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

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.

The Company did not recognize OTTI on any investment securities for the three or six months ended June 30, 2018 and 2017.

There were no sales of securities for the three and six months ended June 30, 2018. All sales of securities for the three and six months ended June 30, 2017 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 and Six Months Ended June 30, 2017
Proceeds from sales of securities	\$ 13,554,075
Gross gains from sales of securities	59,568
Gross losses from sales of securities	(21,104)

The amortized cost and fair value of securities as of June 30, 2018 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.

	Amortized Cost	Fair Value
Securities HTM:		
Due in one year or less	\$ 1,732,495	\$ 1,737,807
Due after one year through five years	25,021,326	25,051,928
Due after five years	373,298,523	370,462,633
	\$ 400,052,344	\$ 397,252,368
Securities AFS:		
Due in one year or less	\$ 2,882,932	\$ 2,891,934
Due after one year through five years	25,265,433	24,969,540
Due after five years	73,034,280	71,548,749
	101,182,645	99,410,223
Residential mortgage-backed and related securities	164,791,715	158,534,448
	\$ 265,974,360	\$ 257,944,671

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

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	\$ 232,556,893	\$ 230,900,385
Securities AFS:		
U.S. govt. sponsored agency securities	4,998,914	4,873,050
Municipal securities	52,730,591	51,992,220
	\$ 57,729,505	\$ 56,865,270

As of June 30, 2018, the Company's municipal securities portfolios were comprised of general obligation bonds issued by 122 issuers with fair values totaling \$94.8 million and revenue bonds issued by 150 issuers, primarily consisting of states, counties, towns, villages and school districts with fair values totaling \$360.9 million. The Company held investments in general obligation bonds in 26 states, including six states in which the aggregate fair value exceeded \$5.0 million. The Company held investments in revenue bonds in 16 states, including seven states in which the aggregate fair value exceeded \$5.0 million.

As of December 31, 2017, the Company's municipal securities portfolios were comprised of general obligation bonds issued by 131 issuers with fair values totaling \$108.0 million and revenue bonds issued by 145 issuers, primarily consisting of states, counties, towns, villages and school districts with fair values totaling \$337.3 million. The Company held investments in general obligation bonds in 26 states, including six states in which the aggregate fair value exceeded \$5.0 million. The Company held investments in revenue bonds in 16 states, including seven states in which the aggregate fair value exceeded \$5.0 million.

Both general obligation and revenue bonds are diversified across many issuers. As of June 30, 2018 and December 31, 2017, 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, 2018, 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, 2018, 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.

Table of Contents

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, 2018 and December 31, 2017 is presented as follows:

	As of June 30, 2018	As of December 31, 2017
C&I loans*	\$ 1,273,000,094	\$ 1,134,516,315
CRE loans		
Owner-occupied CRE	349,007,830	332,742,477
Commercial construction, land development, and other land	162,644,566	186,402,404
Other non owner-occupied CRE	837,666,518	784,347,000
	1,349,318,914	1,303,491,882
Direct financing leases **	133,196,613	141,448,232
Residential real estate loans ***	257,433,713	258,646,265
Installment and other consumer loans	92,952,124	118,610,799
	3,105,901,458	2,956,713,493
Plus deferred loan/lease origination costs, net of fees	8,890,965	7,771,907
	3,114,792,423	2,964,485,400
Less allowance	(37,545,076)	(34,355,728)
	\$ 3,077,247,347	\$ 2,930,129,672
** Direct financing leases:		
Net minimum lease payments to be received	\$ 147,388,211	\$ 156,583,887
Estimated unguaranteed residual values of leased assets	929,932	929,932
Unearned lease/residual income	(15,121,530)	(16,065,587)
	133,196,613	141,448,232
Plus deferred lease origination costs, net of fees	4,159,711	4,624,027
	137,356,324	146,072,259
Less allowance	(2,724,355)	(2,382,098)
	\$ 134,631,969	\$ 143,690,161

* Includes equipment financing agreements outstanding at m2, totaling \$92,815,742 and \$66,758,397 as of June 30, 2018 and December 31, 2017, respectively.

** 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, 2018 and 2017.

*** Includes residential real estate loans held for sale totaling \$1,033,700 and \$645,001 as of June 30, 2018, and December 31, 2017, respectively.

17

Table of Contents

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, 2018			Six months ended June 30, 2018		
	PCI Loans	Performing Loans	Total	PCI Loans	Performing Loans	Total
Balance at the beginning of the period	\$ (156,896)	\$ (5,659,543)	\$ (5,816,439)	\$ (191,132)	\$ (6,280,075)	\$ (6,471,207)
Accretion recognized	14,848	608,119	622,967	49,084	1,228,651	1,277,735
Balance at the end of the period	\$ (142,048)	\$ (5,051,424)	\$ (5,193,472)	\$ (142,048)	\$ (5,051,424)	\$ (5,193,472)

	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, 2018 and December 31, 2017 is presented as follows:

Classes of Loans/Leases	As of June 30, 2018			Accruing Past Due 90 Days or Nonaccrual		Total
	Current	30-59 Days Past Due	60-89 Days Past Due	More Loans/Leases	Loans/Leases	

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

C&I CRE	\$ 1,270,508,073	\$ 602,885	\$ 403,841	\$ —	\$ 1,485,295	\$ 1,273,000,094						
Owner-Occupied CRE	348,357,289	228,703	—	—	421,838	349,007,830						
Commercial Construction, Land Development, and Other Land	158,999,305	1,758,740	—	—	1,886,521	162,644,566						
Other Non Owner-Occupied CRE	832,861,572	91,345	—	—	4,713,601	837,666,518						
Direct Financing Leases	129,115,766	1,019,243	532,600	—	2,529,004	133,196,613						
Residential Real Estate	254,927,412	374,480	816,670	—	1,315,151	257,433,713						
Installment and Other Consumer	92,086,640	588,332	55,189	19,573	202,390	92,952,124						
	\$ 3,086,856,057	\$ 4,663,728	\$ 1,808,300	\$ 19,573	\$ 12,553,800	\$ 3,105,901,458						
As a percentage of total loan/lease portfolio	99.39	%	0.15	%	0.06	%	0.00	%	0.40	%	100.00	%

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

Classes of Loans/Leases	As of December 31, 2017				Accruing Past Due 90 Days or More	Nonaccrual Loans/Leases	Total
	Current	30-59 Days Past Due	60-89 Days Past Due	Due 90 Days or More			
C&I CRE	\$ 1,124,734,486	\$ 8,306,829	\$ 243,647	\$ —	\$ 1,231,353	\$ 1,134,516,315	
Owner-Occupied CRE	331,868,142	540,435	—	—	333,900	332,742,477	
Commercial Construction, Land Development, and Other Land	181,558,092	—	—	—	4,844,312	186,402,404	
Other Non Owner-Occupied CRE	782,526,249	572,877	4,146	—	1,243,728	784,347,000	
Direct Financing Leases	137,708,397	1,305,191	259,600	—	2,175,044	141,448,232	
Residential Real Estate	253,261,821	3,552,709	393,410	74,519	1,363,806	258,646,265	
Installment and Other Consumer	117,773,259	517,537	56,760	14,152	249,091	118,610,799	
	\$ 2,929,430,446	\$ 14,795,578	\$ 957,563	\$ 88,671	\$ 11,441,234	\$ 2,956,713,493	
As a percentage of total loan/lease portfolio	99.08	% 0.50	% 0.03	% 0.00	% 0.39	% 100.00	

NPLs by classes of loans/leases as of June 30, 2018 and December 31, 2017 are presented as follows:

Classes of Loans/Leases	As of June 30, 2018			Total NPLs	Percentage of Total NPLs	
	Accruing Past Due 90 Days or More	Nonaccrual Loans/Leases*	Accruing TDRs			
C&I CRE	\$ —	\$ 1,485,295	\$ 800,176	\$ 2,285,471	16.44	%

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Owner-Occupied CRE	—	421,838	106,874	528,712	3.80	%
Commercial Construction, Land Development, and Other Land	—	1,886,521	—	1,886,521	13.57	%
Other Non Owner-Occupied CRE	—	4,713,601	—	4,713,601	33.92	%
Direct Financing Leases	—	2,529,004	137,432	2,666,436	19.18	%
Residential Real Estate	—	1,315,151	270,903	1,586,054	11.41	%
Installment and Other Consumer	19,573	202,390	11,623	233,586	1.68	%
	\$ 19,573	\$ 12,553,800	\$ 1,327,008	\$ 13,900,381	100.00	%

* Nonaccrual loans/leases included \$1,841,006 of TDRs, including \$66,021 in C&I loans, \$1,066,701 in CRE loans, \$619,727 in direct financing leases, \$83,287 in residential real estate loans, and \$5,270 in installment loans.

Classes of Loans/Leases	As of December 31, 2017		Accruing TDRs	Total NPLs	Percentage of	
	Accruing Past Due 90 Days or More	Nonaccrual Loans/Leases **			Total NPLs	Total NPLs
C&I	\$ —	\$ 1,231,353	\$ 5,224,182	\$ 6,455,535	34.63	%
CRE	—	333,900	107,322	441,222	2.37	%
Owner-Occupied CRE	—	4,844,312	—	4,844,312	25.99	%
Commercial Construction, Land Development, and Other Land	—	1,243,728	—	1,243,728	6.67	%
Other Non Owner-Occupied CRE	—	2,175,044	1,494,448	3,669,492	19.68	%
Direct Financing Leases	74,519	1,363,806	272,493	1,710,818	9.18	%
Residential Real Estate	14,152	249,091	14,027	277,270	1.49	%
Installment and Other Consumer	\$ 88,671	\$ 11,441,234	\$ 7,112,472	\$ 18,642,377	100.00	%

** Nonaccrual loans/leases included \$2,282,495 of TDRs, including \$122,598 in C&I loans, \$1,336,871 in CRE loans, \$700,255 in direct financing leases, \$115,190 in residential real estate loans, and \$7,581 in installment loans.

Table of Contents

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, 2018 and 2017, respectively, are presented as follows:

	Three Months Ended June 30, 2018					
	C&I	CRE	Direct Financing Leases	Residential Estate	Real Installment and Other Consumer	Total
Balance, beginning	\$ 15,065,245	\$ 14,938,020	\$ 2,730,301	\$ 2,375,219	\$ 1,423,817	\$ 36,532,602
Provisions (credits) charged to expense	777,013	871,475	687,908	57,283	(92,944)	2,300,735
Loans/leases charged off	(728,890)	—	(794,299)	—	(1,086)	(1,524,275)
Recoveries on loans/leases previously charged off	120,503	9,545	100,445	600	4,921	236,014
Balance, ending	\$ 15,233,871	\$ 15,819,040	\$ 2,724,355	\$ 2,433,102	\$ 1,334,708	\$ 37,545,076

	Three Months Ended June 30, 2017					
	C&I	CRE	Direct Financing Leases	Residential Estate	Real 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

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

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, 2018						
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
Balance, beginning	\$ 14,323,036	\$ 13,962,688	\$ 2,382,098	\$ 2,466,431	\$ 1,221,475	\$ 34,355,728
Provisions charged to expense	1,585,174	1,836,858	1,292,691	17,946	107,905	4,840,574
Loans/leases charged off	(824,389)	—	(1,078,186)	(52,325)	(5,833)	(1,960,733)
Recoveries on loans/leases previously charged off	150,050	19,494	127,752	1,050	11,161	309,507
Balance, ending	\$ 15,233,871	\$ 15,819,040	\$ 2,724,355	\$ 2,433,102	\$ 1,334,708	\$ 37,545,076
Six Months Ended June 30, 2017						
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
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

The allowance by impairment evaluation and by portfolio segment as of June 30, 2018 and December 31, 2017 is presented as follows:

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

As of June 30, 2018

	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
allowance for impaired leases/leases	\$ 308,091	\$ 2,109,374	\$ 375,803	\$ 239,419	\$ 106,878	\$ 3,139,565
allowance for impaired leases/leases	14,925,780	13,709,666	2,348,552	2,193,683	1,227,830	34,405,511
	\$ 15,233,871	\$ 15,819,040	\$ 2,724,355	\$ 2,433,102	\$ 1,334,708	\$ 37,545,076
impaired leases/leases	\$ 1,551,445	\$ 6,967,425	\$ 2,529,004	\$ 1,449,866	\$ 214,655	\$ 12,712,395
impaired leases/leases	1,271,448,649	1,342,351,489	130,667,609	255,983,847	92,737,469	3,093,189,063
	\$ 1,273,000,094	\$ 1,349,318,914	\$ 133,196,613	\$ 257,433,713	\$ 92,952,124	\$ 3,105,901,458
allowance as a percentage of impaired leases/leases	19.86	% 30.27	% 14.86	% 16.51	% 49.79	% 24.70
allowance as a percentage of impaired leases/leases	1.17	% 1.02	% 1.80	% 0.86	% 1.32	% 1.11
allowance as a percentage of total leases/leases	1.20	% 1.17	% 2.05	% 0.95	% 1.44	% 1.21

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

	As of December 31, 2017									
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total				
allowance for impaired loans/leases	\$ 715,627	\$ 1,429,460	\$ 504,469	\$ 355,167	\$ 38,596	\$ 3,043,319				
allowance										
for impaired loans/leases	13,607,409	12,533,228	1,877,629	2,111,264	1,182,879	31,312,409				
	\$ 14,323,036	\$ 13,962,688	\$ 2,382,098	\$ 2,466,431	\$ 1,221,475	\$ 34,355,728				
for impaired loans/leases	\$ 6,248,209	\$ 6,529,262	\$ 3,669,492	\$ 1,704,846	\$ 202,354	\$ 18,354,163				
for impaired loans/leases	1,128,268,106	1,296,962,620	137,778,740	256,941,419	118,408,445	2,938,359,330				
	\$ 1,134,516,315	\$ 1,303,491,882	\$ 141,448,232	\$ 258,646,265	\$ 118,610,799	\$ 2,956,713,493				
allowance as percentage of impaired loans/leases	11.45	% 21.89	% 13.75	% 20.83	% 19.07	% 16.58				
allowance as percentage of total loans/leases	1.21	% 0.97	% 1.36	% 0.82	% 1.00	% 1.07				
allowance as percentage of total loans/leases	1.26	% 1.07	% 1.68	% 0.95	% 1.03	% 1.16				

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.

Table of Contents

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 six months ended June 30, 2018 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	\$ 1,159,577	\$ 1,173,853	\$ —	\$ 1,465,402	\$ 138,543	\$ 138,543
CRE						
Owner-Occupied CRE	288,813	288,813	—	289,112	11,690	11,690
Commercial Construction, Land						
Development, and Other Land	—	—	—	—	—	—
Other Non Owner-Occupied CRE	982,428	982,428	—	1,151,245	—	—
Direct Financing Leases	1,903,173	1,903,173	—	2,551,149	9,292	9,292
Residential Real Estate	941,520	1,016,299	—	904,898	—	—
Installment and Other Consumer	99,814	99,814	—	95,448	—	—
	\$ 5,375,325	\$ 5,464,380	\$ —	\$ 6,457,254	\$ 159,525	\$ 159,525
Impaired Loans/Leases with Specific Allowance Recorded:						
C&I	\$ 391,868	\$ 391,868	\$ 308,091	\$ 327,859	\$ —	\$ —
CRE	142,788	142,788	39,288	147,375	—	—

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Owner-Occupied CRE Commercial Construction, Land Development, and Other Land Other Non Owner-Occupied CRE	5,553,396	5,553,396	2,070,086	5,275,992	—	—
Direct Financing Leases	625,831	625,831	375,803	521,142	—	—
Residential Real Estate	508,346	531,422	239,419	522,134	5,893	5,893
Installment and Other Consumer	114,841	114,841	106,878	109,254	159	159
	\$ 7,337,070	\$ 7,360,146	\$ 3,139,565	\$ 6,903,756	\$ 6,052	\$ 6,052
 Total Impaired Loans/Leases:						
C&I CRE	\$ 1,551,445	\$ 1,565,721	\$ 308,091	\$ 1,793,261	\$ 138,543	\$ 138,543
Owner-Occupied CRE Commercial Construction, Land Development, and Other Land Other Non Owner-Occupied CRE	431,601	431,601	39,288	436,487	11,690	11,690
Direct Financing Leases	5,553,396	5,553,396	2,070,086	5,275,992	—	—
Residential Real Estate	982,428	982,428	—	1,151,245	—	—
Installment and Other Consumer	2,529,004	2,529,004	375,803	3,072,291	9,292	9,292
	1,449,866	1,547,721	239,419	1,427,032	5,893	5,893
	214,655	214,655	106,878	204,702	159	159
	\$ 12,712,395	\$ 12,824,526	\$ 3,139,565	\$ 13,361,010	\$ 165,577	\$ 165,577

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

Table of Contents

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, 2018 and 2017, respectively, are presented as follows:

Classes of Loans/Leases	Three Months Ended June 30, 2018			Three Months Ended June 30, 2017		
	Average Recorded Investment	Interest Income		Average Recorded Investment	Interest Income	
		Recognized	Cash Payments Received		Recognized	Cash Payments Received
Impaired Loans/Leases with No Specific Allowance Recorded:						
C&I CRE	\$ 1,400,498	\$ 59,176	\$ 59,176	\$ 805,309	\$ 9,399	\$ 9,399
Owner-Occupied CRE	289,036	5,868	5,868	—	—	—
Commercial Construction, Land Development, and Other Land	—	—	—	—	—	—
Other Non Owner-Occupied CRE	1,105,004	—	—	1,160,161	—	—
Direct Financing Leases	2,198,852	2,544	2,544	2,560,019	38,949	38,949
Residential Real Estate	928,809	—	—	712,793	—	—
Installment and Other Consumer	101,582	—	—	173,585	218	218
	\$ 6,023,781	\$ 67,588	\$ 67,588	\$ 5,411,867	\$ 48,566	\$ 48,566
Impaired Loans/Leases with Specific Allowance Recorded:						
C&I CRE	\$ 353,153	\$ 1,978	\$ 1,978	\$ 8,066,702	\$ 35,055	\$ 35,055
Owner-Occupied CRE	145,082	—	—	238,584	—	—

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Commercial Construction, Land Development, and Other Land	5,491,832	—	—	4,348,142	—	—
Other Non Owner-Occupied CRE	—	—	—	38,260	—	—
Direct Financing Leases	566,063	—	—	757,602	—	—
Residential Real Estate	512,222	2,959	2,959	624,641	2,989	2,989
Installment and Other Consumer	116,887	76	76	34,333	—	—
	\$ 7,185,239	\$ 5,014	\$ 5,014	\$ 14,108,264	\$ 38,044	\$ 38,044
Total Impaired Loans/Leases:						
C&I CRE	\$ 1,753,651	\$ 61,154	\$ 61,154	\$ 8,872,011	\$ 44,454	\$ 44,454
Owner-Occupied CRE	434,118	5,868	5,868	238,584	—	—
Commercial Construction, Land Development, and Other Land	5,491,832	—	—	4,348,142	—	—
Other Non Owner-Occupied CRE	1,105,004	—	—	1,198,421	—	—
Direct Financing Leases	2,764,915	2,544	2,544	3,317,621	38,949	38,949
Residential Real Estate	1,441,031	2,959	2,959	1,337,434	2,989	2,989
Installment and Other Consumer	218,469	76	76	207,918	218	218
	\$ 13,209,020	\$ 72,602	\$ 72,602	\$ 19,520,131	\$ 86,610	\$ 86,610

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

Table of Contents

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, 2017 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	\$ 1,634,269	\$ 1,644,706	\$ —
CRE			
Owner-Occupied CRE	289,261	289,261	—
Commercial Construction, Land Development, and Other Land	—	—	—
Other Non Owner-Occupied CRE	1,171,565	1,171,565	—
Direct Financing Leases	2,944,540	2,944,540	—
Residential Real Estate	943,388	1,018,167	—
Installment and Other Consumer	134,245	134,245	—
	\$ 7,117,268	\$ 7,202,484	\$ —
Impaired Loans/Leases with Specific Allowance Recorded:			
C&I	\$ 4,613,940	\$ 4,617,879	\$ 715,627
CRE			
Owner-Occupied CRE	151,962	151,962	48,462
Commercial Construction, Land Development, and Other Land	4,844,312	4,844,312	1,379,235
Other Non Owner-Occupied CRE	72,163	72,163	1,763
Direct Financing Leases	724,953	724,953	504,469
Residential Real Estate	761,458	761,458	355,167
Installment and Other Consumer	68,109	68,109	38,596
	\$ 11,236,897	\$ 11,240,836	\$ 3,043,319
Total Impaired Loans/Leases:			
C&I	\$ 6,248,209	\$ 6,262,585	\$ 715,627
CRE			
Owner-Occupied CRE	441,222	441,222	48,462
Commercial Construction, Land Development, and Other Land	4,844,312	4,844,312	1,379,235
Other Non Owner-Occupied CRE	1,243,728	1,243,728	1,763
Direct Financing Leases	3,669,492	3,669,492	504,469
Residential Real Estate	1,704,846	1,779,625	355,167
Installment and Other Consumer	202,354	202,354	38,596

\$ 18,354,163 \$ 18,443,318 \$ 3,043,319

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

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 certain C&I loans (equipment financing agreements), 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.

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

For each class of financing receivable, the following presents the recorded investment by credit quality indicator as of June 30, 2018 and December 31, 2017:

Internally Assigned Risk Rating	As of June 30, 2018					As a % of	
	C&I	CRE	Owner-Occupied and Other Land	Non Owner-Occupied Commercial Construction, Land Development, and Other CRE	Total	Total	Total
Pass (Ratings 1 through 5)	\$ 1,135,035,263	\$ 342,518,625	\$ 160,224,065	\$ 805,031,050	\$ 2,442,809,003	96.57	%
Special Mention (Rating 6)	29,414,324	3,984,113	—	10,804,187	44,202,624	1.75	%
Substandard (Rating 7)	15,734,765	2,505,092	2,420,501	21,831,281	42,491,639	1.68	%
Doubtful (Rating 8)	—	—	—	—	—	—	%
	\$ 1,180,184,352	\$ 349,007,830	\$ 162,644,566	\$ 837,666,518	\$ 2,529,503,266	100.00	%

Delinquency Status *	As of June 30, 2018					As a % of	
	C&I	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total	Total	Total
Performing	\$ 92,361,366	\$ 130,530,177	\$ 255,847,659	\$ 92,718,538	\$ 571,457,740	99.14	%
Nonperforming	454,376	2,666,436	1,586,054	233,586	4,940,452	0.86	%
	\$ 92,815,742	\$ 133,196,613	\$ 257,433,713	\$ 92,952,124	\$ 576,398,192	100.00	%

As of December 31, 2017

CRE

Non Owner-Occupied

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Internally Assigned Risk Rating	C&I	Owner-Occupied CRE	Commercial Construction, Land Development, and Other Land	Other CRE	Total	As a % of	
						Total	Total
Pass (Ratings 1 through 5)	\$ 1,031,963,703	\$ 318,293,608	\$ 179,142,839	\$ 767,119,909	\$ 2,296,520,059	96.85	%
Special Mention (Rating 6)	10,944,924	8,230,060	1,780,000	10,068,870	31,023,854	1.31	%
Substandard (Rating 7)	24,578,731	6,218,809	5,479,565	7,158,221	43,435,326	1.83	%
Doubtful (Rating 8)	270,559	—	—	—	270,559	0.01	%
	\$ 1,067,757,917	\$ 332,742,477	\$ 186,402,404	\$ 784,347,000	\$ 2,371,249,799	100.00	%

As of December 31, 2017

Delinquency Status *	C&I	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total	As a % of	
						Total	Total
Performing	\$ 65,847,177	\$ 137,778,740	\$ 256,935,447	\$ 118,333,529	\$ 578,894,893	98.88	%
Nonperforming	911,220	3,669,492	1,710,818	277,270	6,568,800	1.12	%
	\$ 66,758,397	\$ 141,448,232	\$ 258,646,265	\$ 118,610,799	\$ 585,463,693	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.

As of June 30, 2018 and December 31, 2017, TDRs totaled \$3,168,014 and \$9,394,967, 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, 2018 and 2017. The difference between

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

the pre-modification recorded investment and the post-modification recorded investment would be any partial charge-offs at the time of the restructuring. No loans were restructured during the three months ended June 30, 2018.

Classes of Loans/Leases	For the three months ended June 30, 2018					For the three months ended June 30, 2017		
	Number of Loans / Leases	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Specific Allowance	Number of Loans / Leases	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Specific Allowance
CONCESSION - Significant Payment Delay C&I	—	\$ —	\$ —	\$ —	1	\$ 47,509	\$ 47,509	\$ —
Direct Financing Leases	—	—	—	—	15	802,542	802,542	—
	—	\$ —	\$ —	\$ —	16	\$ 850,051	\$ 850,051	\$ —
CONCESSION - Extension of Maturity Direct Financing Leases	—	\$ —	\$ —	\$ —	1	\$ 98,119	\$ 98,119	\$ —
	—	\$ —	\$ —	\$ —	1	\$ 98,119	\$ 98,119	\$ —
TOTAL	—	\$ —	\$ —	\$ —	17	\$ 948,170	\$ 948,170	\$ —

Classes of Loans/Leases	For the six months ended June 30, 2018					For the six months ended June 30, 2017		
	Number of Loans/Leases	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Specific Allowance	Number of Loans/Leases	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Speci Allo
CONCESSION - Extension of Maturity Direct Financing Leases	—	—	—	—	2	104,382	104,382	—
	—	\$ —	\$ —	\$ —	2	\$ 104,382	\$ 104,382	\$ —

CONCESSION								
- Significant								
Payment Delay								
C&I	—	\$ —	\$ —	\$ —	3	\$ 181,198	\$ 181,198	\$ —
Real Estate	1	46,320	46,320	—	—	—	—	—
Direct								
Financing								
Leases	2	47,524	47,524	—	23	1,472,403	1,472,403	—
	3	\$ 93,844	\$ 93,844	\$ —	26	\$ 1,653,601	\$ 1,653,601	\$ —
TOTAL	3	\$ 93,844	\$ 93,844	\$ —	28	\$ 1,757,983	\$ 1,757,983	\$ —

Of the TDRs reported above, one with a post-modification recorded balance of \$46,320 was on nonaccrual as of June 30, 2018. Of the TDRs reported above, none were on nonaccrual as of June 30, 2017.

For the three and six months ended June 30, 2018, seven 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. Three of these TDRs were related to one customer whose loans were restructured in the second quarter of 2017 with pre-modification balances totaling \$78 thousand and the other TDRs related to other customers whose loans were restructured in the second and third quarters of 2017 with pre-modification balances totaling \$378 thousand.

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.

Not included in the table above, the Company had 8 TDRs that were restructured and charged off in 2018, totaling \$577,377. The Company had 2 TDRs that were restructured and charged off in 2017, totaling \$65,623.

NOTE 4 – DERIVATIVES

The Company uses interest rate swap and cap instruments to manage interest rate risk related to the variability of interest payments due to changes in interest rates. The Company entered into interest rate caps on June 5, 2014 to hedge against the risk of rising interest rates on short-term liabilities. The short-term liabilities consist of \$30.0 million of 1-month FHLB advances, and the benchmark rate hedged is 1-month LIBOR. The interest rate caps are designated as a cash flow

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

hedge in accordance with ASC 815. An initial premium of \$2.1 million was paid upfront for the two caps. The details of the interest rate caps are as follows:

Hedged Instrument	Effective Date	Maturity Date	Balance Sheet Location	Notional Amount	1-Month LIBOR Strike Rate	Fair Value as of	
						June 30, 2018	December 31, 2017
1-month FHLB Advance	6/3/2014	6/5/2019	Other Assets	\$ 15,000,000	1.00%	\$ 199,821	\$ 190,085
1-month FHLB Advance	6/5/2014	6/5/2021	Other Assets	15,000,000	1.50%	506,470	316,615
				\$ 30,000,000		\$ 706,291	\$ 506,700

On June 21, 2018, the Company entered into interest rate swaps to hedge against the risk of rising rates on its variable rate trust preferred securities. The floating rate trust preferred securities are tied to 3-month LIBOR, and the interest rate swaps utilize 3-month LIBOR, so the hedge is effective. The interest rate swaps are designated as a cash flow hedge in accordance with ASC 815. The details of the interest rate swaps are as follows:

Hedged Instrument	Effective Date	Maturity Date	Balance Sheet Location	Notional Amount	Receive Rate	Pay Rate	Fair Value as of June 30, 2018
QCR Holdings Statutory Trust II	9/30/2018	9/30/2028	Other Liabilities	\$ 10,000,000	5.19%	5.85%	\$ (94,210)
QCR Holdings Statutory Trust III	9/30/2018	9/30/2028	Other Liabilities	8,000,000	5.19%	5.85%	(75,368)
QCR Holdings Statutory Trust V	7/7/2018	7/7/2028	Other Liabilities	10,000,000	3.90%	4.54%	(97,961)
Community National Statutory Trust II	9/20/2018	9/20/2028	Other Liabilities	3,000,000	4.49%	5.17%	(28,329)
Community National Statutory Trust III	9/15/2018	9/15/2028	Other Liabilities	3,500,000	4.09%	4.75%	(33,330)
Guaranty Bankshares	9/15/2018	9/15/2028	Other Liabilities	4,500,000	4.09%	4.75%	(42,852)

Statutory Trust I

\$ 39,000,000 4.58% 5.24% \$ (372,050)

Changes in fair values of derivatives designated as cash flow hedges are recorded in OCI to the extent the hedge is effective, and reclassified to earnings as the hedged transaction (interest payments on debt) impact earnings.

The caps and swaps are valued by the transaction counterparty on a monthly basis and corroborated by a third party annually.

NOTE 5 - EARNINGS PER SHARE

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net income	\$ 10,445,385	\$ 8,766,017	\$ 20,995,346	\$ 17,950,982
Basic EPS	\$ 0.75	\$ 0.67	\$ 1.51	\$ 1.36
Diluted EPS	\$ 0.73	\$ 0.65	\$ 1.48	\$ 1.33
Weighted average common shares outstanding	13,919,565	13,170,283	13,904,113	13,151,833
Weighted average common shares issuable upon exercise of stock options and under the employee stock purchase plan	312,858	346,309	314,890	350,672
Weighted average common and common equivalent shares outstanding	14,232,423	13,516,592	14,219,003	13,502,505

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

The increase in weighted average common shares outstanding when comparing the three and six months ended June 30, 2018 to June 30, 2017 was primarily due to the common stock issuance discussed in Note 2 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10 K for the year ended December 31, 2017.

NOTE 6 – FAIR VALUE

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

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in markets;
 - Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and
 - Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.
- Assets and liabilities measured at fair value on a recurring basis comprise the following at June 30, 2018 and December 31, 2017:

	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)
June 30, 2018:				
Securities AFS:				
U.S. govt. sponsored agency securities	\$ 35,666,536	\$ —	\$ 35,666,536	\$ —
Residential mortgage-backed and related securities	158,534,448	—	158,534,448	—
Municipal securities	59,507,267	—	59,507,267	—
Other securities	4,236,420	—	4,236,420	—
Interest rate caps	706,291	—	706,291	—
Interest rate swaps - assets	6,171,740	—	6,171,740	—
Total assets measured at fair value	\$ 264,822,702	\$ —	\$ 264,822,702	\$ —
Interest rate swaps - liabilities	\$ 6,543,790	\$ —	\$ 6,543,790	\$ —
Total liabilities measured at fair value	\$ 6,543,790	\$ —	\$ 6,543,790	\$ —

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

December 31, 2017:

Securities AFS:

U.S. govt. sponsored agency securities	\$ 38,096,534	\$ —	\$ 38,096,534	\$ —
Residential mortgage-backed and related securities	163,301,304	—	163,301,304	—
Municipal securities	66,625,496	—	66,625,496	—
Other securities	4,884,573	1,028	4,883,545	—
Interest rate caps	506,700	—	506,700	—
Interest rate swaps - assets	4,397,238	—	4,397,238	—
Total assets measured at fair value	\$ 277,811,845	\$ 1,028	\$ 277,810,817	\$ —
Interest rate swaps - liabilities	\$ 4,397,238	\$ —	\$ 4,397,238	\$ —
Total liabilities measured at fair value	\$ 4,397,238	\$ —	\$ 4,397,238	\$ —

28

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

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, 2018 or 2017.

The securities AFS 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 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10 K for the year ended December 31, 2017. 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).

Interest rate swaps are also used for the purpose of hedging interest rate risk on junior subordinated debt. 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, 2018 and December 31, 2017:

		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
	Fair Value	Level 1	Level 2	Level 3
June 30, 2018:				
Impaired loans/leases	\$ 4,674,218	\$ —	\$ —	\$ 4,674,218
OREO	13,770,025	—	—	13,770,025
	\$ 18,444,243	\$ —	\$ —	\$ 18,444,243
December 31, 2017:				
Impaired loans/leases	\$ 8,972,337	\$ —	\$ —	\$ 8,972,337
OREO	14,642,973	—	—	14,642,973
	\$ 23,615,310	\$ —	\$ —	\$ 23,615,310

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.

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

The estimated fair value of the property is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values are discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the property.

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

Quantitative Information about Level Fair Value Measurements

	Fair Value June 30, 2018	Fair Value December 31, 2017	Valuation Technique	Unobservable Input	Range
Impaired loans/leases	\$ 4,674,218	\$ 8,972,337	Appraisal of collateral	Appraisal adjustments	(10.00)% to (30.00)%
OREO	13,770,025	14,642,973	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, 2018 and 2017.

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, 2018 Carrying Value	Estimated Fair Value	As of December 31, 2017 Carrying Value	Estimated Fair Value
Cash and due from banks	Level 1	\$ 69,069,403	\$ 69,069,403	\$ 75,721,663	\$ 75,721,663
Federal funds sold	Level 2	10,866,000	10,866,000	30,197,000	30,197,000
Interest-bearing deposits at financial institutions	Level 2	40,801,388	40,801,388	55,765,012	55,765,012
Investment securities: HTM	Level 2	400,052,344	397,252,368	379,474,205	379,749,804

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

AFS	See Previous Table	257,944,671	257,944,671	272,907,907	272,907,907
Loans/leases receivable, net	Level 3	4,327,980	4,674,218	8,307,719	8,972,337
Loans/leases receivable, net	Level 2	3,072,919,367	3,020,805,000	2,921,821,953	2,892,963,000
Interest rate caps	Level 2	706,291	706,291	506,700	506,700
Interest rate swaps - assets	Level 2	6,171,740	6,171,740	4,397,238	4,397,238
Deposits: Nonmaturity deposits	Level 2	2,622,243,626	2,622,243,626	2,670,583,178	2,670,583,178
Time deposits	Level 2	676,032,401	677,799,000	596,071,878	591,772,000
Short-term borrowings	Level 2	17,585,605	17,585,605	13,993,122	13,993,122
FHLB advances	Level 2	254,100,000	254,008,000	192,000,000	192,115,000
Other borrowings	Level 2	71,125,000	71,645,000	66,000,000	66,520,000
Junior subordinated debentures	Level 2	37,580,881	29,851,237	37,486,487	29,253,624
Interest rate swaps - liabilities	Level 2	6,543,790	6,543,790	4,397,238	4,397,238

NOTE 7 – BUSINESS SEGMENT INFORMATION

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

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

The Company's primary segment, Commercial Banking, is geographically divided by markets into the secondary segments comprised of the five subsidiary banks wholly owned by the Company: QCBT, CRBT, CSB, RB&T and SFC Bank. 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 five 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, 2018 and 2017.

Commercial Banking				Wealth		Intercompany
QCBT	CRBT	CSB	RB&T	Management	All other	Eliminations
\$ 16,682,874	\$ 16,503,977	\$ 8,406,295	\$ 5,119,916	\$ 3,115,653	\$ 13,024,443	\$ (13,142,678)
12,290,034	10,481,055	6,734,510	3,401,849	—	(822,952)	—
1,254,493	627,742	221,000	197,500	—	—	—
4,510,902	4,705,042	2,158,347	813,623	796,911	10,405,693	(12,945,133)
3,222,688	14,979,984	9,888,225	—	—	—	—
—	3,439,864	5,029,987	—	—	—	—
1,563,643,434	1,345,431,093	712,138,515	484,123,277	—	463,206,792	(461,660,406)
\$ 14,210,040	\$ 10,149,769	\$ 8,171,307	\$ 4,241,431	\$ 2,560,836	\$ 10,181,814	\$ (10,279,411)
11,414,818	7,230,425	6,920,820	3,095,512	—	(614,878)	—
552,993	300,000	861,000	309,000	—	—	—
4,073,777	2,870,582	1,920,040	834,842	454,465	8,766,014	(10,153,703)
3,222,688	—	9,888,225	—	—	—	—

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

—	1,172,141	5,747,339	—	—	—	—
1,400,307,827	993,768,912	642,761,140	426,159,677	—	382,407,292	(388,218,153)
\$ 32,490,444	\$ 32,501,309	\$ 16,569,618	\$ 10,117,861	\$ 6,305,078	\$ 25,556,486	\$ (25,742,571)
24,410,336	21,316,903	13,478,457	6,867,003	—	(1,585,285)	—
2,374,902	1,229,570	796,602	439,500	—	—	—
8,968,770	9,321,570	4,026,935	1,554,918	1,567,776	20,920,203	(25,364,826)
3,222,688	14,979,984	9,888,225	—	—	—	—
—	3,439,864	5,029,987	—	—	—	—
1,563,643,434	1,345,431,093	712,138,515	484,123,277	—	463,206,792	(461,660,406)
\$ 27,745,981	\$ 20,536,314	\$ 16,303,013	\$ 8,189,230	\$ 5,262,642	\$ 20,057,957	\$ (20,230,498)
22,716,300	14,204,472	13,947,328	6,063,586	—	(1,216,106)	—
1,484,102	550,000	1,635,000	459,000	—	—	—
7,728,783	5,763,142	3,815,174	1,679,411	1,015,527	17,950,982	(20,002,037)
3,222,688	—	9,888,225	—	—	—	—
—	1,172,141	5,747,339	—	—	—	—
1,400,307,827	993,768,912	642,761,140	426,159,677	—	382,407,292	(388,218,153)

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

NOTE 8 – 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, 2018 and December 31, 2017, 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, 2018 and December 31, 2017 are presented in the following table (dollars in thousands). As of June 30, 2018 and December 31, 2017, each of the subsidiary banks met the requirements to be “well capitalized”.

	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	>	Ratio	For Capital Adequacy Purposes With Capital Conservation Buffer*	>	Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	>	Ratio
of e 30, 2018: Company: al t-based ital r 1 t-based ital r 1 leverage mmon ity Tier 1 ad City nk & Trust:	\$ 407,222	11.23 %	\$ 290,121	>	8.00 %	\$ 358,118	>	9.875 %	\$ 362,652	>	10.00
	369,677	10.19 %	217,591	>	6.00	285,588	>	7.875	290,121	>	8.00
	369,677	9.22 %	160,373	>	4.00	160,373	>	4.000	200,466	>	5.00
	332,096	9.16 %	163,193	>	4.50	231,190	>	6.375	235,723	>	6.50

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

al											
ct-based											
ital	\$ 158,480	11.67 %	\$ 108,599	>	8.00 %	\$ 134,052	>	9.875 %	\$ 135,748	>	10.00
r 1											
ct-based											
ital	145,157	10.69 %	81,449	>	6.00	106,902	>	7.875	108,599	>	8.00
r 1 leverage	145,157	9.19 %	63,193	>	4.00	63,193	>	4.000	78,992	>	5.00
ommon											
ity Tier 1	145,157	10.69 %	61,087	>	4.50	86,540	>	6.375	88,236	>	6.50
dar Rapids											
nk & Trust:											
al											
ct-based											
ital	\$ 143,414	11.76 %	\$ 97,602	>	8.00 %	\$ 120,477	>	9.875 %	\$ 122,003	>	10.00
r 1											
ct-based											
ital	130,203	10.67 %	73,202	>	6.00	96,077	>	7.875	97,602	>	8.00
r 1 leverage	130,203	9.83 %	52,961	>	4.00	52,961	>	4.000	66,201	>	5.00
ommon											
ity Tier 1	130,203	10.67 %	54,901	>	4.50	77,777	>	6.375	79,302	>	6.50
mmunity											
te Bank:											
al											
ct-based											
ital	\$ 70,656	11.70 %	\$ 48,330	>	8.00 %	\$ 59,658	>	9.875 %	\$ 60,413	>	10.00
r 1											
ct-based											
ital	65,443	10.83 %	36,248	>	6.00	47,575	>	7.875	48,330	>	8.00
r 1 leverage	65,443	9.56 %	27,384	>	4.00	27,384	>	4.000	34,229	>	5.00
ommon											
ity Tier 1	65,443	10.83 %	27,186	>	4.50	38,513	>	6.375	39,268	>	6.50
ckford Bank											
Trust:											
al											
ct-based											
ital	\$ 47,697	10.81 %	\$ 35,283	>	8.00 %	\$ 43,553	>	9.875 %	\$ 44,104	>	10.00
r 1											
ct-based											
ital	42,181	9.56 %	26,463	>	6.00	34,732	>	7.875	35,283	>	8.00
r 1 leverage	42,181	8.90 %	18,947	>	4.00	18,947	>	4.000	23,684	>	5.00
ommon											
ity Tier 1	42,181	9.56 %	19,847	>	4.50	28,116	>	6.375	28,668	>	6.50

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	>	Ratio	For Capital Adequacy Purposes With Capital Conservation Buffer*	>	Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	>	Ratio
December 31, 2017:											
any:											
risk-based											
1	\$ 383,282	11.15 %	\$ 275,090	>	8.00 %	\$ 318,073	>	9.25 %	\$ 343,862	>	10.00 %
risk-based											
1	348,530	10.14 %	206,317	>	6.00	249,300	>	7.25	275,090	>	8.00
leverage	348,530	8.98 %	155,256	>	4.00	155,256	>	4.00	194,070	>	5.00
non equity Tier											
	313,012	9.10 %	154,738	>	4.50	197,721	>	5.75	223,510	>	6.50
City Bank &											
risk-based											
1	\$ 160,112	12.35 %	\$ 103,711	>	8.00 %	\$ 119,916	>	9.25 %	\$ 129,639	>	10.00 %
risk-based											
1	147,472	11.38 %	77,783	>	6.00	93,988	>	7.25	103,711	>	8.00
leverage	147,472	9.52 %	61,985	>	4.00	61,985	>	4.00	77,481	>	5.00
non equity Tier											
	147,472	11.38 %	58,337	>	4.50	74,542	>	5.75	84,265	>	6.50
Rapids Bank											
st:											
risk-based											
1	\$ 138,492	11.88 %	\$ 93,272	>	8.00 %	\$ 107,846	>	9.25 %	\$ 116,590	>	10.00 %
risk-based											
1	126,601	10.86 %	69,954	>	6.00	84,528	>	7.25	93,272	>	8.00
leverage	126,601	11.68 %	43,348	>	4.00	43,348	>	4.00	54,185	>	5.00
non equity Tier											
	126,601	10.86 %	52,465	>	4.50	67,039	>	5.75	75,783	>	6.50
Community State											
risk-based											
1	\$ 66,271	11.71 %	\$ 45,293	>	8.00 %	\$ 52,370	>	9.25 %	\$ 56,616	>	10.00 %
risk-based											
1	61,941	10.94 %	33,970	>	6.00	41,047	>	7.25	45,293	>	8.00
leverage	61,941	9.77 %	25,354	>	4.00	25,354	>	4.00	31,693	>	5.00
	61,941	10.94 %	25,477	>	4.50	32,554	>	5.75	36,801	>	6.50

non equity Tier

Ord Bank &

risk-based

l	\$ 45,684	11.28 %	\$ 32,413	>	8.00 %	\$ 37,477	>	9.25 %	\$ 40,516	>	10.00 %
risk-based											
l	40,615	10.02 %	24,310	>	6.00	29,374	>	7.25	32,413	>	8.00
leverage	40,615	8.94 %	18,177	>	4.00	18,177	>	4.00	22,721	>	5.00
non equity Tier	40,615	10.02 %	18,232	>	4.50	23,297	>	5.75	26,335	>	6.50

* 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).

NOTE 9 – REVENUE RECOGNITION

As of January 1, 2018, the Company adopted ASU 2014 09 using the modified retrospective approach. The adoption of the guidance had no material impact on the measurement or recognition of revenue as approximately 89% of the Company's revenue (based on 2017 audited financial results) is outside the scope of this guidance; however, additional disclosures have been added in accordance with the ASU. See Note 1 for additional information on this new accounting standard.

Descriptions of our revenue-generating contracts with customers that are within the scope of ASU 2014 09, which are presented in our income statements as components of non-interest income are as follows:

Trust department and Investment advisory and management fees: This is a contract between the Company and its customers for fiduciary and/or investment administration services on trust and brokerage accounts. Trust services and brokerage fee income is determined as a percentage of assets under management and is recognized over the period the underlying trust account is serviced. Such contracts are generally cancellable at any time, with the customer subject to a pro-rated fee in the month of termination.

Deposit service fees: The deposit contract obligates the Company to serve as a custodian of the customer's deposited funds and is generally terminable at will by either party. The contract permits the customer to access the funds on deposit and request additional services related to the deposit account. Deposit account related fees, including analysis charges, overdraft/nonsufficient fund charges, service charges, debit card usage fees, overdraft fees and wire transfer fees are within the scope of the guidance; however, revenue recognition practices did not change under the guidance, as deposit agreements are considered day-to-day contracts. Income for deposit accounts is recognized over the statement cycle period (typically on a monthly basis) or at the time the service is provided, if additional services are requested.

Table of Contents

Part I

Item 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - continued

Correspondent banking fees: A contract between the Company and its correspondent banks for corresponding banking services. 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. Correspondent banking fee income is tied to transaction activity and revenue is recognized monthly as earned for services provided.

NOTE 10 –MERGERS AND ACQUISITIONS

BATES COMPANIES

On March 20, 2018 the Company announced the signing of definitive agreements to acquire the Bates Companies, headquartered in Rockford, Illinois. The acquisition and subsequent merger of the Bates Companies into RB&T will enhance the wealth management services of RB&T by adding approximately \$700.0 million of assets under management.

In the acquisition, the Company will acquire 100% of the Bates Companies' outstanding common stock for an aggregate consideration of \$3.0 million cash and up to \$3.0 million of the Company's common stock. In a private placement exempt from registration with the SEC, the Company expects to issue upon closing of the transaction approximately 21,528 common shares or \$1.0 million of Company stock. Assuming all future performance based contingent consideration is realized total stock consideration can reach \$3.0 million, which would result in the Company expecting to issue approximately 64,583 common shares based on closing stock price at the date of announcement.

This transaction is subject to regulatory approval and certain closing conditions. The transaction is expected to close early in fourth quarter of 2018.

SPRINGFIELD BANCSHARES, INC.

On July 1, 2018, the Company completed its previously announced merger with Springfield Bancshares, the holding company of SFC Bank, headquartered in Springfield, Missouri. SFC Bank is a Missouri-chartered bank that operates one location in the Springfield, Missouri market. As a result of the transaction, SFC Bank became the Company's fifth independent charter.

Stockholders of Springfield Bancshares received 0.3060 shares of the Company's common stock and \$1.50 in cash in exchange for each common share of Springfield Bancshares held. On June 29, 2018, the last trading date before the closing, the Company's common stock closed at \$47.45, resulting in stock consideration valued at \$79.2 million and total consideration paid by the Company of \$87.4 million. To help fund the cash portion of the purchase price, on June 29, 2018, the Company borrowed \$4.1 million on its existing \$10.0 million revolving line of credit. The Company also borrowed \$4.9 million on this same revolving line of credit to fund the repayment of certain debt assumed in the merger, shortly after closing. This note is included within other borrowings on the June 30, 2018 Consolidated Balance Sheet. The remaining cash consideration paid to the shareholders of Springfield Bancshares came from operating cash.

As of the merger date, SFC Bank had assets with a historical book value of \$573 million, loans with a book value of \$487 million, and deposits with a book value of \$439 million. The Company is in the process of determining the fair value of the individual assets and liabilities purchased/assumed, including goodwill and core deposit intangible.

Table of Contents

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 as of and for the three months ending June 30, 2018. 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, RB&T and SFC Bank.

QCBT, CRBT and CSB are Iowa-chartered commercial banks, RB&T is an Illinois-chartered commercial bank and SFC Bank is a Missouri-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 five offices located in Cedar Rapids and Marion, Iowa. 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 by QCR in 2016, as further described in Note 2 to the Consolidated Financial Statements included in the Annual Report on Form 10-K for the year ended December 31, 2017. CSB provides full-service commercial and consumer banking to the Des Moines, Iowa area and adjacent communities through its 10 offices, 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.
- The financial results of SFC Bank are not included in this report because the Company's acquisition of SFC Bank through merger of Springfield Bancshares, previously the holding company of SFC Bank, into the Company occurred on July 1, 2018.

Table of Contents

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 \$10.4 million and diluted EPS of \$0.73 for the quarter ended June 30, 2018. By comparison, for the quarter ended March 31, 2018, the Company reported net income of \$10.6 million and diluted EPS of \$0.74. For the quarter ended June 30, 2017, the Company reported net income of \$8.8 million and diluted EPS of \$0.65. For the six months ended June 30, 2018, the Company reported net income of \$21.0 million, and diluted EPS of \$1.48. By comparison, for the six months ended June 30, 2017, the Company reported net income of \$18.0 million, and diluted EPS of \$1.33.

The second quarter of 2018 was highlighted by several significant items:

- Net income of \$10.4 million, or \$0.73 per diluted share;
- Core net income (non-GAAP) of \$10.9 million, or \$0.77 per diluted share;
- Annualized loan and lease growth of 7.8% for the quarter ended and 10.1% year-to-date; and
- Annualized noninterest income growth of 17.4%.

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

	For the three months ended			For the six months ended	
	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	June 30, 2017
Net income	\$ 10,445,385	\$ 9,901,590	\$ 8,766,017	\$ 20,995,346	\$ 17,950,982
Diluted earnings per common share	\$ 0.73	\$ 0.70	\$ 0.65	\$ 1.48	\$ 1.33
Weighted average common and common equivalent shares outstanding	14,232,423	14,193,191	13,516,592	14,219,003	13,502,505

The increase in weighted average common shares outstanding from June 30, 2017 to June 30, 2018 was primarily due to the common stock issued to Guaranty as consideration for the acquisition of Guaranty Bank.

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, 2018	March 31, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net interest income	\$ 32,084,496	\$ 32,402,918	\$ 28,046,697	\$ 64,487,414	\$ 55,715,580
Provision expense	2,300,735	2,539,839	2,022,993	4,840,574	4,128,102
Noninterest income	8,912,266	8,541,449	6,782,518	17,453,715	14,066,272
Noninterest expense	26,369,823	25,863,497	21,404,629	52,233,320	42,677,746

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Federal and state income tax expense	1,880,819	1,991,070	2,635,576	3,871,889	5,025,022
Net income	\$ 10,445,385	\$ 10,549,961	\$ 8,766,017	\$ 20,995,346	\$ 17,950,982

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

- Net interest income in the second quarter of 2018 was down 1% compared to the first quarter of 2018. Net interest income increased 14% compared to the second quarter of 2017 and 16% when comparing the first six months of 2018 to the same period in the prior year. This increase was primarily due to strong loan and lease growth and the acquisition of Guaranty Bank.

Table of Contents

Part I

Item 2

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

- Provision expense in the second quarter of 2018 decreased 9% compared to the first quarter of 2018 and increased 14% from the same period of 2017. Provision expense increased 17% in the first six months of 2018 from the same period of 2017 and was attributable to both strong loan growth and accounting for acquired loans. As acquired loans renew, the discount associated with those loans is eliminated and the Company must establish an allowance.
- Noninterest income in the second quarter of 2018 increased 4% compared to the first quarter of 2018, primarily due to higher swap fee income. Noninterest income in the second quarter of 2018 increased 31% from the second quarter of 2017 and 24% when comparing the first six months of 2018 to the same period in the prior year. This increase was primarily attributable to higher swap fee income, as well as solid growth in wealth management fee income and the acquisition of Guaranty Bank.
- Noninterest expense increased 2% from the first quarter of 2018. Noninterest expense increased 23% from the second quarter of 2017 and 22% when comparing the first six months of 2018 to the same period in the prior year which was primarily due to the acquisition of Guaranty Bank.
- Federal and state income tax expense in the second quarter of 2018 decreased 6% compared to the first quarter of 2018. Federal and state income tax expense in the second quarter of 2018 decreased 29% compared to the second quarter of 2017 and decreased 23% when comparing the first six months of 2018 to the same period in the prior year primarily due to a lower federal tax rate. 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, 2017. 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 73 – 78%;
- Improve profitability (measured by NIM and ROAA);
- 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;
- 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.

Table of Contents

Part I

Item 2

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

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

Goal	Key Metric	Target**	For the Quarter Ending		
			June 30, 2018	March 31, 2018	June 30, 2017
Balance sheet efficiency	Gross loans and leases to total assets	73% - 78%	76 %	76 %	74 %
	NIM TEY (non-GAAP)*	> 3.65%	3.52 %	3.64 %	3.81 %
Profitability	ROAA	> 1.10%	1.03 %	1.06 %	1.04 %
	Core ROAA (non-GAAP)*	> 1.10%	1.08 %	1.06 %	1.04 %
Asset quality	NPAs to total assets	< 0.75%	0.65 %	0.77 %	0.75 %
	Net charge-offs to average loans and leases***	< 0.25% annually	0.11 %	0.05 %	0.13 %
Reliance on wholesale funding	Wholesale funding to total assets****	< 15%	13 %	14 %	10 %
Funding mix	Noninterest bearing deposits as a percentage of total assets	> 30%	18 %	19 %	22 %
Consistent, high quality noninterest income revenue streams	Gains on sales of government guaranteed portions of loans and swap fee income***	> \$4 million annually	\$ 5.9 million	\$ 5.3 million	\$ 3.0 million
	Grow wealth management segment net income***	> 10% annually	54 %	37 %	22 %

* See "GAAP to Non-GAAP" reconciliations section.

** 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 to total assets is calculated by dividing total borrowings and brokered deposits by total assets.

STRATEGIC DEVELOPMENTS

The Company took the following actions during the second quarter of 2018 to support its corporate strategy and the long-term financial goals shown above.

- The Company grew loans and leases in the second quarter of 2018 by 7.8% on an annualized basis. 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 targeted range of 73 - 78%.

- The Company has participated, and intends to continue to participate, in a prudent manner as an acquirer in the consolidation taking place in our markets to continue to grow EPS, further boost ROAA and improve the Company's efficiency ratio. The Company announced in March 2018 the signing of definitive agreements to acquire and merge the Bates Companies into RB&T. The Company announced in July 2018 the completion of the merger of Springfield Bancshares. See Note 10 to the Consolidated Financial Statements for additional details about these strategic transactions.
- The Company has continued to focus on lowering the NPAs to total assets ratio. This ratio decreased by 12 basis points to 0.65%, compared to the first quarter 2018. This decrease was primarily due to the upgrade of one large credit that was taken out of TDR status. The Company remains committed to improving asset quality ratios in 2018 and beyond.
- Management has continued to focus on reducing the Company's reliance on wholesale funding. Core deposit growth in the second quarter of 2018 allowed wholesale funding to decrease 1%. Management continues to prioritize core deposit growth through a variety of strategies including growth in correspondent banking.

Table of Contents

Part I

Item 2

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

- Correspondent banking has continued 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 - and to expand into the Missouri market. The Company acts as the correspondent bank for 192 downstream banks with average total noninterest bearing deposits of \$215.3 million that had average total interest bearing deposits of \$208.3 million during the first six months of 2018. 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.
- As a result of the relatively low interest rate environment including a flat yield curve, the Company has 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, 2018, the Company had \$2.72 billion of total financial assets in trust (and related) accounts and \$1.05 billion of total financial assets in brokerage (and related) accounts. Continued growth in assets under management will help 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, both through organic growth as well as the acquisition of managed assets. The Company announced in March 2018 the signing of definitive agreements to acquire and merge the Bates Companies into RB&T. The acquisition and subsequent merger of the Bates Companies into RB&T will add approximately \$700 million of assets under management.

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

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.

Table of Contents

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 is a ratio that management utilizes to compare the Company to peers. It is a standard ratio 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.

GAAP TO NON-GAAP RECONCILIATIONS	As of					
	June 30, 2018	March 31, 2018	December 31, 2017	September 30, 2017	June 30, 2017	
	(dollars in thousands, except per share data)					
TCE/TA RATIO						
Stockholders' equity (GAAP)	\$ 369,588	\$ 360,428	\$ 353,287	\$ 313,039	\$ 305,083	
Less: Intangible assets	36,561	37,108	37,413	19,800	20,030	
TCE (non-GAAP)	\$ 333,027	\$ 323,320	\$ 315,874	\$ 293,239	\$ 285,053	
Total assets (GAAP)	\$ 4,106,883	\$ 4,026,314	\$ 3,982,665	\$ 3,550,463	\$ 3,457,187	
Less: Intangible assets	36,561	37,108	37,413	19,800	20,030	
TA (non-GAAP)	\$ 4,070,322	\$ 3,989,206	\$ 3,945,252	\$ 3,530,663	\$ 3,437,157	
TCE/TA ratio (non-GAAP)	8.18	% 8.10	% 8.01	% 8.31	% 8.29	%

Table of Contents

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, 2018	March 31, 2018	December 31, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands, except per share data)				
CORE NET INCOME					
Net income (GAAP)	\$ 10,445	\$ 10,550	\$ 9,902	\$ 20,995	\$ 17,951
Less nonrecurring items (post-tax) (*):					
Income:					
Securities gains, net	\$ —	\$ —	\$ (41)	\$ —	\$ 25
Total nonrecurring income (non-GAAP)	\$ —	\$ —	\$ (41)	\$ —	\$ 25
Expense:					
Acquisition costs	\$ 327	\$ 73	\$ 430	\$ 400	\$ —
Post-acquisition compensation, transition and integration costs	130	—	2,462	130	—
Total nonrecurring expense (non-GAAP)	\$ 457	\$ 73	\$ 2,892	\$ 530	\$ —
Adjustment of tax expense related to the Tax Act	\$ —	\$ —	\$ 2,919	\$ —	\$ —
Core net income (non-GAAP)	\$ 10,902	\$ 10,623	\$ 9,916	\$ 21,525	\$ 17,926
CORE EPS					

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Core net income (non-GAAP) (from above)	\$ 10,902		\$ 10,623		\$ 9,916		\$ 21,525		\$ 17,926	
Weighted average common shares outstanding	13,919,565		13,888,661		13,845,497		13,904,113		13,151,833	
Weighted average common and common equivalent shares outstanding	14,232,423		14,205,584		14,193,191		14,219,003		13,502,505	
Core EPS (non-GAAP):										
Basic	\$ 0.78		\$ 0.76		\$ 0.72		\$ 1.55		\$ 1.36	
Diluted	\$ 0.77		\$ 0.75		\$ 0.70		\$ 1.51		\$ 1.33	
CORE ROAA										
Core net income (non-GAAP) (from above)	\$ 10,902		\$ 10,623		\$ 9,916		\$ 21,525		\$ 17,926	
Average Assets	\$ 4,053,684		\$ 3,994,691		\$ 3,923,337		\$ 4,024,188		\$ 3,326,454	
Core ROAA (annualized) (non-GAAP)	1.08	%	1.06	%	1.01	%	1.07	%	1.08	%
NIM (TEY)*										
Net interest income (GAAP)	\$ 32,085		\$ 32,403		\$ 31,793		\$ 64,488		\$ 55,716	
Plus:										
Taxequivalent adjustment	1,462		1,353		2,585		2,815		4,218	
Net interest income - taxequivalent (non-GAAP)	\$ 33,547		\$ 33,756		\$ 34,378		\$ 67,303		\$ 59,934	
Average earning assets	\$ 3,820,333		\$ 3,759,475		\$ 3,699,193		\$ 3,789,905		\$ 3,128,569	
NIM (GAAP)	3.37	%	3.50	%	3.41	%	3.43	%	3.59	%
NIM (TEY) (non-GAAP)	3.52	%	3.64	%	3.69	%	3.58	%	3.86	%
EFFICIENCY RATIO	\$ 26,370		\$ 25,863		\$ 31,351		\$ 52,234		\$ 42,678	

Noninterest
expense (GAAP)

Net interest income (GAAP)	\$ 32,085	\$ 32,403	\$ 31,793	\$ 64,488	\$ 55,716
Noninterest income (GAAP)	8,912	8,541	9,714	17,454	14,066
Total income	\$ 40,997	\$ 40,944	\$ 41,507	\$ 81,942	\$ 69,782

Efficiency ratio
(noninterest
expense/total
income)

(non-GAAP)	64.32	%	63.17	%	75.53	%	63.75	%	61.16	%
------------	-------	---	-------	---	-------	---	-------	---	-------	---

* Nonrecurring items (after-tax) are calculated using an estimated effective tax rate of 35% for periods prior to March 31, 2018 and 21% for periods including and after March 31, 2018.

NET INTEREST INCOME - (TAX EQUIVALENT BASIS)

As part of the Tax Act, the Company's federal income tax rate was reduced from 35% down to 21% effective January 1, 2018. In order to compare periods before and after the effective date of the Tax Act, it's important to note the difference in the federal income tax rate and the impact on the Company's tax exempt earning assets (loans and securities) and the related tax equivalent yield reporting.

Table of Contents

Part I

Item 2

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

Net interest income, on a tax equivalent basis, increased 11% to \$33.5 million for the quarter ended June 30, 2018, compared to the same quarter of the prior year, and increased 12% to \$67.3 million for the six months ended June 30, 2018 compared to the same period of the prior year. Excluding the tax equivalent adjustments, net interest income increased 14% for the quarter ended June 30, 2018 compared to the same quarter of the prior year, and increased 16% for the six months ended June 30, 2018 compared to the same period of the prior year. Net interest income improved due to several factors:

- Organic loan and lease growth has been strong over the past 12 months pushing loans/leases up to 76% of total assets;
- The acquisition of Guaranty Bank in the fourth quarter of 2017, whose strong NIM has contributed to the Company's results; and
- The Company's continued strategy to redeploy funds from the lower yielding taxable securities portfolio into higher yielding loans and municipal bonds, especially with the Company's most recent acquisitions of CSB and Guaranty Bank.

A comparison of yields, spread and margin on a tax equivalent and GAAP basis is as follows:

	Tax Equivalent Basis For the Quarter Ended			GAAP For the Quarter Ended		
	June 30, 2018	March 31, 2018	June 30, 2017	June 30, 2018	March 31, 2018	June 30, 2017
Average Yield on Interest-Earning Assets	4.44 %	4.41 %	4.37 %	4.28 %	4.27 %	4.09 %
Average Cost of Interest-Bearing Liabilities	1.21 %	1.03 %	0.77 %	1.21 %	1.03 %	0.77 %
Net Interest Spread	3.23 %	3.38 %	3.60 %	3.07 %	3.24 %	3.32 %
NIM	3.52 %	3.64 %	3.81 %	3.37 %	3.50 %	3.54 %
NIM Excluding Acquisition Accounting Net Accretion	3.46 %	3.56 %	3.61 %	3.31 %	3.42 %	3.34 %

	Tax Equivalent Basis For the Six Months Ended		GAAP For the Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Average Yield on Interest-Earning Assets	4.42 %	4.38 %	4.28 %	4.11 %
Average Cost of Interest-Bearing Liabilities	1.13 %	0.73 %	1.13 %	0.73 %
Net Interest Spread	3.29 %	3.65 %	3.15 %	3.38 %
NIM	3.58 %	3.86 %	3.43 %	3.59 %

NIM Excluding Acquisition Accounting Net Accretion	3.51	%	3.63	%	3.37	%	3.36	%
--	------	---	------	---	------	---	------	---

Acquisition accounting net accretion can fluctuate depending on the payoff activity of the acquired loans. In evaluating net interest income and NIM, it's important to understand the impact of acquisition accounting net accretion when comparing periods. The above table reports NIM with and without the acquisition accounting net accretion to allow for more appropriate comparisons. A comparison of acquisition accounting net accretion included in NIM is as follows:

	For the Quarter Ended		June 30, 2017	For the Six Months Ended	
	June 30, 2018	March 31, 2018		June 30, 2018	June 30, 2017
	dollars in thousands				
Acquisition Accounting Net Accretion in NIM	\$ 545	\$ 699	\$ 1,553	\$ 1,244	\$ 3,584

NIM on a tax equivalent basis was down 12 basis points on a linked quarter basis. . Excluding acquisition accounting net accretion, NIM was down 10 basis points on a linked quarter basis. This margin compression was primarily due to the following:

Table of Contents

Part I

Item 2

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

- Increases in the cost of funds due to both mix and rate as the Company continues to grow larger commercial and public deposits which tend to have higher interest rate sensitivity;
- In the first quarter of 2018, the Company recognized elevated loan origination fee income through NIM for select commercial loans which contributed to approximately five basis points of the core NIM decline;
- With the flat yield curve and continued competition in our markets, loan pricing continues to be pressured. The Company had success in widening spreads as core loan yields increased 13 basis points on linked quarter basis; however, the pace and magnitude of the widening has been offset by the increasing cost of funds;
- The majority of the Company's earning asset growth in the second quarter of 2018 occurred at the end of the quarter. 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 focusing on quality growth in conjunction with the improvement of their NIMs. Management continually addresses this issue with pricing and other balance sheet management strategies which included better loan pricing, reducing reliance on very rate-sensitive funding, closely managing deposit rate increases and finding additional ways to manage cost of funds through derivatives.

Table of Contents

Part I

Item 2

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

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

	For the three months ended June 30, 2018			2017		
	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost
	(dollars in thousands)					
ASSETS						
Interest earning assets:						
Federal funds sold	\$ 18,561	\$ 61	1.32 %	\$ 18,742	\$ 38	0.81 %
Interest-bearing deposits at financial institutions	54,879	228	1.67 %	86,236	220	1.02 %
Investment securities (1)	648,276	5,752	3.56 %	573,747	5,384	3.76 %
Restricted investment securities	21,100	212	4.03 %	13,226	132	4.00 %
Gross loans/leases receivable (1) (2) (3)	3,077,517	36,008	4.69 %	2,488,828	28,881	4.65 %
Total interest earning assets	\$ 3,820,333	\$ 42,261	4.44 %	\$ 3,180,779	\$ 34,655	4.37 %
Noninterest-earning assets:						
Cash and due from banks	\$ 68,266			\$ 63,526		
Premises and equipment	63,665			61,327		
Less allowance	(36,960)			(32,361)		
Other	138,380			104,924		
Total assets	\$ 4,053,684			\$ 3,378,195		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 1,919,406	4,089	0.85 %	\$ 1,566,106	1,835	0.47 %
Time deposits	665,643	2,439	1.47 %	527,719	1,156	0.88 %
Short-term borrowings	19,024	63	1.33 %	17,936	19	0.42 %
FHLB advances	174,826	882	2.02 %	76,739	354	1.85 %
Other borrowings	67,044	733	4.39 %	72,000	696	3.88 %
	37,558	508	5.43 %	33,530	347	4.15 %

Junior subordinated debentures							
Total interest-bearing liabilities	\$ 2,883,501	\$ 8,714	1.21 %	\$ 2,294,030	\$ 4,407	0.77 %	
Noninterest-bearing demand deposits	\$ 757,954			\$ 741,886			
Other noninterest-bearing liabilities	47,198			41,411			
Total liabilities	\$ 3,688,653			\$ 3,077,327			
Stockholders' equity	365,031			300,868			
Total liabilities and stockholders' equity	\$ 4,053,684			\$ 3,378,195			
Net interest income		\$ 33,547			\$ 30,248		
Net interest spread			3.23 %			3.60 %	
Net interest margin			3.52 %			3.81 %	
Ratio of average interest-earning assets to average interest-bearing liabilities	132.49 %			138.65 %			

-
- (1) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 35% tax rate for periods prior to March 31, 2018 and 21% for periods including and after March 31, 2018.
 - (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.

Table of Contents

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, 2018

	Inc./Dec.) from Prior Period 2018 vs. 2017 (dollars in thousands)	Components of Change (1) Rate	Volume
INTEREST INCOME			
Federal funds sold	\$ 23	\$ 25	\$ (2)
Interest-bearing deposits at financial institutions	8	412	(404)
Investment securities (2)	368	(1,549)	1,917
Restricted investment securities	80	1	79
Gross loans/leases receivable (2) (3) (4)	7,127	241	6,886
Total change in interest income	\$ 7,606	\$ (870)	\$ 8,476
INTEREST EXPENSE			
Interest-bearing deposits	\$ 2,254	\$ 1,767	\$ 487
Time deposits	1,283	924	359
Short-term borrowings	44	43	1
Federal Home Loan Bank advances	528	36	492
Other borrowings	37	276	(239)
Junior subordinated debentures	161	116	45
Total change in interest expense	\$ 4,307	\$ 3,162	\$ 1,145
Total change in net interest income	\$ 3,299	\$ (4,032)	\$ 7,331

-
- (1) The column "Inc./Dec.) from Prior Period" is segmented into the changes attributable to variations in volume and the changes attributable to changes in interest rates. The variations attributable to simultaneous volume and rate changes have been proportionately allocated to rate and volume.
- (2) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 35% tax rate for periods prior to March 31, 2018 and 21% for periods including and after March 31, 2018.
- (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.

Table of Contents

Part I

Item 2

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

	For the six months ended June 30, 2018			2017		
	Average Balance	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	\$ 19,132	\$ 118	1.24 %	\$ 14,917	\$ 53	0.72 %
Interest-bearing deposits at financial institutions	52,205	425	1.64	89,394	418	0.94 %
Investment securities (1)	648,656	11,418	3.55	567,101	10,543	3.75 %
Restricted investment securities	21,465	446	4.19	13,549	262	3.90 %
Gross loans/leases receivable (1) (2) (3)	3,048,447	70,753	4.68	2,443,608	56,741	4.68 %
Total interest earning assets	\$ 3,789,905	83,160	4.42	\$ 3,128,569	68,017	4.38 %
Noninterest-earning assets:						
Cash and due from banks	\$ 67,745			\$ 64,409		
Premises and equipment, net	63,530			61,152		
Less allowance for estimated losses on loans/leases	(36,048)			(31,930)		
Other	139,057			104,256		
Total assets	\$ 4,024,189			\$ 3,326,456		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 1,873,817	7,109	0.77 %	\$ 1,486,876	2,974	0.40 %
Time deposits	641,152	4,301	1.35	519,419	2,249	0.87 %
Short-term borrowings	18,148	95	1.06	21,562	43	0.40 %

Edgar Filing: QCR HOLDINGS INC - Form 10-Q

Federal Home Loan							
Bank advances	205,758	1,946	1.91	95,548	758	1.60	%
Other borrowings	65,862	1,451	4.44	73,381	1,379	3.79	%
Junior subordinated debentures	37,534	955	5.13	33,514	680	4.09	%
Total interest-bearing liabilities	\$ 2,842,271	15,857	1.13	\$ 2,230,300	8,083	0.73	%
Noninterest-bearing demand deposits	\$ 776,314			\$ 757,566			
Other noninterest-bearing liabilities	44,826			42,704			
Total liabilities	\$ 3,663,411			\$ 3,030,569			
Stockholders' equity	360,778			295,887			
Total liabilities and stockholders' equity	\$ 4,024,189			\$ 3,326,456			
Net interest income		\$ 67,303			\$ 59,934		
Net interest spread			3.29			3.65	%
Net interest margin			3.58			3.86	%
Ratio of average interest earning assets to average interest-bearing liabilities	133.34	%		140.28	%		

-
- (1) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 35% tax rate for periods prior to March 31, 2018 and 21% for periods including and after March 31, 2018.
- (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.

Table of Contents

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, 2018

	Inc./Dec.) from Prior Period 2018 vs. 2017 (dollars in thousands)	Components of Change (1) Rate	Volume
INTEREST INCOME			
Federal funds sold	\$ 65	\$ 47	\$ 18
Interest-bearing deposits at other financial institutions	7	454	(447)
Investment securities (2)	875	(1,414)	2,289
Restricted investment securities	184	21	163
Gross loans/leases receivable (2) (3) (4)	14,012	(80)	14,092
Total change in interest income	\$ 15,143	\$ (972)	\$ 16,115
INTEREST EXPENSE			
Interest-bearing demand deposits	\$ 4,135	\$ 3,205	\$ 930
Time deposits	2,052	1,438	614
Short-term borrowings	52	73	(21)
Federal Home Loan Bank advances	1,188	170	1,018
Other borrowings	72	403	(331)
Junior subordinated debentures	275	(40)	315
Total change in interest expense	\$ 7,774	\$ 5,249	\$ 2,525
Total change in net interest income	\$ 7,369	\$ (6,221)	\$ 13,590

- (1) The column "Inc./Dec.) from Prior Period" is segmented into the changes attributable to variations in volume and the changes attributable to changes in interest rates. The variations attributable to simultaneous volume and rate changes have been proportionately allocated to rate and volume.
- (2) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 35% tax rate for periods prior to March 31, 2018 and 21% for periods including and after March 31, 2018.
- (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.

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 for loan and lease losses.

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

Table of Contents

Part I

Item 2

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

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, 2018 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.

RESULTS OF OPERATIONS

INTEREST INCOME

Interest income increased 26%, comparing the second quarter of 2018 to the same period of 2017 and comparing the first half of 2018 to the same period of 2017. This increase was primarily the result of strong organic loan growth, the acquisition of Guaranty Bank, and improved pricing with the rising rate environment. Although the latter has been less than the Company would like due to competitive pressures and the flat yield curve, the Company is focused on growing loans at higher rates with widening spreads to more than offset the rising cost of funds.

Overall, the Company's average earning assets increased 20%, comparing the second quarter of 2018 to the second quarter of 2017. During the same time period, average gross loans and leases increased 24%, while average investment securities increased 13% with a portion being private placement tax-exempt municipal securities. Average earning assets increased 21%, comparing the first half of 2018 to the same period of 2017. Average gross loans and leases increased 25% and average investment securities increased 14%, comparing the first half of 2018 to the same period to 2017. These increases were also the result of strong loan growth and the acquisition of Guaranty Bank.

The Company intends to continue to grow quality loans and leases as well as its private placement tax-exempt securities portfolio to maximize yield while minimizing credit and interest rate risk.

INTEREST EXPENSE

Interest expense for the second quarter of 2018 increased 98% from the second quarter of 2017 and increased 96%, comparing the first half of 2018 to the same period of 2017. The acquisition of Guaranty Bank contributed to this increase as we added over \$200MM in deposits. Additionally, as the Company has grown organically at a significant pace over the past several years, the loan growth has been funded in larger part by bigger depositor relationships with higher rate sensitivity and many of those relationships which have pricing tied to a certain index. As a result, the cost of these funds is higher than the rest of the Company's core deposit portfolio, and the cost rises at a higher rate (beta) as market interest rates rise which has been the case over the past several quarters. The beta on the balance of the Company's core deposit portfolio has performed well and is much lower than the beta on these relationships with

pricing tied to a certain index. Additionally, the loan growth has outpaced deposit growth, short-term borrowings have increased to fill in the funding gap and the cost of these funds has increased with the rising rate environment.

The Company's management intends to continue to shift the mix of funding from wholesale funds to well-priced 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.

Table of Contents

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 \$2.3 million for the second quarter of 2018, which was an increase of \$278 thousand or 14% from the same quarter of the prior year. Provision for the first six months of the year totaled \$4.8 million, which was up \$712 thousand or 17%, compared to the first six months of 2017. The increase from the second quarter of 2017 to the second quarter of 2018 was primarily attributable to loan growth and the accounting for the loans acquired through the acquisitions of CSB and Guaranty Bank. As acquired loans renew, the discount associated with those loans is eliminated and the Company must establish an allowance through provision. This provision, when coupled with net charge-offs of \$1.7 million for the first six months of 2018, increased the Company's allowance to \$37.5 million at June 30, 2018. As of June 30, 2018, the Company's allowance to total loans/leases was 1.21%, which was relatively flat from 1.20% at March 31, 2018 and down from 1.31% at June 30, 2017.

In accordance with GAAP for business combination accounting, acquired loans are recorded at fair value; therefore, no allowance is associated with such loans at acquisition. Management continues to evaluate the allowance needed on acquired loans factoring in the net remaining discount (\$6.6 million and \$6.3 million at June 30, 2018 and June 30, 2017, respectively). 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 1.21% to 1.42% as of June 30, 2018 and increases from 1.31% to 1.55% as of June 30, 2017.

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

NONINTEREST INCOME

	Three Months Ended		\$ Change	% Change	
	June 30, 2018	June 30, 2017			
Trust department fees	\$ 2,057,987	\$ 1,692,001	\$ 365,986	21.6	%
Investment advisory and management fees	1,057,666	868,835	188,831	21.7	