

# Section 1: 10-Q (10-Q)

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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 September 30, 2019

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

**OCR HOLDINGS, INC.**

(Exact name of Registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**42-1397595**

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

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

(Address of principal executive offices, including zip code)

**(309) 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth 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.

Large accelerated filer  Accelerated filer  Non-accelerated filer   
Smaller reporting company  Emerging growth company

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$1.00 Par Value	QRH	The Nasdaq Global Market

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of November 1, 2019, the Registrant had outstanding 15,794,839 shares of common stock, \$1.00 par value per share.

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**QCR HOLDINGS, INC. AND SUBSIDIARIES**  
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Throughout this Quarterly Report on Form 10-Q, we use certain acronyms and abbreviations, as defined in Note 1 to the Consolidated Financial Statements.



**QCR HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS (UNAUDITED)**  
**As of September 30, 2019 and December 31, 2018**

	<u>September 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
	<i>(dollars in thousands)</i>	
<b>Assets</b>		
Cash and due from banks	\$ 91,671	\$ 85,523
Federal funds sold	9,300	26,398
Interest-bearing deposits at financial institutions	187,963	133,198
Securities held to maturity, at amortized cost	343,477	401,913
Securities available for sale, at fair value	211,932	261,056
<b>Total securities</b>	<u>555,409</u>	<u>662,969</u>
Loans receivable held for sale	8,890	1,295
Loans/leases receivable held for investment	3,601,380	3,731,459
Gross loans/leases receivable	3,610,270	3,732,754
Less allowance for estimated losses on loans/leases	(36,116)	(39,847)
<b>Net loans/leases receivable</b>	<u>3,574,154</u>	<u>3,692,907</u>
Bank-owned life insurance	58,367	67,783
Premises and equipment, net	74,486	75,582
Restricted investment securities	24,562	25,689
Other real estate owned, net	4,248	9,378
Goodwill	77,748	77,832
Intangibles	15,529	17,450
Assets held for sale	465,547	—
Other assets	153,398	75,001
<b>Total assets</b>	<u>\$ 5,292,382</u>	<u>\$ 4,949,710</u>
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 782,232	\$ 791,102
Interest-bearing	3,020,009	3,185,929
<b>Total deposits</b>	<u>3,802,241</u>	<u>3,977,031</u>
Short-term borrowings	18,526	28,774
Federal Home Loan Bank advances	195,800	266,492
Other borrowings	—	67,250
Subordinated notes	68,334	4,782
Junior subordinated debentures	37,797	37,670
Liabilities held for sale	470,530	—
Other liabilities	179,411	94,573
<b>Total liabilities</b>	<u>4,772,639</u>	<u>4,476,572</u>
Stockholders' Equity:		
Preferred stock, \$1 par value; shares authorized 250,000 September 2019 and December 2018 - no shares issued or outstanding	—	—
Common stock, \$1 par value; shares authorized 20,000,000 September 2019 - 15,790,462 shares issued and outstanding December 2018 - 15,718,208 shares issued and outstanding	15,790	15,718
Additional paid-in capital	273,475	270,761
Retained earnings	230,892	192,203
Accumulated other comprehensive income (loss):		
Securities available for sale	3,832	(4,268)
Derivatives	(4,246)	(1,276)
<b>Total stockholders' equity</b>	<u>519,743</u>	<u>473,138</u>
<b>Total liabilities and stockholders' equity</b>	<u>\$ 5,292,382</u>	<u>\$ 4,949,710</u>

See Notes to Consolidated Financial Statements (Unaudited)

**QCR HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**  
**Three Months Ended September 30, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
	<i>(dollars in thousands, except share data)</i>	
Interest and dividend income:		
Loans/leases, including fees	\$ 50,406	\$ 44,034
Securities:		
Taxable	1,682	1,522
Nontaxable	3,443	3,517
Interest-bearing deposits at financial institutions	951	324
Restricted investment securities	293	329
Federal funds sold	42	105
<b>Total interest and dividend income</b>	<b>56,817</b>	<b>49,831</b>
Interest expense:		
Deposits	13,394	8,723
Short-term borrowings	97	78
Federal Home Loan Bank advances	1,023	1,422
Other borrowings	—	705
Subordinated notes	1,003	70
Junior subordinated debentures	581	519
<b>Total interest expense</b>	<b>16,098</b>	<b>11,517</b>
<b>Net interest income</b>	<b>40,719</b>	<b>38,314</b>
Provision for loan/lease losses	2,012	6,206
<b>Net interest income after provision for loan/lease losses</b>	<b>38,707</b>	<b>32,108</b>
Noninterest income:		
Trust department fees	2,340	2,196
Investment advisory and management fees	1,782	1,059
Deposit service fees	1,813	1,656
Gains on sales of residential real estate loans, net	890	337
Gains on sales of government guaranteed portions of loans, net	519	46
Swap fee income	9,797	1,110
Securities losses, net	(3)	—
Earnings on bank-owned life insurance	489	474
Debit card fees	886	846
Correspondent banking fees	189	195
Other	1,204	890
<b>Total noninterest income</b>	<b>19,906</b>	<b>8,809</b>
Noninterest expense:		
Salaries and employee benefits	24,215	17,433
Occupancy and equipment expense	3,860	3,318
Professional and data processing fees	4,030	2,396
Acquisition costs	—	1,292
Post-acquisition compensation, transition and integration costs	884	494
FDIC insurance, other insurance and regulatory fees	542	933
Loan/lease expense	221	369
Net cost of (income from) and gains/losses on operations of other real estate	2,078	(50)
Advertising and marketing	1,056	984
Bank service charges	502	462
Losses on debt extinguishment, net	148	—
Correspondent banking expense	209	205
Intangibles amortization	560	542
Other	1,640	2,122
<b>Total noninterest expense</b>	<b>39,945</b>	<b>30,500</b>
<b>Net income before income taxes</b>	<b>18,668</b>	<b>10,417</b>
Federal and state income tax expense	3,573	1,608
<b>Net income</b>	<b>\$ 15,095</b>	<b>\$ 8,809</b>
Basic earnings per common share	\$ 0.96	\$ 0.56
Diluted earnings per common share	\$ 0.94	\$ 0.55
Weighted average common shares outstanding	15,739,430	15,625,123
Weighted average common and common equivalent shares outstanding	15,976,742	15,922,324
Cash dividends declared per common share	\$ 0.06	\$ 0.06

See Notes to Consolidated Financial Statements (Unaudited)

**QCR HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**  
**Nine months ended September 30, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
	<i>(dollars in thousands, except share data)</i>	
<b>Interest and dividend income:</b>		
Loans/leases, including fees	\$ 143,488	\$ 113,655
<b>Securities:</b>		
Taxable	5,026	4,671
Nontaxable	10,461	10,101
Interest-bearing deposits at financial institutions	3,042	749
Restricted investment securities	891	776
Federal funds sold	191	223
<b>Total interest and dividend income</b>	<b>163,099</b>	<b>130,175</b>
<b>Interest expense:</b>		
Deposits	39,697	20,132
Short-term borrowings	275	186
Federal Home Loan Bank advances	2,685	3,637
Other borrowings	512	1,875
Subordinated notes	2,561	70
Junior subordinated debentures	1,729	1,474
<b>Total interest expense</b>	<b>47,459</b>	<b>27,374</b>
<b>Net interest income</b>	<b>115,640</b>	<b>102,801</b>
Provision for loan/lease losses	6,087	11,046
<b>Net interest income after provision for loan/lease losses</b>	<b>109,553</b>	<b>91,755</b>
<b>Noninterest income:</b>		
Trust department fees	7,194	6,491
Investment advisory and management fees	5,406	3,069
Deposit service fees	5,025	4,797
Gains on sales of residential real estate loans, net	1,748	539
Gains on sales of government guaranteed portions of loans, net	589	405
Swap fee income	20,886	3,718
Securities losses, net	(56)	—
Earnings on bank-owned life insurance	1,441	1,292
Debit card fees	2,591	2,456
Correspondent banking fees	578	673
Other	3,562	2,822
<b>Total noninterest income</b>	<b>48,964</b>	<b>26,262</b>
<b>Noninterest expenses:</b>		
Salaries and employee benefits	67,843	49,215
Occupancy and equipment expense	11,087	9,517
Professional and data processing fees	9,811	8,016
Acquisition costs	—	1,799
Post-acquisition compensation, transition and integration costs	1,727	659
FDIC insurance, other insurance and regulatory fees	2,432	2,529
Loan/lease expense	748	920
Net cost of (income from) and gains/losses on operations of other real estate	3,557	11
Advertising and marketing	2,878	2,430
Bank service charges	1,494	1,368
Losses on debt extinguishment, net	148	—
Correspondent banking expense	619	614
CDI amortization	1,706	1,151
Other	4,891	4,504
<b>Total noninterest expenses</b>	<b>108,941</b>	<b>82,733</b>
<b>Net income before income taxes</b>	<b>49,576</b>	<b>35,284</b>
Federal and state income tax expense	8,059	5,480
<b>Net income</b>	<b>\$ 41,517</b>	<b>\$ 29,804</b>
<b>Basic earnings per common share</b>		
	\$ 2.64	\$ 2.06
<b>Diluted earnings per common share</b>		
	\$ 2.60	\$ 2.02
<b>Weighted average common shares outstanding</b>		
	15,715,788	14,477,783
<b>Weighted average common and common equivalent shares outstanding</b>		
	15,946,020	14,786,777
Cash dividends declared per common share	<u>\$ 0.18</u>	<u>\$ 0.18</u>

See Notes to Consolidated Financial Statements (Unaudited)

QCR HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)  
Three and Nine months ended September 30, 2019 and 2018

	Three Months Ended September 30,	
	2019	2018
<i>(dollars in thousands)</i>		
Net income	\$ 15,095	\$ 8,809
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale:		
Unrealized holding gains (losses) arising during the period before tax	1,827	(1,652)
Less reclassification adjustment for losses included in net income before tax	(3)	—
	<u>1,830</u>	<u>(1,652)</u>
Unrealized gains (losses) on derivatives:		
Unrealized holding losses arising during the period before tax	(1,159)	577
Less reclassification adjustment for caplet amortization before tax	—	(187)
	<u>(1,159)</u>	<u>764</u>
Unrealized gains (losses) on assets held for sale:		
Unrealized holding gains (losses) arising during the period before tax on securities held for sale	48	—
Unrealized holding losses arising during the period before tax on derivatives held for sale	(31)	—
Less reclassification adjustment for caplet amortization before tax	(80)	—
	<u>97</u>	<u>—</u>
Other comprehensive income (loss), before tax	768	(888)
Tax expense (benefit)	224	(276)
Other comprehensive income (loss), net of tax	<u>544</u>	<u>(612)</u>
Comprehensive income	<u>\$ 15,639</u>	<u>\$ 8,197</u>

	Nine Months Ended September 30,	
	2019	2018
<i>(dollars in thousands)</i>		
Net income	\$ 41,517	\$ 29,804
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale:		
Unrealized holding gains (losses) arising during the period before tax	10,639	(8,531)
Less reclassification adjustment for losses included in net income before tax	(56)	—
Less reclassification adjustment for adoption of ASU 2016-01	—	855
	<u>10,695</u>	<u>(7,676)</u>
Unrealized losses on derivatives:		
Unrealized holding losses arising during the period before tax	(4,101)	404
Less reclassification adjustment for ineffectiveness and caplet amortization before tax	(291)	(90)
	<u>(3,810)</u>	<u>494</u>
Unrealized gains (losses) on assets held for sale:		
Unrealized holding gains (losses) arising during the period before tax on securities held for sale	48	—
Unrealized holding losses arising during the period before tax on derivatives held for sale	(31)	—
Less reclassification adjustment for ineffectiveness and caplet amortization before tax	(80)	—
	<u>97</u>	<u>—</u>
Other comprehensive income (loss), before tax	6,982	(7,182)
Tax expense (benefit)	1,852	(2,034)
Other comprehensive income (loss), net of tax	<u>5,130</u>	<u>(5,148)</u>
Comprehensive income	<u>\$ 46,647</u>	<u>\$ 24,656</u>

See Notes to Consolidated Financial Statements (Unaudited)

**QCR HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)**  
**Three and Nine months ended September 30, 2019 and 2018**

	Common Stock	Additional Paid-In Capital	Retained Earnings <i>(dollars in thousands)</i>	Accumulated Other Comprehensive (Loss)	Total
<b>Balance December 31, 2018</b>	<b>\$ 15,718</b>	<b>\$ 270,761</b>	<b>\$ 192,203</b>	<b>\$ (5,544)</b>	<b>\$ 473,138</b>
Net income	—	—	12,918	—	12,918
Other comprehensive income, net of tax	—	—	—	2,344	2,344
Common cash dividends declared, \$0.06 per share	—	—	(942)	—	(942)
Issuance of 4,446 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan	4	124	—	—	128
Issuance of 25,238 shares of common stock as a result of stock options exercised	25	263	—	—	288
Stock-based compensation expense	—	722	—	—	722
Restricted stock awards and restricted stock units - 12,719 shares of common stock, net of restricted stock units withheld for payment of taxes	13	(50)	—	—	(37)
Exchange of 5,169 shares of common stock in connection with payroll taxes for restricted stock vested and in connection with stock options exercised	(5)	(147)	—	—	(152)
<b>Balance, March 31, 2019</b>	<b>\$ 15,755</b>	<b>\$ 271,673</b>	<b>\$ 204,179</b>	<b>\$ (3,200)</b>	<b>\$ 488,407</b>
Net income	—	—	13,504	—	13,504
Other comprehensive loss, net of tax	—	—	—	2,242	2,242
Common cash dividends declared, \$0.06 per share	—	—	(942)	—	(942)
Issuance of 11,346 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan	11	323	—	—	334
Issuance of 2,414 shares of common stock as a result of stock options exercised	3	41	—	—	44
Stock-based compensation expense	—	719	—	—	719
Restricted stock awards and restricted stock units- 4,769 shares of common stock, net of restricted stock units withheld for payment of taxes	5	(5)	—	—	—
Exchange of 1,032 shares of common stock in connection with payroll taxes for restricted stock vested and in connection with stock options exercised	(1)	(7)	—	—	(8)
<b>Balance, June 30, 2019</b>	<b>\$ 15,773</b>	<b>\$ 272,744</b>	<b>\$ 216,741</b>	<b>\$ (958)</b>	<b>\$ 504,300</b>
Net income	—	—	15,095	—	15,095
Other comprehensive income, net of tax	—	—	—	544	544
Common cash dividends declared, \$0.06 per share	—	—	(944)	—	(944)
Issuance of 5,674 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan	6	187	—	—	193
Issuance of 12,438 shares of common stock as a result of stock options exercised	12	144	—	—	156
Stock-based compensation expense	—	428	—	—	428
Exchange of 589 shares of common stock in connection with payroll taxes for restricted stock and in connection with stock options exercised	(1)	(28)	—	—	(29)
<b>Balance September 30, 2019</b>	<b>\$ 15,790</b>	<b>\$ 273,475</b>	<b>\$ 230,892</b>	<b>\$ (414)</b>	<b>\$ 519,743</b>



**QCR HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED) - continued**  
**Three and Nine months ended September 30, 2019 and 2018**

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Total
	<i>(dollars in thousands)</i>				
<b>Balance December 31, 2017</b>	<b>\$ 13,918</b>	<b>\$ 189,077</b>	<b>\$ 151,963</b>	<b>\$ (1,671)</b>	<b>\$ 353,287</b>
Net income	—	—	10,550	—	10,550
Other comprehensive loss, net of tax	—	—	—	(3,202)	(3,202)
Impact of adoption of ASU 2016-01	—	—	667	(667)	—
Common cash dividends declared, \$0.06 per share	—	—	(834)	—	(834)
Issuance of 2,669 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan	3	100	—	—	103
Issuance of 13,074 shares of common stock as a result of stock options exercised	13	193	—	—	206
Stock-based compensation expense	—	496	—	—	496
Restricted stock awards - 6,860 shares of common stock	7	(7)	—	—	—
Exchange of 3,814 shares of common stock in connection with payroll taxes for restricted stock vested and in connection with stock options exercised	(4)	(174)	—	—	(178)
<b>Balance, March 31, 2018</b>	<b>\$ 13,937</b>	<b>\$ 189,685</b>	<b>\$ 162,346</b>	<b>\$ (5,540)</b>	<b>\$ 360,428</b>
Net income	—	—	10,445	—	10,445
Other comprehensive loss, net of tax	—	—	—	(1,334)	(1,334)
Common cash dividends declared, \$0.06 per share	—	—	(836)	—	(836)
Issuance of 5,728 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan	6	215	—	—	221
Issuance of 26,641 shares of common stock as a result of stock options exercised	26	362	—	—	388
Stock-based compensation expense	—	292	—	—	292
Restricted stock awards - 3,972 shares of common stock	4	(4)	—	—	—
Exchange of 642 shares of common stock in connection with payroll taxes for restricted stock vested and in connection with stock options exercised	1	(17)	—	—	(16)
<b>Balance, June 30, 2018</b>	<b>\$ 13,974</b>	<b>\$ 190,533</b>	<b>\$ 171,955</b>	<b>\$ (6,874)</b>	<b>\$ 369,588</b>
Net income	—	—	8,809	—	8,809
Other comprehensive loss, net of tax	—	—	—	(612)	(612)
Common cash dividends declared, \$0.06 per share	—	—	(938)	—	(938)
Issuance of 1,699,414 shares of common stock as a result of merger with Springfield Bancshares, net of issuance costs of \$106,237	1,699	78,832	—	—	80,531
Issuance of 3,205 shares of common stock as a result of stock purchased under the Employee Stock Purchase Plan	4	120	—	—	124
Issuance of 1,754 shares of common stock as a result of stock options exercised	2	32	—	—	34
Stock-based compensation expense	—	319	—	—	319
Restricted stock awards - 5,300 shares of common stock	5	(5)	—	—	—
Exchange of 9,853 shares of common stock in connection with payroll taxes for restricted stock vested and in connection with stock options exercised	(10)	(458)	—	—	(468)
<b>Balance, September 30, 2018</b>	<b>\$ 15,674</b>	<b>\$ 269,373</b>	<b>\$ 179,826</b>	<b>\$ (7,486)</b>	<b>\$ 457,387</b>

See Notes to Consolidated Financial Statements (Unaudited)

**QCR HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**Nine months ended September 30, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
	<i>(dollars in thousands)</i>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 41,517	\$ 29,804
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,889	3,257
Provision for loan/lease losses	6,087	11,046
Stock-based compensation expense	1,869	1,106
Deferred compensation expense accrued	2,087	1,453
Losses on other real estate owned, net	3,205	49
Amortization of premiums on securities, net	1,339	1,201
Securities losses, net	56	—
Loans originated for sale	(104,824)	(39,923)
Proceeds on sales of loans	97,916	38,954
Gains on sales of residential real estate loans	(1,748)	(539)
Gains on sales of government guaranteed portions of loans	(589)	(405)
Loss on debt extinguishment, net	148	—
Gains on sales of premises and equipment	(67)	—
Amortization of intangibles	1,706	1,151
Accretion of acquisition fair value adjustments, net	(3,413)	(2,951)
Increase in cash value of bank-owned life insurance	(1,441)	(1,292)
Increase in other assets	(1,953)	(8,293)
Increase in other liabilities	336	2,254
<b>Net cash provided by operating activities</b>	<b>\$ 46,120</b>	<b>\$ 36,872</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net decrease (increase) in federal funds sold	17,098	(2,873)
Net decrease (increase) in interest-bearing deposits at financial institutions	(57,180)	22,099
Proceeds from sales of other real estate owned	840	1,288
Activity in securities portfolio:		
Purchases	(28,119)	(66,420)
Calls, maturities and redemptions	9,074	22,915
Paydowns	36,649	36,279
Sales	33,128	1,938
Activity in restricted investment securities:		
Purchases	(5,682)	(5,352)
Redemptions	5,006	109
Net increase in loans/leases originated and held for investment	(237,286)	(208,738)
Purchase of premises and equipment	(8,755)	(7,112)
Proceeds from sales of premises and equipment	146	—
Net cash paid for acquisition	—	(3,747)
<b>Net cash (used in) investing activities</b>	<b>\$ (235,081)</b>	<b>\$ (209,614)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposit accounts	276,960	82,309
Net decrease in short-term borrowings	(9,091)	(2,207)
Activity in Federal Home Loan Bank advances:		
Term advances	25,000	—
Calls and maturities	(35,000)	(27,000)
Net change in short-term and overnight advances	(15,965)	120,330
Prepayments	(30,228)	—
Activity in other borrowings:		
Proceeds from other borrowings	—	9,000
Calls, maturities and scheduled principal payments	(11,937)	(10,613)
Prepayments	(46,313)	—
Paydown of revolving line of credit	(9,000)	—
Proceeds from subordinated notes	63,393	—
Payment of cash dividends on common stock	(2,822)	(2,362)
Net proceeds from common stock offering	—	—
Proceeds from issuance of common stock, net	1,143	970
<b>Net cash provided by financing activities</b>	<b>\$ 206,140</b>	<b>\$ 170,427</b>

**QCR HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) - continued**  
**Nine months ended September 30, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
	<i>(dollars in thousands)</i>	
<b>Net increase (decrease) in cash and due from banks</b>	<b>17,179</b>	<b>(2,315)</b>
Cash and due from banks, beginning	85,523	75,722
Cash and due from banks, ending	<u>\$ 102,702</u>	<u>\$ 73,407</u>
Reconciliation of cash and due from banks:		
Cash and due from banks	91,671	73,407
Cash included in assets held for sale	11,031	—
Cash and due from banks at end of period	<u>\$ 102,702</u>	<u>\$ 73,407</u>
<b>Supplemental disclosure of cash flow information, cash payments (receipts) for:</b>		
Interest	\$ 45,826	\$ 23,102
Income/franchise taxes	(769)	(1,100)
<b>Supplemental schedule of noncash investing activities:</b>		
Change in accumulated other comprehensive income, unrealized gains on securities available for sale and derivative instruments, net	5,130	(5,148)
Exchange of shares of common stock in connection with payroll taxes for restricted stock and in connection with stock options exercised	(189)	(662)
Transfers of loans to other real estate owned	1,049	46
Increase (decrease) in the fair value of back-to-back interest rate swap assets and liabilities	80,760	(2,441)
Dividends payable	944	938
Transfer of equity securities from securities available for sale to other assets at fair value	—	2,614
<b>Supplemental disclosure of cash flow information for acquisitions:</b>		
<b>Fair value of assets acquired:</b>		
Cash and due from banks	\$ —	\$ 4,587
Interest-bearing deposits at financial institutions	—	62,925
Securities	—	4,845
Loans receivable, net	—	477,337
Bank-owned life insurance	—	7,092
Premises and equipment, net	—	6,092
Restricted investment securities	—	3,654
Intangibles	—	8,209
Other assets	—	988
Total assets acquired	<u>\$ —</u>	<u>\$ 575,729</u>
<b>Fair value of liabilities assumed:</b>		
Deposits	\$ —	\$ 439,580
Short-term borrowings	—	1,144
FHLB advances	—	73,610
Other borrowings	—	9,544
Other liabilities	—	8,408
Total liabilities assumed	<u>—</u>	<u>532,286</u>
Net assets acquired	<u>\$ —</u>	<u>\$ 43,443</u>
<b>Consideration paid:</b>		
Cash paid *	\$ —	\$ 8,334
Common stock	—	80,637
Total consideration paid	<u>—</u>	<u>88,971</u>
Goodwill	<u>\$ —</u>	<u>\$ 45,528</u>

\* Net cash paid at closing totaled \$3,747 for acquisition of SFC Bank in 2018.

See Notes to Consolidated Financial Statements (Unaudited)

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QCR HOLDINGS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
September 30, 2019

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, 2018, included in the Company's Annual Report on Form 10-K filed with the SEC on March 15, 2019. 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 September 30, 2019 are not necessarily indicative of the results expected for the year ending December 31, 2019, 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 AOCI: Accumulated other comprehensive income (loss) AFS: Available for sale ASC: Accounting Standards Codification ASU: Accounting Standards Update Bates Companies: Bates Financial Advisors, Inc., Bates Financial Services, Inc., Bates Securities, Inc. and Bates Financial Group, Inc. BOLI: Bank-owned life insurance Caps: Interest rate cap derivatives CDI: Core deposit intangible Community National: Community National Bancorporation CRBT: Cedar Rapids Bank & Trust Company CRE: Commercial real estate CSB: Community State Bank C&I: Commercial and industrial EPS: Earnings per share Exchange Act: Securities Exchange Act of 1934, as amended FASB: Financial Accounting Standards Board FDIC: Federal Deposit Insurance Corporation FHLB: Federal Home Loan Bank FRB: Federal Reserve Bank of Chicago GAAP: Generally Accepted Accounting Principles	Guaranty: Guaranty Bankshares, Ltd. Guaranty Bank: Guaranty Bank and Trust Company HTM: Held to maturity IB&T: Illinois Bank & Trust m2: m2 Lease Funds, LLC NIM: Net interest margin NPA: Nonperforming asset NPL: Nonperforming loan OREO: Other real estate owned OTTI: Other-than-temporary impairment PCI: Purchased credit impaired Provision: Provision for loan/lease losses QCBT: Quad City Bank & Trust Company RB&T: Rockford Bank & Trust Company ROAA: Return on Average Assets SBA: U.S. Small Business Administration SEC: Securities and Exchange Commission SFC Bank: Springfield First Community Bank Springfield Bancshares: Springfield Bancshares, Inc. TA: Tangible assets TCE: Tangible common equity TDRs: Troubled debt restructurings TEY: Tax equivalent yield The Company: QCR Holdings, Inc. USDA: U.S. Department of Agriculture
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries which include the accounts of five commercial banks: QCBT, CRBT, CSB, SFC Bank and RB&T. All are state-chartered commercial banks and all are members of the Federal Reserve system. The Company engages in direct financing lease contracts through m2, a wholly-owned subsidiary of QCBT. The Company also engages in wealth management services through its banking subsidiaries and its subsidiaries, the Bates Companies. All material intercompany transactions and balances have been eliminated in consolidation.

The acquisition of the Bates Companies, headquartered in Rockford, Illinois, occurred on October 1, 2018. The merger with Springfield Bancshares, the holding company of SFC Bank, headquartered in Springfield, Missouri, occurred on July 1, 2018. The financial results for the periods since acquisition/merger are included in this report. See Note 2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for additional information about the acquisition and merger.

On August 13, 2019, the Company entered into a definitive agreement to sell certain assets and liabilities of RB&T, a wholly-owned subsidiary headquartered in Rockford, Illinois, to IB&T, a wholly-owned subsidiary of Heartland Financial USA, Inc. Under the terms of the agreement, IB&T will acquire certain assets and assume certain liabilities for a cash payment. The transaction is subject to approval by federal and state bank regulators and to customary closing conditions. The transaction is expected to close in the fourth quarter of 2019. The assets and liabilities that will be sold are classified as held for sale on the Consolidated Balance Sheet and corresponding footnotes. See Note 2 to the Company's Consolidated Financial Statements for additional information about the sale.

**Recent accounting developments:** In February 2016, the FASB issued ASU 2016-02, *Leases*. Under ASU 2016-02, lessees will be required to recognize a lease liability measured on a discounted basis and a right-of-use asset for all leases (with the exception of short-term leases). Lessor accounting is largely unchanged under ASU 2016-02. However, the definition of initial direct costs was updated to include only initial direct costs that are considered incremental. This change in definition will change the manner in which the Company recognizes the costs associated with originating leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted for all entities. The standard was adopted on January 1, 2019 and did not have a significant impact on the Company's Consolidated Financial Statements.

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

In January 2017, the FASB issued ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350)*. ASU 2017-04 is intended to simplify goodwill impairment testing by eliminating the second step of the analysis. ASU 2017-04 requires entities to compare the fair value of a reporting unit with its carrying amount and recognize an impairment charge for any amount by which the carrying amount exceeds the reporting unit's fair value, to the extent that the loss recognized does not exceed the amount of goodwill allocated to that reporting unit. This guidance is effective for annual and interim periods beginning after December 15, 2019, with early adoption permitted. The Company does not expect this guidance to have a significant impact on its Consolidated Financial Statements.

**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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

NOTE 2 – ASSETS AND LIABILITIES HELD FOR SALE

On August 13, 2019, the Company and RB&T entered into a Purchase and Assumption Agreement (the Agreement) to sell certain assets and liabilities of RB&T, a wholly-owned subsidiary headquartered in Rockford, Illinois, to IB&T, a wholly-owned subsidiary of Heartland Financial USA, Inc. Under the terms of the Agreement, IB&T will acquire certain assets and assume certain liabilities of RB&T for a cash payment. The actual cash payment amount will be determined substantially by the following formula: (i) the “Purchase Price Premium”, plus (ii) the aggregate net book value of the acquired assets, minus (iii) the aggregate book value of the assumed liabilities. The Purchase Price Premium is equal to: (a) 8% of RB&T’s tangible assets, multiplied by (b) 0.345. Based on RB&T’s balance sheet as of September 30, 2019, the Purchase Price Premium would be \$14.2 million and the total payment by IB&T to the Company would be \$59.7 million. The transaction is subject to approval by federal and state bank regulators and to customary closing conditions. The transaction is expected to close in the fourth quarter of 2019.

Assets and liabilities of RB&T classified as held for sale are summarized as follows as of September 30, 2019:

	<b>As of</b> <b>September 30, 2019</b> <i>(dollars in thousands)</i>
<b>ASSETS</b>	
Cash and cash equivalents	\$ 13,446
Securities	66,009
Loans, net	362,011
Other assets	24,081
Assets held for sale	<u>\$ 465,547</u>
<b>LIABILITIES</b>	
Deposits	\$ 451,546
Borrowings	16,157
Other liabilities	2,827
Liabilities held for sale	<u>\$ 470,530</u>



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

**NOTE 3 – INVESTMENT SECURITIES**

The amortized cost and fair value of investment securities as of September 30, 2019 and December 31, 2018 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
	<i>(dollars in thousands)</i>			
<b>September 30, 2019:</b>				
Securities HTM:				
Municipal securities	\$ 342,427	\$ 20,122	\$ (119)	\$ 362,430
Other securities	1,050	—	(6)	1,044
	<u>\$ 343,477</u>	<u>\$ 20,122</u>	<u>\$ (125)</u>	<u>\$ 363,474</u>
Securities AFS:				
U.S. govt. sponsored agency securities	\$ 20,861	\$ 470	\$ (63)	\$ 21,268
Residential mortgage-backed and related securities	121,118	2,962	(200)	123,880
Municipal securities	47,259	1,653	(10)	48,902
Other securities	17,711	172	(1)	17,882
	<u>\$ 206,949</u>	<u>\$ 5,257</u>	<u>\$ (274)</u>	<u>\$ 211,932</u>
<b>December 31, 2018:</b>				
Securities HTM:				
Municipal securities	\$ 400,863	\$ 5,661	\$ (6,803)	\$ 399,721
Other securities	1,050	—	(1)	1,049
	<u>\$ 401,913</u>	<u>\$ 5,661</u>	<u>\$ (6,804)</u>	<u>\$ 400,770</u>
Securities AFS:				
U.S. govt. sponsored agency securities	\$ 37,150	\$ 39	\$ (778)	\$ 36,411
Residential mortgage-backed and related securities	163,698	182	(4,631)	159,249
Municipal securities	59,069	180	(703)	58,546
Other securities	6,754	100	(4)	6,850
	<u>\$ 266,671</u>	<u>\$ 501</u>	<u>\$ (6,116)</u>	<u>\$ 261,056</u>

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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

Gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2019 and December 31, 2018, 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
<i>(dollars in thousands)</i>						
<b>September 30, 2019:</b>						
Securities HTM:						
Municipal securities	\$ 1,037	\$ (1)	\$ 7,839	\$ (118)	\$ 8,876	\$ (119)
Other securities	1,044	(6)	—	—	1,044	(6)
	<u>\$ 2,081</u>	<u>\$ (7)</u>	<u>\$ 7,839</u>	<u>\$ (118)</u>	<u>\$ 9,920</u>	<u>\$ (125)</u>
Securities AFS:						
U.S. govt. sponsored agency securities	\$ 1,618	\$ (1)	\$ 2,318	\$ (62)	\$ 3,936	\$ (63)
Residential mortgage-backed and related securities	1,194	(1)	20,376	(199)	21,570	(200)
Municipal securities	1,686	(3)	723	(7)	2,409	(10)
Other securities	248	(1)	—	—	248	(1)
	<u>\$ 4,746</u>	<u>\$ (6)</u>	<u>\$ 23,417</u>	<u>\$ (268)</u>	<u>\$ 28,163</u>	<u>\$ (274)</u>
<i>(dollars in thousands)</i>						
<b>December 31, 2018:</b>						
Securities HTM:						
Municipal securities	\$ 114,201	\$ (2,187)	\$ 69,412	\$ (4,616)	\$ 183,613	\$ (6,803)
Other securities	549	(1)	—	—	549	(1)
	<u>\$ 114,750</u>	<u>\$ (2,188)</u>	<u>\$ 69,412</u>	<u>\$ (4,616)</u>	<u>\$ 184,162</u>	<u>\$ (6,804)</u>
Securities AFS:						
U.S. govt. sponsored agency securities	\$ 1,565	\$ (34)	\$ 29,605	\$ (744)	\$ 31,170	\$ (778)
Residential mortgage-backed and related securities	12,810	(148)	133,535	(4,483)	146,345	(4,631)
Municipal securities	28,356	(394)	15,932	(309)	44,288	(703)
Other securities	4,249	(4)	—	—	4,249	(4)
	<u>\$ 46,980</u>	<u>\$ (580)</u>	<u>\$ 179,072</u>	<u>\$ (5,536)</u>	<u>\$ 226,052</u>	<u>\$ (6,116)</u>

At September 30, 2019, the investment portfolio included 510 securities. Of this number, 31 securities were in an unrealized loss position. The aggregate losses of these securities totaled approximately 0.1% of the total amortized cost of the portfolio. Of these 31 securities, 21 securities had an unrealized loss for twelve months or more. All of the debt securities in unrealized loss positions are considered acceptable credit risks. Based upon an evaluation of the available evidence, including the recent changes in market rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these debt securities are temporary. In addition, the Company lacks the intent to sell these securities and it is not more-likely-than-not that the Company will be required to sell these debt securities before their anticipated recovery.

The Company did not recognize OTTI on any investment securities for the three or nine months ended September 30, 2019 and 2018.



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

All sales of securities for the three and nine months ended September 30, 2019 and September 30, 2018 were 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:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30, 2019</u>	<u>September 30, 2018</u>	<u>September 30, 2019</u>	<u>September 30, 2018</u>
	<i>(dollars in thousands)</i>			
Proceeds from sales of securities	\$ 23,364	\$ 1,938	\$ 28,025	\$ 1,938
Gross gains from sales of securities	143	—	150	—
Gross losses from sales of securities	(146)	—	(206)	—

The amortized cost and fair value of securities as of September 30, 2019 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.

	<u>Amortized Cost</u>	<u>Fair Value</u>
	<i>(dollars in thousands)</i>	
Securities HTM:		
Due in one year or less	\$ 2,946	\$ 2,954
Due after one year through five years	31,055	31,689
Due after five years	309,476	328,831
	<u>\$ 343,477</u>	<u>\$ 363,474</u>
Securities AFS:		
Due in one year or less	\$ 1,084	\$ 1,088
Due after one year through five years	17,157	17,384
Due after five years	67,590	69,580
	85,831	88,052
Residential mortgage-backed and related securities	121,118	123,880
	<u>\$ 206,949</u>	<u>\$ 211,932</u>

Portions of the U.S. government sponsored agency securities, municipal securities and other 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:

	<u>Amortized Cost</u>	<u>Fair Value</u>
	<i>(dollars in thousands)</i>	
Securities HTM:		
Municipal securities	<u>\$ 176,339</u>	<u>\$ 181,785</u>
Securities AFS:		
Municipal securities	40,262	41,646
Other securities	6,504	6,677
	<u>\$ 46,766</u>	<u>\$ 48,323</u>

As of September 30, 2019, the Company's municipal securities portfolios were comprised of general obligation bonds issued by 91 issuers with fair values totaling \$76.1 million and revenue bonds issued by 148 issuers, primarily consisting

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

of states, counties, towns, villages and school districts with fair values totaling \$335.2 million. The Company held investments in general obligation bonds in 23 states, including six states in which the aggregate fair value exceeded \$5.0 million. The Company held investments in revenue bonds in 17 states, including seven states in which the aggregate fair value exceeded \$5.0 million.

As of December 31, 2018, the Company's municipal securities portfolios were comprised of general obligation bonds issued by 110 issuers with fair values totaling \$86.4 million and revenue bonds issued by 160 issuers, primarily consisting of states, counties, towns, villages and school districts with fair values totaling \$371.9 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 19 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 September 30, 2019 and December 31, 2018 the Company held revenue bonds of one single issuer, located in Ohio, of which the aggregate book or market value exceeded 5% of the Company's stockholders' equity. The issuer's financial condition is strong and the source of repayment is diversified. The Company monitors the investment and concentration closely. 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 held for investment charters, whose investment policies set forth limits for various subcategories within the municipal securities portfolio. Each charter is monitored individually, and as of September 30, 2019, 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 September 30, 2019, 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

NOTE 4 – LOANS/LEASES RECEIVABLE

The composition of the loan/lease portfolio as of September 30, 2019 and December 31, 2018 is presented as follows:

	<u>As of September 30,</u> <u>2019</u>	<u>As of December 31,</u> <u>2018</u>
	<i>(dollars in thousands)</i>	
C&I loans *	\$ 1,469,978	\$ 1,429,410
CRE loans		
Owner-occupied CRE	441,122	500,654
Commercial construction, land development, and other land	369,123	236,787
Other non owner-occupied CRE	877,677	1,028,670
	<u>1,687,922</u>	<u>1,766,111</u>
Direct financing leases **	92,307	117,969
Residential real estate loans ***	245,667	290,759
Installment and other consumer loans	106,540	119,381
	<u>3,602,414</u>	<u>3,723,630</u>
Plus deferred loan/lease origination costs, net of fees	7,856	9,124
	<u>3,610,270</u>	<u>3,732,754</u>
Less allowance	(36,116)	(39,847)
	<u>\$ 3,574,154</u>	<u>\$ 3,692,907</u>
** Direct financing leases:		
Net minimum lease payments to be received	\$ 101,869	\$ 130,371
Estimated unguaranteed residual values of leased assets	547	828
Unearned lease/residual income	(10,109)	(13,230)
	<u>92,307</u>	<u>117,969</u>
Plus deferred lease origination costs, net of fees	2,153	3,642
	<u>94,460</u>	<u>121,611</u>
Less allowance	(1,302)	(1,792)
	<u>\$ 93,158</u>	<u>\$ 119,819</u>

\* Includes equipment financing agreements outstanding at m2, totaling \$131.0 million and \$103.4 million as of September 30, 2019 and December 31, 2018, 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 nine months ended September 30, 2019 and 2018.

\*\*\* Includes residential real estate loans held for sale totaling \$8.9 million and \$1.3 million as of September 30, 2019 and December 31, 2018, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

Changes in accretible yield for acquired loans were as follows:

	Three months ended September 30, 2019			Nine months ended September 30, 2019		
	PCI Loans	Performing Loans	Total	PCI Loans	Performing Loans	Total
	<i>(dollars in thousands)</i>					
Balance at the beginning of the period	\$ (151)	\$ (8,489)	\$ (8,640)	\$ (667)	\$ (10,127)	\$ (10,794)
Reclassification of nonaccretible discount to accretible	—	—	—	(159)	—	(159)
Accretion recognized	94	1,344	1,438	769	2,982	3,751
Balance at the end of the period	\$ (57)	\$ (7,145)	\$ (7,202)	\$ (57)	\$ (7,145)	\$ (7,202)

	Three months ended September 30, 2018			Nine months ended September 30, 2018		
	PCI Loans	Performing Loans	Total	PCI Loans	Performing Loans	Total
	<i>(dollars in thousands)</i>					
Balance at the beginning of the period	\$ (142)	\$ (5,051)	\$ (5,193)	\$ (191)	\$ (6,280)	\$ (6,471)
Discount added at acquisition	(293)	(7,800)	(8,093)	(293)	(7,800)	(8,093)
Reclassification of nonaccretible discount to accretible	(892)	—	(892)	(892)	—	(892)
Accretion recognized	269	1,579	1,848	318	2,808	3,126
Balance at the end of the period	\$ (1,058)	\$ (11,272)	\$ (12,330)	\$ (1,058)	\$ (11,272)	\$ (12,330)

The aging of the loan/lease portfolio by classes of loans/leases as of September 30, 2019 and December 31, 2018 is presented as follows:

Classes of Loans/Leases	As of September 30, 2019					
	Current	30-59 Days Past Due	60-89 Days Past Due	Accruing Past Due 90 Days or More	Nonaccrual Loans/Leases	Total
	<i>(dollars in thousands)</i>					
C&I	\$ 1,466,347	\$ 2,067	\$ 246	\$ —	\$ 1,318	\$ 1,469,978
CRE						
Owner-Occupied CRE	440,668	276	—	—	178	441,122
Commercial Construction, Land Development, and Other Land	368,422	701	—	—	—	369,123
Other Non Owner-Occupied CRE	872,591	1,491	—	—	3,595	877,677
Direct Financing Leases	89,776	816	318	—	1,397	92,307
Residential Real Estate	243,785	58	704	—	1,120	245,667
Installment and Other Consumer	105,580	337	—	—	623	106,540
	<u>\$ 3,587,169</u>	<u>\$ 5,746</u>	<u>\$ 1,268</u>	<u>\$ —</u>	<u>\$ 8,231</u>	<u>\$ 3,602,414</u>

As a percentage of total loan/lease portfolio

Classes of Loans/Leases	As of December 31, 2018					
	Current	30-59 Days Past Due	60-89 Days Past Due	Accruing Past Due 90 Days or More	Nonaccrual Loans/Leases	Total
	<i>(dollars in thousands)</i>					
C&I	\$ 1,423,406	\$ 930	\$ 597	\$ 389	\$ 4,088	\$ 1,429,410
CRE						
Owner-Occupied CRE	500,138	—	193	107	216	500,654
Commercial Construction, Land Development, and Other Land	234,704	1,764	—	—	319	236,787
Other Non Owner-Occupied CRE	1,022,664	484	—	—	5,522	1,028,670
Direct Financing Leases	114,078	1,642	488	—	1,761	117,969
Residential Real Estate	284,844	3,877	206	89	1,743	290,759
Installment and Other Consumer	118,343	356	24	47	611	119,381
	<u>\$ 3,698,177</u>	<u>\$ 9,053</u>	<u>\$ 1,508</u>	<u>\$ 632</u>	<u>\$ 14,260</u>	<u>\$ 3,723,630</u>

As a percentage of total loan/lease portfolio

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NPLs by classes of loans/leases as of September 30, 2019 and December 31, 2018 are presented as follows:

Classes of Loans/Leases	As of September 30, 2019					Percentage of Total NPLs
	Accruing Past Due 90 Days or More*	Nonaccrual Loans/Leases*	Accruing TDRs	Total NPLs		
	(dollars in thousands)					
C&I	\$ —	\$ 1,318	\$ 565	\$ 1,883		20.94 %
CRE						
Owner-Occupied CRE	—	178	—	178		1.98 %
Commercial Construction, Land Development, and Other						
Land	—	—	—	—		- %
Other Non Owner-Occupied CRE	—	3,595	—	3,595		39.97 %
Direct Financing Leases	—	1,397	198	1,595		17.73 %
Residential Real Estate	—	1,120	—	1,120		12.45 %
Installment and Other Consumer	—	623	—	623		6.93 %
	<u>\$ —</u>	<u>\$ 8,231</u>	<u>\$ 763</u>	<u>\$ 8,994</u>		<u>100.00 %</u>

\* Nonaccrual loans/leases included \$932 thousand of TDRs, including \$26 thousand in C&I loans, \$513 thousand in CRE loans, \$304 thousand in direct financing leases, \$32 thousand in residential real estate loans, and \$57 thousand in installment loans.

Classes of Loans/Leases	As of December 31, 2018					Percentage of Total NPLs
	Accruing Past Due 90 Days or More*	Nonaccrual Loans/Leases**	Accruing TDRs	Total NPLs		
	(dollars in thousands)					
C&I	\$ 389	\$ 4,088	\$ 454	\$ 4,931		26.58 %
CRE						
Owner-Occupied CRE	107	216	—	323		1.74 %
Commercial Construction, Land Development, and Other						
Land	—	319	—	319		1.72 %
Other Non Owner-Occupied CRE	—	5,522	2,984	8,506		45.86 %
Direct Financing Leases	—	1,761	111	1,872		10.09 %
Residential Real Estate	89	1,743	100	1,932		10.41 %
Installment and Other Consumer	47	611	9	667		3.60 %
	<u>\$ 632</u>	<u>\$ 14,260</u>	<u>\$ 3,658</u>	<u>\$ 18,550</u>		<u>100.00 %</u>

\* As of December 31, 2018 accruing past due 90 days or more included \$496 thousand of TDRs, including \$389 thousand in C&I loans and \$107 thousand in CRE loans.

\*\* Nonaccrual loans/leases included \$2.3 million of TDRs, including \$265 thousand in C&I loans, \$1.4 million in CRE loans, \$321 thousand in direct financing leases, \$344 thousand in residential real estate loans, and \$3 thousand in installment loans.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

Changes in the allowance by portfolio segment for the three and nine months ended September 30, 2019 and 2018, respectively, are presented as follows:

	Three Months Ended September 30, 2019					
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
	<i>(dollars in thousands)</i>					
Balance, beginning	\$ 18,248	\$ 17,363	\$ 1,459	\$ 2,582	\$ 1,452	\$ 41,104
Reclassification of allowance related to held for sale assets	(2,814)	(2,392)	—	(628)	(288)	(6,122)
Provisions (credits) charged to expense *	998	220	80	241	45	1,584
Loans/leases charged off	(349)	—	(351)	(37)	(4)	(741)
Recoveries on loans/leases previously charged off	68	100	114	—	9	291
Balance, ending	<u>\$ 16,151</u>	<u>\$ 15,291</u>	<u>\$ 1,302</u>	<u>\$ 2,158</u>	<u>\$ 1,214</u>	<u>\$ 36,116</u>

	Three Months Ended September 30, 2018					
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
	<i>(dollars in thousands)</i>					
Balance, beginning	\$ 15,234	\$ 15,819	\$ 2,724	\$ 2,433	\$ 1,335	\$ 37,545
Provisions (credits) charged to expense	3,699	2,254	125	132	(4)	6,206
Loans/leases charged off	(87)	(387)	(428)	(58)	(31)	(991)
Recoveries on loans/leases previously charged off	71	30	211	—	5	317
Balance, ending	<u>\$ 18,917</u>	<u>\$ 17,716</u>	<u>\$ 2,632</u>	<u>\$ 2,507</u>	<u>\$ 1,305</u>	<u>\$ 43,077</u>

	Nine Months Ended September 30, 2019					
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
	<i>(dollars in thousands)</i>					
Balance, beginning	\$ 16,420	\$ 17,719	\$ 1,792	\$ 2,557	\$ 1,359	\$ 39,847
Reclassification of allowance related to held for sale assets	(2,814)	(2,392)	—	(628)	(288)	(6,122)
Provisions charged to expense *	3,120	1,168	856	309	206	5,659
Loans/leases charged off	(876)	(1,369)	(1,501)	(109)	(99)	(3,953)
Recoveries on loans/leases previously charged off	300	164	155	31	36	685
Balance, ending	<u>\$ 16,151</u>	<u>\$ 15,291</u>	<u>\$ 1,302</u>	<u>\$ 2,158</u>	<u>\$ 1,214</u>	<u>\$ 36,116</u>

	Nine Months Ended September 30, 2018					
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
	<i>(dollars in thousands)</i>					
Balance, beginning	\$ 14,323	\$ 13,963	\$ 2,382	\$ 2,466	\$ 1,221	\$ 34,355
Provisions charged to expense	5,284	4,091	1,418	150	104	11,046
Loans/leases charged off	(911)	(388)	(1,506)	(110)	(36)	(2,951)
Recoveries on loans/leases previously charged off	221	50	338	1	16	626
Balance, ending	<u>\$ 18,917</u>	<u>\$ 17,716</u>	<u>\$ 2,632</u>	<u>\$ 2,507</u>	<u>\$ 1,305</u>	<u>\$ 43,077</u>

\*Excludes provision related to loans included in assets held for sale of \$428 thousand for the three and nine months ended September 30, 2019.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

The allowance by impairment evaluation and by portfolio segment as of September 30, 2019 and December 31, 2018 is presented as follows:

	As of September 30, 2019					
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
	<i>(dollars in thousands)</i>					
Allowance for impaired loans/leases	\$ 160	\$ 374	\$ 59	\$ 27	\$ 84	\$ 704
Allowance for nonimpaired loans/leases	15,991	14,917	1,243	2,131	1,130	35,412
	<u>\$ 16,151</u>	<u>\$ 15,291</u>	<u>\$ 1,302</u>	<u>\$ 2,158</u>	<u>\$ 1,214</u>	<u>\$ 36,116</u>
Impaired loans/leases	\$ 1,764	\$ 4,148	\$ 1,581	\$ 1,062	\$ 623	\$ 9,178
Nonimpaired loans/leases	1,468,214	1,683,774	90,726	244,605	105,917	3,593,236
	<u>\$ 1,469,978</u>	<u>\$ 1,687,922</u>	<u>\$ 92,307</u>	<u>\$ 245,667</u>	<u>\$ 106,540</u>	<u>\$ 3,602,414</u>
Allowance as a percentage of impaired loans/leases	9.07 %	9.02 %	3.73 %	2.54 %	13.48 %	7.67 %
Allowance as a percentage of nonimpaired loans/leases	1.09 %	0.89 %	1.37 %	0.87 %	1.07 %	0.99 %
Total allowance as a percentage of total loans/leases	<u>1.10 %</u>	<u>0.91 %</u>	<u>1.41 %</u>	<u>0.88 %</u>	<u>1.14 %</u>	<u>1.00 %</u>

	As of December 31, 2018					
	C&I	CRE	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer	Total
	<i>(dollars in thousands)</i>					
Allowance for impaired loans/leases	\$ 973	\$ 2,124	\$ 194	\$ 257	\$ 111	\$ 3,659
Allowance for nonimpaired loans/leases	15,447	15,595	1,598	2,300	1,248	36,188
	<u>\$ 16,420</u>	<u>\$ 17,719</u>	<u>\$ 1,792</u>	<u>\$ 2,557</u>	<u>\$ 1,359</u>	<u>\$ 39,847</u>
Impaired loans/leases	\$ 4,499	\$ 10,447	\$ 2,249	\$ 2,110	\$ 898	\$ 20,203
Nonimpaired loans/leases	1,424,911	1,755,664	115,720	288,649	118,483	3,703,427
	<u>\$ 1,429,410</u>	<u>\$ 1,766,111</u>	<u>\$ 117,969</u>	<u>\$ 290,759</u>	<u>\$ 119,381</u>	<u>\$ 3,723,630</u>
Allowance as a percentage of impaired loans/leases	21.62 %	20.33 %	8.63 %	12.18 %	12.38 %	18.11 %
Allowance as a percentage of nonimpaired loans/leases	1.08 %	0.89 %	1.38 %	0.80 %	1.05 %	0.98 %
Total allowance as a percentage of total loans/leases	<u>1.15 %</u>	<u>1.00 %</u>	<u>1.52 %</u>	<u>0.88 %</u>	<u>1.14 %</u>	<u>1.07 %</u>

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.

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Loans/leases, by classes of financing receivable, considered to be impaired as of and for the nine months ended September 30, 2019 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
<i>(dollars in thousands)</i>						
<b>Impaired Loans/Leases with No Specific Allowance Recorded:</b>						
C&I	\$ 1,545	\$ 1,585	\$ —	\$ 1,026	\$ 18	\$ 18
<b>CRE</b>						
Owner-Occupied CRE	40	56	—	21	—	—
Commercial Construction, Land Development, and Other Land	—	—	—	—	—	—
Other Non Owner-Occupied CRE	733	733	—	751	22	22
Direct Financing Leases	1,440	1,440	—	1,246	19	19
Residential Real Estate	648	764	—	522	—	—
Installment and Other Consumer	539	539	—	510	—	—
	<u>\$ 4,945</u>	<u>\$ 5,117</u>	<u>\$ —</u>	<u>\$ 4,076</u>	<u>\$ 59</u>	<u>\$ 59</u>
<b>Impaired Loans/Leases with Specific Allowance Recorded:</b>						
C&I	\$ 219	\$ 219	\$ 160	\$ 102	\$ —	\$ —
<b>CRE</b>						
Owner-Occupied CRE	121	121	18	127	—	—
Commercial Construction, Land Development, and Other Land	—	—	—	—	—	—
Other Non Owner-Occupied CRE	3,254	3,254	356	1,995	—	—
Direct Financing Leases	141	141	59	108	2	2
Residential Real Estate	414	414	27	381	—	—
Installment and Other Consumer	84	84	84	57	—	—
	<u>\$ 4,233</u>	<u>\$ 4,233</u>	<u>\$ 704</u>	<u>\$ 2,770</u>	<u>\$ 2</u>	<u>\$ 2</u>
<b>Total Impaired Loans/Leases:</b>						
C&I	\$ 1,764	\$ 1,804	\$ 160	\$ 1,128	\$ 18	\$ 18
<b>CRE</b>						
Owner-Occupied CRE	161	177	18	148	—	—
Commercial Construction, Land Development, and Other Land	—	—	—	—	—	—
Other Non Owner-Occupied CRE	3,987	3,987	356	2,746	22	22
Direct Financing Leases	1,581	1,581	59	1,354	21	21
Residential Real Estate	1,062	1,178	27	903	—	—
Installment and Other Consumer	623	623	84	567	—	—
	<u>\$ 9,178</u>	<u>\$ 9,350</u>	<u>\$ 704</u>	<u>\$ 6,846</u>	<u>\$ 61</u>	<u>\$ 61</u>



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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 September 30, 2019 and 2018, respectively are presented as follows:

Classes of Loans/Leases	Three Months Ended September 30, 2019			Three Months Ended September 30, 2018		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized for Cash Payments Received	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized for Cash Payments Received
<i>(dollars in thousands)</i>						
<b>Impaired Loans/Leases with No Specific Allowance Recorded:</b>						
C&I	\$ 1,433	\$ 6	\$ 6	\$ 2,795	\$ 17	\$ 17
CRE						
Owner-Occupied CRE	42	—	—	289	—	—
Commercial Construction, Land Development, and Other Land	—	—	—	—	—	—
Other Non Owner-Occupied CRE	739	7	7	1,009	9	9
Direct Financing Leases	1,359	6	6	1,780	3	3
Residential Real Estate	540	—	—	666	—	—
Installment and Other Consumer	543	—	—	115	—	—
	<u>\$ 4,656</u>	<u>\$ 19</u>	<u>\$ 19</u>	<u>\$ 6,654</u>	<u>\$ 29</u>	<u>\$ 29</u>
<b>Impaired Loans/Leases with Specific Allowance Recorded:</b>						
C&I	\$ 141	\$ —	\$ —	\$ 3,401	\$ 2	\$ 2
CRE						
Owner-Occupied CRE	123	—	—	141	—	—
Commercial Construction, Land Development, and Other Land	—	—	—	5,484	—	—
Other Non Owner-Occupied CRE	3,254	—	—	3,848	8	8
Direct Financing Leases	120	—	—	558	—	—
Residential Real Estate	390	—	—	461	3	3
Installment and Other Consumer	84	—	—	113	—	—
	<u>\$ 4,112</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 14,006</u>	<u>\$ 13</u>	<u>\$ 13</u>
<b>Total Impaired Loans/Leases:</b>						
C&I	\$ 1,574	\$ 6	\$ 6	\$ 6,196	\$ 19	\$ 19
CRE						
Owner-Occupied CRE	165	—	—	430	—	—
Commercial Construction, Land Development, and Other Land	—	—	—	5,484	—	—
Other Non Owner-Occupied CRE	3,993	7	7	4,857	17	17
Direct Financing Leases	1,479	6	6	2,338	3	3
Residential Real Estate	930	—	—	1,127	3	3
Installment and Other Consumer	627	—	—	228	—	—
	<u>\$ 8,768</u>	<u>\$ 19</u>	<u>\$ 19</u>	<u>\$ 20,660</u>	<u>\$ 42</u>	<u>\$ 42</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – continued

Loans/leases, by classes of financing receivable, considered to be impaired as of December 31, 2018 are presented as follows:

<u>Classes of Loans/Leases</u>	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>
		<i>(dollars in thousands)</i>	
<u>Impaired Loans/Leases with No Specific Allowance Recorded:</u>			
C&I	\$ 1,846	\$ 4,540	\$ —
CRE			
Owner-Occupied CRE	106	106	—
Commercial Construction, Land Development, and Other Land	507	507	—
Other Non Owner-Occupied CRE	1,804	1,804	—
Direct Financing Leases	1,929	1,929	—
Residential Real Estate	984	1,058	—
Installment and Other Consumer	762	762	—
	<u>\$ 7,938</u>	<u>\$ 10,706</u>	<u>\$ —</u>
<u>Impaired Loans/Leases with Specific Allowance Recorded:</u>			
C&I	\$ 2,653	\$ 2,653	\$ 973
CRE			
Owner-Occupied CRE	304	660	39
Commercial Construction, Land Development, and Other Land	149	149	33
Other Non Owner-Occupied CRE	7,577	7,577	2,052
Direct Financing Leases	320	320	194
Residential Real Estate	1,126	1,126	257
Installment and Other Consumer	136	136	111
	<u>\$ 12,265</u>	<u>\$ 12,621</u>	<u>\$ 3,659</u>
<u>Total Impaired Loans/Leases:</u>			
C&I	\$ 4,499	\$ 7,193	\$ 973
CRE			
Owner-Occupied CRE	410	766	39
Commercial Construction, Land Development, and Other Land	656	656	33
Other Non Owner-Occupied CRE	9,381	9,381	2,052
Direct Financing Leases	2,249	2,249	194
Residential Real Estate	2,110	2,184	257
Installment and Other Consumer	898	898	111
	<u>\$ 20,203</u>	<u>\$ 23,327</u>	<u>\$ 3,659</u>

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.

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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 September 30, 2019 and December 31, 2018:

Internally Assigned Risk Rating	As of September 30, 2019						As a % of Total
	CRE						
	C&I	Non-Owner Occupied				Total	
		Owner-Occupied CRE	Commercial Construction, Land Development, and Other Land		Other CRE		
Pass (Ratings 1 through 5)	\$ 1,306,314	\$ 435,761	\$ 368,659	\$ 861,561	\$ 2,972,295	98.19 %	
Special Mention (Rating 6)	14,043	2,888	40	6,224	23,195	0.77 %	
Substandard (Rating 7)	18,597	2,473	424	9,892	31,386	1.04 %	
Doubtful (Rating 8)	—	—	—	—	—	— %	
	<u>\$ 1,338,954</u>	<u>\$ 441,122</u>	<u>\$ 369,123</u>	<u>\$ 877,677</u>	<u>\$ 3,026,876</u>	<u>100.00 %</u>	

Delinquency Status *	As of September 30, 2019					As a % of Total
	CRE					
	C&I	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer		
Performing	\$ 130,291	\$ 90,712	\$ 244,547	\$ 105,917	\$ 571,467	99.29 %
Nonperforming	733	1,595	1,120	623	4,071	0.71 %
	<u>\$ 131,024</u>	<u>\$ 92,307</u>	<u>\$ 245,667</u>	<u>\$ 106,540</u>	<u>\$ 575,538</u>	<u>100.00 %</u>

Internally Assigned Risk Rating	As of December 31, 2018						As a % of Total
	CRE						
	C&I	Non-Owner Occupied				Total	
		Owner-Occupied CRE	Commercial Construction, Land Development, and Other Land		Other CRE		
Pass (Ratings 1 through 5)	\$ 1,294,418	\$ 487,949	\$ 230,473	\$ 1,008,626	\$ 3,021,466	97.72 %	
Special Mention (Rating 6)	23,302	9,599	3,848	5,309	42,058	1.36 %	
Substandard (Rating 7)	8,286	3,106	2,466	14,735	28,593	0.92 %	
Doubtful (Rating 8)	—	—	—	—	—	— %	
	<u>\$ 1,326,006</u>	<u>\$ 500,654</u>	<u>\$ 236,787</u>	<u>\$ 1,028,670</u>	<u>\$ 3,092,117</u>	<u>100.00 %</u>	

Delinquency Status *	As of December 31, 2018					As a % of Total
	CRE					
	C&I	Direct Financing Leases	Residential Real Estate	Installment and Other Consumer		
Performing	\$ 102,713	\$ 116,097	\$ 288,827	\$ 118,714	\$ 626,351	99.18 %
Nonperforming	691	1,872	1,932	667	5,162	0.82 %
	<u>\$ 103,404</u>	<u>\$ 117,969</u>	<u>\$ 290,759</u>	<u>\$ 119,381</u>	<u>\$ 631,513</u>	<u>100.00 %</u>

\* 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.

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As of September 30, 2019 and December 31, 2018, TDRs totaled \$1.7 million and \$6.5 million, 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 nine months ended September 30, 2019 and 2018. The difference between the pre-modification recorded investment and the post-modification recorded investment would be any partial charge-offs at the time of the restructuring.

Classes of Loans/Leases	For the three months ended September 30, 2019				For the three months ended September 30, 2018			
	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
<i>(dollars in thousands)</i>								
<b>CONCESSION - Significant Payment Delay</b>								
C&I	—	\$ —	\$ —	\$ —	1	\$ 274	\$ 274	\$ 274
Other Non Owner-Occupied CRE	—	—	—	—	2	981	981	60
Direct Financing Leases	3	116	116	—	2	44	44	—
	<u>3</u>	<u>\$ 116</u>	<u>\$ 116</u>	<u>\$ —</u>	<u>5</u>	<u>\$ 1,299</u>	<u>\$ 1,299</u>	<u>\$ 334</u>
<b>CONCESSION - Extension of Maturity</b>								
Installment and Other Consumer	1	56	56	56	—	—	—	—
	<u>1</u>	<u>\$ 56</u>	<u>\$ 56</u>	<u>\$ 56</u>	<u>—</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
<b>TOTAL</b>	<u>4</u>	<u>\$ 172</u>	<u>\$ 172</u>	<u>\$ 56</u>	<u>5</u>	<u>\$ 1,299</u>	<u>\$ 1,299</u>	<u>\$ 334</u>

Classes of Loans/Leases	For the nine months ended September 30, 2019				For the nine months ended September 30, 2018			
	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
<i>(dollars in thousands)</i>								
<b>CONCESSION - Significant Payment Delay</b>								
C&I	1	\$ 19	\$ 19	\$ —	1	\$ 274	\$ 274	\$ 274
Other Non Owner-Occupied CRE	—	—	—	—	2	981	981	60
Residential Real Estate	—	—	—	—	1	46	46	—
Direct Financing Leases	6	219	219	20	4	92	92	—
	<u>7</u>	<u>\$ 238</u>	<u>\$ 238</u>	<u>\$ 20</u>	<u>8</u>	<u>\$ 1,393</u>	<u>\$ 1,393</u>	<u>\$ 334</u>
<b>CONCESSION - Forgiveness of Principal</b>								
C&I	1	\$ 587	\$ 537	\$ —	—	\$ —	\$ —	\$ —
	<u>1</u>	<u>\$ 587</u>	<u>\$ 537</u>	<u>\$ —</u>	<u>—</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
<b>CONCESSION - Extension of Maturity</b>								
Other Non Owner-Occupied CRE	—	\$ —	\$ —	\$ —	2	\$ 2,976	\$ 2,976	\$ 816
Installment and Other Consumer	1	56	56	56	—	—	—	—
Direct Financing Leases	—	—	—	—	1	35	35	—
	<u>1</u>	<u>\$ 56</u>	<u>\$ 56</u>	<u>\$ 56</u>	<u>3</u>	<u>\$ 3,011</u>	<u>\$ 3,011</u>	<u>\$ 816</u>
<b>TOTAL</b>	<u>9</u>	<u>\$ 881</u>	<u>\$ 831</u>	<u>\$ 76</u>	<u>11</u>	<u>\$ 4,404</u>	<u>\$ 4,404</u>	<u>\$ 1,150</u>

Of the loans restructured during the nine months ended September 30, 2019, three with post-modification recorded balances of \$121 thousand were on nonaccrual. Of the loans restructured during the nine months ended September 30, 2018, four with a post-modification recorded balance of \$1.3 million was on nonaccrual.

For the nine months ended September 30, 2019, 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 TDRs were related to one customer whose leases were restructured in the first quarter of 2019 with pre-modification balances totaling \$66 thousand.

For the three and nine months ended September 30, 2018, 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 TDRs were related to customers whose loans were restructured in the third quarter of 2018 with pre-modification balances totaling \$774 thousand.

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Not included in the table above, the Company had three TDRs that were restructured and charged off for the nine months ended September 30, 2019, totaling \$108 thousand. The Company had nine TDRs that were restructured and charged off for the nine months ended September 30, 2018, totaling \$577 thousand.

**NOTE 5 – DERIVATIVES**

The Company uses interest rate swap instruments to manage interest rate risk related to the variability of interest payments due to changes in interest rates. 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 three-month LIBOR, and the interest rate swaps utilize three-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		Receive Rate	Pay Rate	Fair Value as of	
			Location	Notional Amount			September 30, 2019	December 31, 2018
<i>(dollars in thousands)</i>								
QCR Holdings Statutory Trust II	9/30/2018	9/30/2028	Other Liabilities	\$ 10,000	4.95 %	5.85 %	\$ (1,265)	\$ (298)
QCR Holdings Statutory Trust III	9/30/2018	9/30/2028	Other Liabilities	8,000	4.95 %	5.85 %	(1,012)	(239)
QCR Holdings Statutory Trust V	7/7/2018	7/7/2028	Other Liabilities	10,000	3.85 %	4.54 %	(1,229)	(288)
Community National Statutory Trust II	9/20/2018	9/20/2028	Other Liabilities	3,000	4.33 %	5.17 %	(378)	(89)
Community National Statutory Trust III	9/15/2018	9/15/2028	Other Liabilities	3,500	3.87 %	4.75 %	(441)	(104)
Guaranty Bankshares Statutory Trust I	9/15/2018	9/15/2028	Other Liabilities	4,500	3.87 %	4.75 %	(566)	(133)
				<u>\$ 39,000</u>	<u>4.40 %</u>	<u>5.24 %</u>	<u>\$ (4,891)</u>	<u>\$ (1,151)</u>

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

The Company has also entered into interest rate swap contracts that are not designated as hedging instruments. These derivative contracts relate to transactions in which the Company enters into an interest rate swap with a customer while at the same time entering into an equal and offsetting interest rate swap with a third party financial institution. Because the Company acts as an intermediary for the customer, changes in the fair value of the underlying derivative contracts, for the most part, offset each other and do not significantly impact the Company's results of operations.

	September 30, 2019		December 31, 2018	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
<i>(dollars in thousands)</i>				
Non-Hedging Interest Rate Derivatives Assets:				
Interest rate swap contracts	\$ 694,928	\$ 102,956	\$ 445,022	\$ 22,196
Non-Hedging Interest Rate Derivatives Liabilities:				
Interest rate swap contracts	\$ 694,928	\$ 102,956	\$ 445,022	\$ 22,196

Swap fee income totaled \$20.9 million and \$3.7 million for the nine months ended September 30, 2019 and 2018, respectively. Swap fee income totaled \$10.6 million for the year ended December 31, 2018.

**NOTE 6 – BORROWINGS**

On February 12, 2019, the Company completed an underwritten public offering of \$65.0 million in aggregate principal amount of fixed-to-floating subordinated notes that mature on February 15, 2029. Net proceeds, after deducting the underwriting discount and estimated expenses, were \$63.4 million. The subordinated notes, which qualify as Tier 2 capital for the Company, are at a fixed rate of 5.375% per year until but excluding February 15, 2024. On this date, the interest rate will change to an annual floating rate equal to three-month LIBOR plus 282 basis points until the maturity date. The interest on the subordinated notes are payable semi-annually, commencing on August 15, 2019 during the five year fixed term and thereafter quarterly, commencing on February 15, 2024. The subordinated notes have an optional redemption in whole or in part on any interest payment date on or after February 15, 2024. The subordinated notes are subordinate in

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the right of payment to the Company's senior indebtedness and the indebtedness and other liabilities of the subsidiary banks. Unamortized debt issuance costs related to the subordinated notes totaled \$1.5 million at September 30, 2019.

Immediately following the issuance, the Company repaid term notes totaling \$21.3 million and the outstanding balance of \$9.0 million on its revolving line of credit. The Company intends to use the remaining net proceeds from this offering for general corporate purposes, including the pursuit of opportunistic acquisitions of similar or complementary financial service organizations, repaying indebtedness, financing investments and capital expenditures, repurchasing shares of the Company's common stock, investing in the subsidiary banks or other strategic opportunities that may arise in the future.

In the second quarter of 2019, the Company renewed its revolving line of credit. At renewal, the line amount was increased from \$10.0 million to \$20.0 million. The interest on the revolving line of credit is calculated at the effective LIBOR rate plus 2.25% per annum (4.34% at September 30, 2019). Prior to the renewal, the interest on the revolving line of credit was calculated at the effective LIBOR rate plus 2.50% per annum. The collateral on the revolving line of credit is 100% of the outstanding capital stock of the Company's bank subsidiaries. The outstanding balance on the revolving line of credit was \$0 and \$9.0 million at September 30, 2019 and December 31, 2018, respectively.

The Company prepaid \$30.2 million of FHLB term advances in the third quarter of 2019 using excess funds generated by strong deposit growth. The term advances had original maturities from February 2020 to October 2021 with rates ranging from 1.50% to 2.97%.

The Company prepaid two wholesale structured repurchase agreements in the second quarter of 2019 using excess funds generated by strong deposit growth. The first wholesale structured repurchase agreement totaled \$5.0 million and had original maturity date of March 13, 2020 with a rate of 2.58%. The second wholesale structured repurchase agreement totaled \$20.0 million and had an original maturity of June 13, 2020 with a rate of 2.46%. In addition, wholesale structured repurchase agreements totaling \$10.0 million matured in the second quarter of 2019. The wholesale structured repurchase agreements were utilized as an alternative funding source to FHLB advances and customer deposits. Wholesale structured repurchase agreements were collateralized by certain U.S. government agency securities and residential mortgage backed and related securities.

**NOTE 7 - EARNINGS PER SHARE**

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
	<i>(dollars in thousands, except share data)</i>			
Net income	\$ 15,095	\$ 8,809	\$ 41,517	\$ 29,804
Basic EPS	\$ 0.96	\$ 0.56	\$ 2.64	\$ 2.06
Diluted EPS	\$ 0.94	\$ 0.55	\$ 2.60	\$ 2.02
Weighted average common shares outstanding	15,739,430	15,625,123	15,715,788	14,477,783
Weighted average common shares issuable upon exercise of stock options and under the employee stock purchase plan	237,312	297,201	230,232	308,994
Weighted average common and common equivalent shares outstanding	15,976,742	15,922,324	15,946,020	14,786,777

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**NOTE 8 – FAIR VALUE**

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

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

Assets and liabilities measured at fair value on a recurring basis comprise the following at September 30, 2019 and December 31, 2018:

	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)
<i>(dollars in thousands)</i>				
<b>September 30, 2019:</b>				
Securities AFS:				
U.S. govt. sponsored agency securities	\$ 21,268	\$ —	\$ 21,268	\$ —
Residential mortgage-backed and related securities	123,880	—	123,880	—
Municipal securities	48,902	—	48,902	—
Other securities	17,882	—	17,882	—
Interest rate swaps - assets	102,956	—	102,956	—
Total assets measured at fair value	<u>\$ 314,888</u>	<u>\$ —</u>	<u>\$ 314,888</u>	<u>\$ —</u>
Interest rate swaps - liabilities	\$ 107,847	\$ —	\$ 107,847	\$ —
Total liabilities measured at fair value	<u>\$ 107,847</u>	<u>\$ —</u>	<u>\$ 107,847</u>	<u>\$ —</u>
<b>December 31, 2018:</b>				
Securities AFS:				
U.S. govt. sponsored agency securities	\$ 36,411	\$ —	\$ 36,411	\$ —
Residential mortgage-backed and related securities	159,249	—	159,249	—
Municipal securities	58,546	—	58,546	—
Other securities	6,850	—	6,850	—
Interest rate swaps - assets	22,196	—	22,196	—
Total assets measured at fair value	<u>\$ 283,252</u>	<u>\$ —</u>	<u>\$ 283,252</u>	<u>\$ —</u>
Interest rate swaps - liabilities	\$ 23,347	\$ —	\$ 23,347	\$ —
Total liabilities measured at fair value	<u>\$ 23,347</u>	<u>\$ —</u>	<u>\$ 23,347</u>	<u>\$ —</u>

There were no transfers of assets or liabilities between Levels 1, 2, and 3 of the fair value hierarchy for the three and nine months ended September 30, 2019 or 2018.

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).

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Interest rate swaps are executed for select commercial customers. The interest rate swaps are further described in Note 5 to the Consolidated Financial Statements. 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 interest rate swaps are further described in Note 5 to the Consolidated Financial Statements. 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 September 30, 2019 and December 31, 2018:

	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
<i>(dollars in thousands)</i>				
<b>September 30, 2019:</b>				
Impaired loans/leases	\$ 3,839	\$ —	\$ —	\$ 3,839
OREO	4,588	—	—	4,588
	<u>\$ 8,427</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 8,427</u>
<b>December 31, 2018:</b>				
Impaired loans/leases	\$ 9,657	\$ —	\$ —	\$ 9,657
OREO	10,128	—	—	10,128
	<u>\$ 19,785</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 19,785</u>

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

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



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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 September 30, 2019	Fair Value December 31, 2018	Valuation Technique	Unobservable Input	Range	
	<i>(dollars in thousands)</i>					
Impaired loans/leases	\$ 3,839	\$ 9,657	Appraisal of collateral	Appraisal adjustments	(10.00)% to	(30.00)%
OREO	4,588	10,128	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 or liabilities measured at fair value during the three and nine months ended September 30, 2019 and 2018.

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 September 30, 2019		As of December 31, 2018	
		Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<i>(dollars in thousands)</i>					
Cash and due from banks	Level 1	\$ 91,671	\$ 91,671	\$ 85,523	\$ 85,523
Federal funds sold	Level 2	9,300	9,300	26,398	26,398
Interest-bearing deposits at financial institutions	Level 2	187,963	187,963	133,198	133,198
Investment securities:					
HTM	Level 2	343,477	363,474	401,913	400,770
AFS	*	211,932	211,932	261,056	261,056
Loans/leases receivable, net	Level 3	3,555	3,839	8,942	9,657
Loans/leases receivable, net	Level 2	3,570,599	3,495,905	3,683,965	3,639,329
Interest rate caps	Level 2	—	—	459	459
Interest rate swaps - assets	Level 2	102,956	102,956	22,196	22,196
Assets held for sale:					
Cash and cash equivalents	Level 2	13,446	13,446	—	—
Securities	Level 2	66,009	68,389	—	—
Loans, net	Level 2	362,011	354,438	—	—
Deposits:					
Nonmaturity deposits	Level 2	3,050,033	3,050,033	3,002,327	3,002,327
Time deposits	Level 2	752,208	748,305	974,704	968,906
Short-term borrowings	Level 2	18,526	18,526	28,774	28,774
FHLB advances	Level 2	195,800	195,697	266,492	265,926
Other borrowings	Level 2	—	—	67,250	67,770
Subordinated notes	Level 2	68,334	68,521	4,782	4,933
Junior subordinated debentures	Level 2	37,797	30,494	37,670	29,992
Interest rate swaps - liabilities	Level 2	107,847	107,847	23,347	23,347
Liabilities hed for sale:					
Deposits	Level 2	451,546	447,869	—	—
Borrowings	Level 2	16,157	16,149	—	—

\*See previous table in Note 8.

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NOTE 9 – BUSINESS SEGMENT INFORMATION

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

The Company's primary segment, Commercial Banking, is geographically divided by markets into the secondary segments comprised of the four held for investment subsidiary banks wholly owned by the Company: QCBT, CRBT, CSB, 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, asset management, investment management and advisory services offered at the Company's four subsidiary banks and the Bates Companies 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 as well as the corporate operations of the parent company. This segment also includes the results of segments classified as held for sale.

Selected financial information on the Company's business segments is presented as follows as of and for the three and nine months ended September 30, 2019 and 2018.

	Commercial Banking				Wealth Management	All other	Intercompany Eliminations	Consolidated Total
	QCBT	CRBT	CSB	SFC Bank				
<i>(dollars in thousands)</i>								
<b>Three Months Ended September 30, 2019</b>								
Total revenue	\$ 21,230	\$ 25,707	\$ 11,596	\$ 8,351	\$ 4,122	\$ 27,753	\$ (22,036)	\$ 76,723
Net interest income	13,357	11,478	8,894	5,056	—	1,934	—	40,719
Provision	948	150	150	276	—	488	—	2,012
Net income (loss)	4,870	7,900	3,482	2,116	926	15,081	(19,280)	15,095
Goodwill	3,223	14,980	9,888	45,975	—	3,682	—	77,748
Intangibles	—	2,810	4,154	7,034	—	1,531	—	15,529
Total assets	1,642,950	1,592,896	801,596	693,898	—	1,180,872	(619,830)	5,292,382
<b>Three Months Ended September 30, 2018</b>								
Total revenue	\$ 17,322	\$ 16,800	\$ 8,889	\$ 7,360	\$ 3,255	\$ 17,721	\$ (12,707)	\$ 58,640
Net interest income	12,218	10,833	7,101	5,701	—	2,456	5	38,314
Provision	409	453	20	475	—	4,849	—	6,206
Net income (loss) from continuing operations	4,827	4,869	2,533	2,198	768	6,081	(12,467)	8,809
Goodwill	3,223	14,979	9,888	45,528	—	—	—	73,618
Intangibles	—	3,313	4,852	7,972	—	—	—	16,137
Total assets	1,579,327	1,354,293	734,536	623,520	—	1,038,405	(537,349)	4,792,732
<b>Nine Months Ended September 30, 2019</b>								
Total revenue	\$ 60,148	\$ 68,526	\$ 30,596	\$ 23,396	\$ 12,599	\$ 71,361	\$ (54,563)	\$ 212,063
Net interest income	38,129	32,671	23,154	15,707	—	5,979	—	115,640
Provision for loan/lease losses	2,941	875	451	1,261	—	559	—	6,087
Net income (loss)	13,560	19,928	7,845	5,848	2,667	42,566	(50,897)	41,517
Goodwill	3,223	14,980	9,888	45,975	—	3,682	—	77,748
Intangibles	—	2,810	4,154	7,034	—	1,531	—	15,529
Total assets	1,642,950	1,592,896	801,596	693,898	—	1,180,872	(619,830)	5,292,382
<b>Nine Months Ended September 30, 2018</b>								
Total revenue	\$ 49,812	\$ 49,301	\$ 25,459	\$ 7,360	\$ 9,560	\$ 53,395	\$ (38,450)	\$ 156,437
Net interest income	36,629	32,149	20,579	5,701	—	7,738	5	102,801
Provision for loan/lease losses	2,784	1,682	817	475	—	5,288	—	11,046
Net income (loss) from continuing operations	13,796	14,191	6,560	2,197	2,336	28,556	(37,832)	29,804
Goodwill	3,223	14,979	9,888	45,528	—	—	—	73,618
Intangibles	—	3,313	4,852	7,972	—	—	—	16,137
Total assets	1,579,327	1,354,293	734,536	623,520	—	1,038,405	(537,349)	4,792,732

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**NOTE 10 – 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 September 30, 2019 and December 31, 2018, 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 September 30, 2019 and December 31, 2018 are presented in the following table (dollars in thousands). As of September 30, 2019 and December 31, 2018, each of the subsidiary banks met the requirements to be “well capitalized”.

	Actual		For Capital Adequacy Purposes		For Capital Adequacy Purposes With Capital Conservation Buffer*		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2019:								
Company:								
Total risk-based capital	\$ 567,977	12.22 %	\$ 371,904	≥ 8.00 %	\$ 488,124	≥ 10.50 %	\$ 464,880	≥ 10.00 %
Tier 1 risk-based capital	461,899	9.94	278,928	≥ 6.00	395,148	≥ 8.50	371,904	≥ 8.00
Tier 1 leverage	461,899	9.02	204,868	≥ 4.00	204,868	≥ 4.00	256,085	≥ 5.00
Common equity Tier 1	424,102	9.12	209,196	≥ 4.50	325,416	≥ 7.00	302,172	≥ 6.50
Quad City Bank & Trust:								
Total risk-based capital	\$ 177,834	11.72 %	\$ 121,345	≥ 8.00 %	\$ 159,265	≥ 10.50 %	\$ 151,681	≥ 10.00 %
Tier 1 risk-based capital	163,998	10.81	91,009	≥ 6.00	128,929	≥ 8.50	121,345	≥ 8.00
Tier 1 leverage	163,998	9.85	66,604	≥ 4.00	66,604	≥ 4.00	83,255	≥ 5.00
Common equity Tier 1	163,998	10.81	68,257	≥ 4.50	106,177	≥ 7.00	98,593	≥ 6.50
Cedar Rapids Bank & Trust:								
Total risk-based capital	\$ 168,158	11.64 %	\$ 115,524	≥ 8.00 %	\$ 151,625	≥ 10.50 %	\$ 144,405	≥ 10.00 %
Tier 1 risk-based capital	154,769	10.72	86,643	≥ 6.00	122,744	≥ 8.50	115,524	≥ 8.00
Tier 1 leverage	154,769	9.99	61,993	≥ 4.00	61,993	≥ 4.00	77,491	≥ 5.00
Common equity Tier 1	154,769	10.72	64,982	≥ 4.50	101,083	≥ 7.00	93,863	≥ 6.50
Community State Bank:								
Total risk-based capital	\$ 89,088	12.92 %	\$ 55,147	≥ 8.00 %	\$ 72,380	≥ 10.50 %	\$ 68,933	≥ 10.00 %
Tier 1 risk-based capital	82,399	11.95	41,360	≥ 6.00	58,593	≥ 8.50	55,147	≥ 8.00
Tier 1 leverage	82,399	10.35	31,846	≥ 4.00	31,846	≥ 4.00	39,808	≥ 5.00
Common equity Tier 1	82,399	11.95	31,020	≥ 4.50	48,253	≥ 7.00	44,807	≥ 6.50
Springfield First Community Bank:								
Total risk-based capital	\$ 68,371	13.16 %	\$ 41,561	≥ 8.00 %	\$ 54,549	≥ 10.50 %	\$ 51,951	≥ 10.00 %
Tier 1 risk-based capital	61,328	11.80	31,171	≥ 6.00	44,159	≥ 8.50	41,561	≥ 8.00
Tier 1 leverage	61,328	9.67	25,375	≥ 4.00	25,375	≥ 4.00	31,719	≥ 5.00
Common equity Tier 1	61,328	11.80	23,378	≥ 4.50	36,366	≥ 7.00	33,768	≥ 6.50

\* September 30, 2019 minimums reflect the fully phased-in ratios (including the capital conservation buffer).

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	Actual		For Capital Adequacy Purposes				For Capital Adequacy Purposes With Capital Conservation Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	
As of December 31, 2018:											
Company:											
Total risk-based capital	\$ 460,416	10.69 %	\$ 344,551	>	8.00 %	\$ 425,305	>	9.875 %	\$ 430,689	>	10.00 %
Tier 1 risk-based capital	420,569	9.77	258,413	>	6.00	339,168	>	7.875	344,551	>	8.00
Tier 1 leverage	420,569	8.87	189,858	>	4.00	189,858	>	4.000	237,322	>	5.00
Common equity Tier 1	382,899	8.89	193,810	>	4.50	274,564	>	6.375	279,948	>	6.50
Quad City Bank & Trust:											
Total risk-based capital	\$ 162,009	11.38 %	\$ 113,900	>	8.00 %	\$ 140,596	>	9.875 %	\$ 142,376	>	10.00 %
Tier 1 risk-based capital	148,529	10.43	85,425	>	6.00	112,121	>	7.875	113,900	>	8.00
Tier 1 leverage	148,529	9.04	65,744	>	4.00	65,744	>	4.000	82,180	>	5.00
Common equity Tier 1	148,529	10.43	64,069	>	4.50	90,764	>	6.375	92,544	>	6.50
Cedar Rapids Bank & Trust:											
Total risk-based capital	\$ 146,292	11.55 %	\$ 101,310	>	8.00 %	\$ 125,054	>	9.875 %	\$ 126,637	>	10.00 %
Tier 1 risk-based capital	133,982	10.58	75,982	>	6.00	99,727	>	7.875	101,310	>	8.00
Tier 1 leverage	133,982	9.98	53,682	>	4.00	53,682	>	4.000	67,103	>	5.00
Common equity Tier 1	133,982	10.58	56,987	>	4.50	80,731	>	6.375	82,314	>	6.50
Community State Bank:											
Total risk-based capital	\$ 75,233	11.24 %	\$ 53,567	>	8.00 %	\$ 66,122	>	9.875 %	\$ 66,959	>	10.00 %
Tier 1 risk-based capital	69,101	10.32	40,175	>	6.00	52,730	>	7.875	53,567	>	8.00
Tier 1 leverage	69,101	9.19	30,070	>	4.00	30,070	>	4.000	37,588	>	5.00
Common equity Tier 1	69,101	10.32	30,131	>	4.50	42,686	>	6.375	43,523	>	6.50
Springfield First Community Bank:											
Total risk-based capital	\$ 57,051	12.24 %	\$ 37,278	>	8.00 %	\$ 46,016	>	9.875 %	\$ 46,598	>	10.00 %
Tier 1 risk-based capital	51,279	11.00	27,959	>	6.00	36,696	>	7.875	37,278	>	8.00
Tier 1 leverage	51,279	9.39	21,849	>	4.00	21,849	>	4.000	27,312	>	5.00
Common equity Tier 1	51,279	11.00	20,969	>	4.50	29,706	>	6.375	30,289	>	6.50
Rockford Bank & Trust											
Total risk-based capital	\$ 50,648	10.89 %	\$ 37,208	>	8.00 %	\$ 45,929	>	9.875 %	\$ 46,511	>	10.00 %
Tier 1 risk-based capital	44,821	9.64	27,906	>	6.00	36,627	>	7.875	37,208	>	8.00
Tier 1 leverage	44,821	8.93	20,081	>	4.00	20,081	>	4.000	25,101	>	5.00
Common equity Tier 1	44,821	9.64	20,930	>	4.50	29,650	>	6.375	30,232	>	6.50

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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 and nine months ending September 30, 2019. 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 in this discussion 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, SFC Bank and RB&T. QCBT, CRBT and CSB are Iowa-chartered commercial banks, SFC Bank is a Missouri-chartered commercial bank, and RB&T is an Illinois-chartered commercial bank. All are members of the Federal Reserve system with depository accounts insured to the maximum amount permitted by 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 (one in Cedar Falls and two in Waterloo).
- CSB was acquired by the Company in 2016 and provides full-service commercial and consumer banking services 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.
- SFC Bank became a subsidiary of the Company in 2018, as further described in Note 2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2018. SFC Bank provides full-service commercial and consumer banking services to the Springfield, Missouri area through its main office located on Glenstone Avenue in Springfield, Missouri.
- 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 in Rockford and its branch facility in downtown Rockford. On August 13, 2019, the Company entered into a definitive agreement to sell certain assets and liabilities of RB&T, a wholly-owned subsidiary headquartered in Rockford, Illinois, to IB&T, a wholly-owned subsidiary of Heartland Financial USA, Inc. Under the terms of the agreement, IB&T will acquire certain assets and assume certain liabilities for a cash payment. The transaction is subject to approval by federal and state bank regulators and to customary closing conditions. The transaction is expected to close in the fourth quarter of 2019. The assets and liabilities that will be sold are classified as held for sale on the Consolidated Balance Sheet and corresponding footnotes. See Note 2 to the Company's Consolidated Financial Statements for additional information about the sale.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
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EXECUTIVE OVERVIEW

The Company reported net income of \$15.1 million and diluted EPS of \$0.94 for the quarter ended September 30, 2019. By comparison, for the quarter ended June 30, 2019, the Company reported net income of \$13.5 million and diluted EPS of \$0.85. For the quarter ended September 30, 2018, the Company reported net income of \$8.8 million, and diluted EPS of \$0.55.

For the nine months ended September 30, 2019, the Company reported net income of \$41.5 million, and diluted EPS of \$2.60. By comparison, for the nine months ended September 30, 2018, the Company reported net income of \$29.8 million, and diluted EPS of \$2.02.

The third quarter of 2019 was also highlighted by the following results and events:

- Adjusted net income (non-GAAP) of \$15.9 million, or \$1.00 per diluted share;
- Expanded NIM and NIM(TEY)(non-GAAP) each by 12 basis points, to 3.37% and 3.52%, respectively;
- Record noninterest income of \$19.9 million for the quarter and \$49.0 million year-to-date;
- Entered a definitive agreement to sell certain assets and liabilities of RB&T;
- Excluding RB&T's held for sale assets and liabilities:
  - Annualized loan and lease growth of 9.1% for the quarter and 9.4% year-to-date;
  - Deposits were down 1.7% on a linked quarter basis and up 9.6% annualized year-to-date; and
  - Nonperforming assets were down \$2.5 million, or 15.6%, from the prior quarter.

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

	For the three months ended			For the nine months ended	
	September 30, 2019	June 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
Net income	\$ 15,095	\$ 13,504	\$ 8,809	\$ 41,517	\$ 29,804
Diluted earnings per common share	\$ 0.94	\$ 0.85	\$ 0.55	\$ 2.60	\$ 2.02
Weighted average common and common equivalent shares outstanding	15,976,742	15,938,377	15,922,324	15,946,020	14,786,777

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

	For the three months ended			For the nine months ended	
	September 30, 2019	June 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
	<i>(dollars in thousands)</i>				
Net interest income	\$ 40,719	\$ 38,013	\$ 38,314	\$ 115,640	\$ 102,801
Provision expense	2,012	1,941	6,206	6,087	11,046
Noninterest income	19,906	17,065	8,809	48,964	26,262
Noninterest expense	39,945	36,560	30,500	108,941	82,733
Federal and state income tax expense	3,573	3,073	1,608	8,059	5,480
Net income	<u>\$ 15,095</u>	<u>\$ 13,504</u>	<u>\$ 8,809</u>	<u>\$ 41,517</u>	<u>\$ 29,804</u>

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

- Net interest income in the third quarter of 2019 was up 7% compared to the second quarter of 2019. The increase was primarily due to a \$93.2 million increase in average interest earning assets combined with a 12 basis point increase in reported net interest margin. Net interest income increased 6% compared to the third quarter of 2018 and 12% when comparing the first nine months of 2019 to the same period in the prior year. These increases were primarily due to strong loan growth and the addition of SFC Bank.
- Provision expense in the third quarter of 2019 increased 4% compared to the second quarter of 2019. Provision expense decreased 68% compared to the third quarter of 2018 and 45% when comparing the first nine months of 2019 to the same period in the prior year. The increase in the third quarter was primarily due to \$493 thousand of provision related to a nonperforming loan included in assets held for sale. The decreases in provision when comparing to the prior periods of 2018 were primarily due to continued asset quality improvements. See the Provision for Loan Lease Losses section of this report for additional details.
- Noninterest income in the third quarter of 2019 increased 17% compared to the second quarter of 2019 primarily due to higher swap fee income. Noninterest income increased 126% compared to the third quarter of 2018 and 86% when comparing the first nine months of 2019 to the same period in the prior year. These increases were primarily attributable to higher swap fee income as well as solid growth in wealth management fee income and the addition of SFC Bank and the Bates Companies.
- Noninterest expense increased 9% in the third quarter of 2019 compared to the second quarter of 2019. Net cost and gains/losses on operations of other real estate was \$2.1 million in the third quarter of 2019 as compared to \$1.1 million in the second quarter of 2019 primarily due to a write down of one OREO property of \$2 million in the third quarter. Additionally, the Company incurred approximately \$1.5 million in additional bonus and commission expense during the third quarter due to strong year-to-date results and higher than expected fee income. Professional and data processing fees increased \$999 thousand comparing the third quarter of 2019 to the second quarter of 2019. This increased expense was primarily due to recent mergers/acquisitions. Noninterest expense increased 31% compared to the third quarter of 2018 and 32% when comparing the first nine months of 2019 to the same period in the prior year primarily due to the addition of SFC Bank.
- Federal and state income tax expense in the third quarter of 2019 increased 16% compared to the second quarter of 2019. Federal and state income tax expense increased 122% compared to the third quarter of 2018 and 47% when comparing the first nine months of 2019 to the same period in the prior year. See the "Income Taxes" section of this report for additional details on these increases.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
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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, 2018. The Company's long-term financial goals are as follows:

- Generate strong organic loan and lease growth in order to maintain a gross loans and leases to total assets ratio in the range of 73 – 78%;
- Improve profitability (measured by NIM and ROAA);
- Support strong asset quality by maintaining NPAs to total assets to below 0.75% and maintaining charge-offs as a percentage of average loans/leases of under 0.25% annually;
- Grow core deposits to maintain reliance on wholesale funding at less than 15% of total assets;
- Continue to focus on generating gains on sales of government guaranteed portions of loans and swap fee income between \$8 million and \$12 million annually; and
- Grow wealth management net income by 10% annually.

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

Goal	Key Metric	Target **	For the Quarter Ending		
			September 30, 2019	June 30, 2019	September 30, 2018
Balance sheet efficiency	Gross loans and leases to total assets	73% - 78%	75 %	75 %	76 %
	NIM TEY (non-GAAP)*	> 3.35%	3.52 %	3.40 %	3.60 %
Profitability	ROAA	> 1.10%	1.16 %	1.06 %	0.75 %
	Adjusted ROAA (non-GAAP)*	> 1.10%	1.22 %	1.11 %	0.89 %
Asset quality	NPAs to total assets	< 0.75%	0.27 %	0.45 %	0.87 %
	Net charge-offs to average loans and leases***	< 0.25% annually	0.11 %	0.15 %	0.09 %
Reliance on wholesale funding	Wholesale funding to total assets****	< 15%	11 %	10 %	16 %
Consistent, high quality noninterest income revenue streams	Gains on sales of government guaranteed portions of loans and swap fee income***	\$8-12 million annually	\$ 28.6 million	\$ 22.3 million	\$ 5.5 million
	Grow wealth management net income***	> 10% annually	20 %	18 %	39 %

\* 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.



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STRATEGIC DEVELOPMENTS

The Company has taken the following actions during the third quarter of 2019 to support its corporate strategy and the long-term financial goals shown above:

- Excluding the impact of loans classified as held for sale, the Company grew loans and leases in the third quarter of 2019 by 9.1% on an annualized basis and 10.3% year-to-date. Strong loan and lease growth for the remainder of the year is anticipated to keep the Company's loans and leases to assets ratio within the targeted range of 73-78%.
- Excluding RB&T's loans/leases, which are classified as held for sale, the Company has continued to focus on lowering the NPAs to total assets ratio. This ratio decreased by 18 basis points to 0.27% compared to the second quarter 2019. The Company remains committed to maintaining strong asset quality ratios in 2019 and beyond.
- Management has continued to focus on reducing the Company's reliance on wholesale funding. Wholesale funding as a percentage of total assets remained stable in the third quarter of 2019 at 11%. Management continues to prioritize core deposit growth through a variety of strategies including growth in correspondent banking.
- 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 four states currently served – Iowa, Illinois, Wisconsin and Missouri. The Company acts as the correspondent bank for 195 downstream banks with average total noninterest bearing deposits of \$170.5 million and average total interest bearing deposits of \$330.5 million during the first nine months of 2019. By comparison, the Company acted as the correspondent bank for 191 downstream banks with average total noninterest bearing deposits of \$197.5 million and average total interest bearing deposits of \$221.1 million during the first nine 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.
- As a result of the relatively low interest rate environment including a flat to inverted yield curve, the Company has focused on executing interest rate swaps on select commercial loans. The interest rate swaps allow 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. The Company will continue to review opportunities to execute these swaps at all of its subsidiary banks as appropriate for the borrowers and the Company. Swap fee income totaled \$20.9 million for the nine months ended September 30, 2019 as compared to \$3.7 million for the nine months ended September 30, 2018.
- 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 September 30, 2019, the Company had \$2.97 billion of total financial assets in trust (and related) accounts and \$1.51 billion of total financial assets in brokerage (and related) accounts. Continued growth in assets under management are expected to drive trust and investment advisory fees. The Company offers trust and investment advisory services to the correspondent banks that it serves. As management continues to focus on growing wealth management fee income, expanding market share will continue to be a primary strategy, both through organic growth as well as through the acquisition of managed assets.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
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GAAP TO NON-GAAP RECONCILIATIONS

The following table presents certain non-GAAP financial measures related to the “TCE/TA ratio”, “adjusted net income”, “adjusted EPS”, “adjusted ROAA”, “NIM (TEY)”, “adjusted NIM”, 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;
- Adjusted net income, adjusted EPS and adjusted ROAA (all non-GAAP measures) are reconciled to net income;
- NIM (TEY) (non-GAAP) and adjusted NIM (non-GAAP) are 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.

The following tables also include several “adjusted” 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 performance.

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. In addition, the Company calculates NIM without the impact of acquisition accounting net accretion (adjusted NIM), as accretion amounts can fluctuate widely, making comparisons difficult.

The efficiency ratio is a ratio that management utilizes to compare the Company to its peers. It is a standard ratio used to calculate overhead as a percentage of revenue in the banking industry and is widely utilized by investors.

GAAP TO NON-GAAP RECONCILIATIONS	As of		
	September 30, 2019	June 30, 2019	September 30, 2018
	<i>(dollars in thousands, except per share data)</i>		
<b>TCE/TA RATIO</b>			
Stockholders' equity (GAAP)	\$ 519,743	\$ 504,300	\$ 457,387
Less: Intangible assets	93,277	93,837	89,755
TCE (non-GAAP)	\$ 426,466	\$ 410,463	\$ 367,632
Total assets (GAAP)	\$ 5,292,382	\$ 5,194,852	\$ 4,792,732
Less: Intangible assets	93,277	93,837	89,755
TA (non-GAAP)	\$ 5,199,105	\$ 5,101,015	\$ 4,702,977
<b>TCE/TA ratio (non-GAAP)</b>	<b>8.20 %</b>	<b>8.05 %</b>	<b>7.82 %</b>

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	For the Quarter Ended			For the Nine Months Ended	
	September 30, 2019	June 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
<i>(dollars in thousands, except per share data)</i>					
<b>ADJUSTED NET INCOME</b>					
Net income (GAAP)	\$ 15,095	\$ 13,504	\$ 8,809	\$ 41,517	\$ 29,804
Less nonrecurring items (post-tax) (*):					
Income:					
Securities losses, net	\$ (2)	\$ (41)	\$ —	\$ (43)	\$ —
Total nonrecurring income (non-GAAP)	\$ (2)	\$ (41)	\$ —	\$ (43)	\$ —
Expense:					
Losses on debt extinguishment	\$ 117	\$ —	\$ —	\$ 117	\$ —
Acquisition costs	\$ —	\$ —	\$ 1,216	\$ —	\$ 1,616
Post-acquisition compensation, transition and integration costs	\$ 698	\$ 559	\$ 390	\$ 1,363	\$ 520
Total nonrecurring expense (non-GAAP)	\$ 815	\$ 559	\$ 1,606	\$ 1,480	\$ 2,136
<b>Adjusted net income (non-GAAP)</b>	<b>\$ 15,913</b>	<b>\$ 14,104</b>	<b>\$ 10,415</b>	<b>\$ 43,041</b>	<b>\$ 31,940</b>
<b>ADJUSTED EPS</b>					
Adjusted net income (non-GAAP) (from above)	\$ 15,913	\$ 14,104	\$ 10,415	\$ 43,041	\$ 31,940
Weighted average common shares outstanding	15,739,430	15,714,588	15,625,123	15,715,788	14,477,783
Weighted average common and common equivalent shares outstanding	15,976,742	15,938,377	15,922,324	15,946,020	14,786,777
<b>Adjusted EPS (non-GAAP):</b>					
Basic	\$ 1.01	\$ 0.90	\$ 0.67	\$ 2.74	\$ 2.21
Diluted	\$ 1.00	\$ 0.88	\$ 0.65	\$ 2.70	\$ 2.16
<b>ADJUSTED ROAA</b>					
Adjusted net income (non-GAAP) (from above)	\$ 15,913	\$ 14,104	\$ 10,415	\$ 43,041	\$ 31,940
Average Assets	\$ 5,217,763	\$ 5,077,900	\$ 4,677,875	\$ 5,088,055	\$ 4,242,083
<b>Adjusted ROAA (annualized) (non-GAAP)</b>	<b>1.22 %</b>	<b>1.11 %</b>	<b>0.89 %</b>	<b>1.13 %</b>	<b>1.00 %</b>
<b>ADJUSTED NIM (TEY)*</b>					
Net interest income (GAAP)	\$ 40,719	\$ 38,013	\$ 38,314	\$ 115,640	\$ 102,801
Plus: Tax equivalent adjustment	1,763	1,808	1,548	4,944	4,329
Net interest income - tax equivalent (non-GAAP)	\$ 42,482	\$ 39,821	\$ 39,862	\$ 120,584	\$ 107,130
Less: Acquisition accounting net accretion	1,268	1,076	1,677	3,413	2,921
Adjusted net interest income	41,214	38,745	38,185	117,171	104,209
Average earning assets	\$ 4,791,274	\$ 4,698,021	\$ 4,387,487	\$ 4,700,617	\$ 3,989,099
NIM (GAAP)	3.37 %	3.25 %	3.46 %	3.29 %	3.45 %
NIM (TEY) (non-GAAP)	3.52 %	3.40 %	3.60 %	3.43 %	3.59 %
Adjusted NIM (TEY) (non-GAAP)	3.41 %	3.31 %	3.45 %	3.33 %	3.49 %
<b>EFFICIENCY RATIO</b>					
Noninterest expense (GAAP)	\$ 39,945	\$ 36,560	\$ 30,500	\$ 108,941	\$ 82,733
Net interest income (GAAP)	\$ 40,719	\$ 38,013	\$ 38,314	\$ 115,640	\$ 102,801
Noninterest income (GAAP)	19,906	17,065	8,809	48,964	26,262
Total income	\$ 60,625	\$ 55,078	\$ 47,123	\$ 164,604	\$ 129,063
<b>Efficiency ratio (noninterest expense/total income) (non-GAAP)</b>	<b>65.89 %</b>	<b>66.38 %</b>	<b>64.72 %</b>	<b>66.18 %</b>	<b>64.10 %</b>

\* Nonrecurring items (after-tax) are calculated using an estimated effective tax rate of 21%.

**NET INTEREST INCOME - (TAX EQUIVALENT BASIS)**

Net interest income, on a tax equivalent basis, increased 7% to \$42.5 million for the quarter ended September 30, 2019 compared to the same quarter of the prior year, and increased 13% to \$120.6 million for the nine months ended September 30, 2019 compared to the same period of the prior year. Excluding the tax equivalent adjustments, net interest income increased 6% for the quarter ended September 30, 2019 compared to the same quarter of the prior year, and increased 12% for the nine months ended September 30, 2019 compared to the same period of the prior year. Net interest income improved due to two main factors:

- The addition of SFC Bank in the third quarter of 2018; and
- Strong organic loan and deposit growth over the past 12 months.

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

	Tax Equivalent Basis			GAAP		
	For the Quarter Ended			For the Quarter Ended		
	September 30, 2019	June 30, 2019	September 30, 2018	September 30, 2019	June 30, 2019	September 30, 2018
Average Yield on Interest-Earning Assets	4.85 %	4.78 %	4.65 %	4.70 %	4.63 %	4.51 %
Average Cost of Interest-Bearing Liabilities	1.71 %	1.76 %	1.35 %	1.71 %	1.76 %	1.35 %
Net Interest Spread	3.14 %	3.02 %	3.30 %	2.99 %	2.87 %	3.16 %
NIM	3.52 %	3.40 %	3.60 %	3.37 %	3.25 %	3.46 %
NIM Excluding Acquisition Accounting Net Accretion	3.41 %	3.31 %	3.44 %	3.27 %	3.15 %	3.31 %

	Tax Equivalent Basis		GAAP	
	For the Nine Months Ended		For the Nine Months Ended	
	September 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
Average Yield on Interest-Earning Assets	4.78 %	4.51 %	4.64 %	4.36 %
Average Cost of Interest-Bearing Liabilities	1.73 %	1.21 %	1.73 %	1.21 %
Net Interest Spread	3.05 %	3.30 %	2.91 %	3.15 %
NIM	3.43 %	3.59 %	3.29 %	3.45 %
NIM Excluding Acquisition Accounting Net Accretion	3.33 %	3.49 %	3.19 %	3.29 %

Acquisition accounting net accretion can fluctuate mostly 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 table above 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			For the Nine Months Ended	
	September 30, 2019	June 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
	Acquisition Accounting Net Accretion in NIM	\$ 1,268	\$ 1,076	\$ 1,677	\$ 3,413

*(dollars in thousands)*

NIM on a tax equivalent basis was up 12 basis points on a linked quarter basis. Excluding acquisition accounting net accretion, NIM was up 10 basis points on a linked quarter basis. The increase in net interest margin during the quarter was due to a seven basis point increase in the yield on interest earning assets and a five basis point decrease in the total cost of funds (due to both mix and rate).

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

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management strategies which include better loan pricing, reducing reliance on very rate-sensitive funding, closely managing deposit rate changes and finding additional ways to manage NIM through derivatives.

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 September 30,					
	2019 (4)			2018		
	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost
<i>(dollars in thousands)</i>						
<b>ASSETS</b>						
Interest earning assets:						
Federal funds sold	\$ 7,234	\$ 42	2.30 %	\$ 23,199	\$ 105	1.80 %
Interest-bearing deposits at financial institutions	172,386	951	2.19 %	61,815	323	2.07 %
Investment securities (1)	626,471	6,080	3.85 %	667,142	5,973	3.55 %
Restricted investment securities	22,719	293	5.12 %	22,683	330	5.77 %
Gross loans/leases receivable (1) (2) (3)	3,962,464	51,214	5.13 %	3,612,648	44,648	4.90 %
Total interest earning assets	4,791,274	58,580	4.85 %	4,387,487	51,379	4.65 %
Noninterest-earning assets:						
Cash and due from banks	85,262			78,103		
Premises and equipment	79,646			72,489		
Less allowance	(41,673)			(38,083)		
Other	303,254			177,879		
Total assets	\$ 5,217,763			\$ 4,677,875		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 2,505,383	7,907	1.25 %	\$ 2,214,480	5,432	0.97 %
Time deposits	975,736	5,486	2.23 %	825,020	3,290	1.58 %
Short-term borrowings	17,333	98	2.24 %	21,407	78	1.45 %
FHLB advances	123,107	1,023	3.30 %	209,111	1,422	2.70 %
Other borrowings	—	—	— %	74,503	776	4.13 %
Subordinated notes	68,299	1,003	5.83 %	—	—	— %
Junior subordinated debentures	37,774	581	6.10 %	37,600	519	5.48 %
Total interest-bearing liabilities	3,727,632	16,098	1.71 %	3,382,121	11,517	1.35 %
Noninterest-bearing demand deposits	821,876			800,577		
Other noninterest-bearing liabilities	152,060			59,112		
Total liabilities	4,701,568			4,241,810		
Stockholders' equity	516,195			436,065		
Total liabilities and stockholders' equity	\$ 5,217,763			\$ 4,677,875		
Net interest income		\$ 42,482			\$ 39,862	
Net interest spread			3.14 %			3.30 %
Net interest margin			3.37 %			3.46 %
Net interest margin (TEY)(Non-GAAP)			3.52 %			3.60 %
Adjusted net interest margin (TEY)(Non-GAAP)			3.41 %			3.45 %
Ratio of average interest-earning assets to average interest-bearing liabilities	128.53 %			129.73 %		

- (1) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 21% tax rate.
- (2) Loan/lease fees are not material and are included in interest income from loans/leases receivable in accordance with accounting and regulatory guidance.
- (3) Non-accrual loans/leases are included in the average balance for gross loans/leases receivable in accordance with accounting and regulatory guidance.
- (4) Interest earning assets and interest bearing liabilities classified as held for sale as of September 30, 2019 are included in the calculations above.

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**Analysis of Changes of Interest Income/Interest Expense  
For the Three Months Ended September 30, 2019**

	Inc./(Dec.) from Prior Period (1)	Components of Change (1)	
		Rate	Volume
		2019 vs. 2018	
<i>(dollars in thousands)</i>			
<b>INTEREST INCOME</b>			
Federal funds sold	\$ (63)	\$ 149	\$ (212)
Interest-bearing deposits at financial institutions	628	19	609
Investment securities (2)	107	1,737	(1,630)
Restricted investment securities	(37)	(40)	3
Gross loans/leases receivable (2) (3)	6,566	2,108	4,458
Total change in interest income	7,201	3,973	3,228
<b>INTEREST EXPENSE</b>			
Interest-bearing deposits	2,475	1,697	778
Time deposits	2,196	1,519	677
Short-term borrowings	20	103	(83)
Federal Home Loan Bank advances	(399)	1,486	(1,885)
Other borrowings	(776)	(388)	(388)
Subordinated notes	1,003	—	1,003
Junior subordinated debentures	62	59	3
Total change in interest expense	4,581	4,476	105
Total change in net interest income	\$ 2,620	\$ (503)	\$ 3,123

- (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 21% tax rate.
- (3) Loan/lease fees are not material and are included in interest income from loans/leases receivable in accordance with accounting and regulatory guidance.

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	For the Nine Months Ended September 30,					
	2019 (4)			2018		
	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost
<i>(dollars in thousands)</i>						
<b>ASSETS</b>						
Interest earning assets:						
Federal funds sold	\$ 10,887	\$ 191	2.35 %	\$ 20,488	\$ 223	1.46 %
Interest-bearing deposits at financial institutions	170,167	3,042	2.39 %	55,408	749	1.81 %
Investment securities (1)	643,975	18,237	3.79 %	654,818	17,391	3.55 %
Restricted investment securities	21,670	891	5.50 %	21,871	776	4.74 %
Gross loans/leases receivable (1) (2) (3)	3,853,918	145,682	5.05 %	3,236,514	115,365	4.77 %
Total interest earning assets	4,700,617	168,043	4.78 %	3,989,099	134,504	4.51 %
Noninterest-earning assets:						
Cash and due from banks	82,096			71,198		
Premises and equipment, net	78,059			66,516		
Less allowance for estimated losses on loans/leases	(41,119)			(36,726)		
Other	268,403			151,996		
Total assets	<u>\$ 5,088,055</u>			<u>\$ 4,242,083</u>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 2,418,420	23,351	1.29 %	\$ 1,987,371	12,541	0.84 %
Time deposits	1,000,529	16,346	2.18 %	702,441	7,591	1.44 %
Short-term borrowings	15,952	275	2.30 %	19,234	186	1.29 %
Federal Home Loan Bank advances	115,539	2,685	3.11 %	206,875	3,267	2.11 %
Other borrowings	18,034	512	3.79 %	68,742	2,315	4.50 %
Subordinated notes	58,392	2,561	5.86 %	—	—	—
Junior subordinated debentures	37,730	1,729	6.13 %	37,556	1,474	5.25 %
Total interest-bearing liabilities	3,664,646	47,459	1.73 %	3,022,219	27,374	1.21 %
Noninterest-bearing demand deposits	809,469			784,401		
Other noninterest-bearing liabilities	114,980			49,589		
Total liabilities	4,589,095			3,856,209		
Stockholders' equity	498,960			385,874		
Total liabilities and stockholders' equity	<u>\$ 5,088,055</u>			<u>\$ 4,242,083</u>		
Net interest income		<u>\$ 120,584</u>			<u>\$ 107,130</u>	
Net interest spread			<u>3.05 %</u>			<u>3.30 %</u>
Net interest margin			<u>3.29 %</u>			<u>3.45 %</u>
Net interest margin (TEY)(Non-GAAP)			<u>3.43 %</u>			<u>3.59 %</u>
Adjusted net interest margin (TEY)(Non-GAAP)			<u>3.33 %</u>			<u>3.49 %</u>
Ratio of average interest earning assets to average interest-bearing liabilities	<u>128.27 %</u>			<u>131.99 %</u>		

- (1) Interest earned and yields on nontaxable investment securities and nontaxable loans are determined on a tax equivalent basis using a 21% tax rate.
- (2) Loan/lease fees are not material and are included in interest income from loans/leases receivable in accordance with accounting and regulatory guidance.
- (3) Non-accrual loans/leases are included in the average balance for gross loans/leases receivable in accordance with accounting and regulatory guidance.
- (4) Interest earning assets and interest bearing liabilities classified as held for sale as of September 30, 2019 are included in the calculations above.

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**Analysis of Changes of Interest Income/Interest Expense  
For the nine months ended September 30, 2019**

	Inc./(Dec.) from Prior Period (1)	Components of Change (1)	
		Rate	Volume
		2019 vs. 2018	
<i>(dollars in thousands)</i>			
<b>INTEREST INCOME</b>			
Federal funds sold	\$ (32)	\$ 140	\$ (172)
Interest-bearing deposits at other financial institutions	2,293	309	1,984
Investment securities (2)	846	1,293	(447)
Restricted investment securities	115	127	(12)
Gross loans/leases receivable (2) (3)	30,317	7,299	23,018
Total change in interest income	33,539	9,168	24,371
<b>INTEREST EXPENSE</b>			
Interest-bearing demand deposits	10,810	7,671	3,139
Time deposits	8,755	4,786	3,969
Short-term borrowings	89	142	(53)
Federal Home Loan Bank advances	(582)	1,691	(2,273)
Other borrowings	(1,803)	(320)	(1,483)
Subordinated notes	2,561	—	2,561
Junior subordinated debentures	255	—	255
Total change in interest expense	20,085	13,970	6,115
Total change in net interest income	\$ 13,454	\$ (4,802)	\$ 18,256

(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 21% tax rate.

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

**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.

Based on its consideration of accounting policies that involve the most complex and subjective decisions and assessments, management has identified the following as critical accounting policies:

**GOODWILL**

The Company records all assets and liabilities purchased in an acquisition, including intangibles, at fair value. Goodwill is not amortized but is subject, at a minimum, to annual tests for impairment. A more detailed discussion of this critical accounting policy can be found in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.



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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. A more detailed discussion of this critical accounting policy can be found in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

RESULTS OF OPERATIONS

INTEREST INCOME

Interest income increased 14%, comparing the third quarter of 2019 to the same period of 2018, and increased 25% comparing the first nine months of 2019 to the same period of 2018. This increase was primarily the result of the addition of SFC Bank, strong organic loan and deposit growth.

Overall, the Company's average earning assets increased 9%, comparing the third quarter of 2019 to the third quarter of 2018. During the same time period, average gross loans and leases increased 10%, while average investment securities decreased 6%. Average earning assets increased 18%, comparing the first nine months of 2019 to the same period of 2018. Average gross loans and leases increased 19% and average investment securities decreased 2%, comparing the first nine months of 2019 to the same period of 2018. The increases in average earning assets and average gross loans and leases were the result of the addition of SFC Bank and strong organic loan growth.

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 third quarter of 2019 increased 40% from the third quarter of 2018 and increased 73%, comparing the first nine months of 2019 to the same period of 2018. The addition of SFC Bank primarily contributed to this increase as the Company added over \$439 million in deposits. The Company has grown organically at a significant pace over the past several years and the loan growth has been funded in large part by larger depositor relationships with higher rate sensitivity, many of 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. The beta on the balance of the Company's core deposit portfolio has performed well and is much lower than the beta on relationships with pricing tied to a certain index. Additionally, the cost of funds on the Company's short-term wholesale funds has increased with the rising rate environment. During the third quarter, market interest rates fell as the Federal Reserve cut the Federal Funds rate 50 basis points. As a direct result, the Company's interest expense declined modestly on a linked-quarter basis.

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.

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, state and national economies and risk associated with the loans/leases in the portfolio as described in more detail in the "Critical Accounting Policies" section.



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The Company's provision totaled \$2.0 million for the third quarter of 2019, which was a decrease of 68% from the same quarter of the prior year. Provision for the first nine months of 2019 totaled \$6.1 million, which was down 45% compared to the first nine months of 2018. These decreases were primarily attributable to improved asset quality.

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. 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 \$3.3 million for the first nine months of 2019, increased the Company's allowance to \$36.1 million at September 30, 2019. As of September 30, 2019, the Company's allowance to total loans/leases was 1.00%, which was down from 1.07% at December 31, 2018 and 1.18% at September 30, 2018. Management continues to evaluate the allowance needed on acquired loans factoring in the net remaining discount (\$7.7 million and \$14.4 million at September 30, 2019 and September 30, 2018, respectively).

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

NONINTEREST INCOME

The following tables set forth the various categories of noninterest income for the three and nine months ended September 30, 2019 and 2018.

	<u>Three Months Ended</u>		<u>\$ Change</u>	<u>% Change</u>
	<u>September 30, 2019</u>	<u>September 30, 2018</u>		
			<i>(dollars in thousands)</i>	
Trust department fees	\$ 2,340	\$ 2,196	\$ 144	6.6 %
Investment advisory and management fees	1,782	1,059	723	68.3
Deposit service fees	1,813	1,656	157	9.5
Gains on sales of residential real estate loans, net	890	337	553	164.1
Gains on sales of government guaranteed portions of loans, net	519	46	473	1,028.3
Swap fee income	9,797	1,110	8,687	782.6
Securities losses, net	(3)	—	(3)	(100.0)
Earnings on bank-owned life insurance	489	474	15	3.2
Debit card fees	886	846	40	4.7
Correspondent banking fees	189	195	(6)	(3.1)
Other	1,204	890	314	35.3
Total noninterest income	<u>\$ 19,906</u>	<u>\$ 8,809</u>	<u>\$ 11,097</u>	126.0 %

	<u>Nine Months Ended</u>		<u>\$ Change</u>	<u>% Change</u>
	<u>September 30, 2019</u>	<u>September 30, 2018</u>		
			<i>(dollars in thousands)</i>	
Trust department fees	\$ 7,194	\$ 6,491	\$ 703	10.8 %
Investment advisory and management fees	5,406	3,069	2,337	76.1
Deposit service fees	5,025	4,797	228	4.8
Gains on sales of residential real estate loans, net	1,748	539	1,209	224.3
Gains on sales of government guaranteed portions of loans, net	589	405	184	45.4
Swap fee income	20,886	3,718	17,168	461.8
Securities losses, net	(56)	—	(56)	(100.0)
Earnings on bank-owned life insurance	1,441	1,292	149	11.5
Debit card fees	2,591	2,456	135	5.5
Correspondent banking fees	578	673	(95)	(14.1)
Other	3,562	2,822	740	26.2
Total noninterest income	<u>\$ 48,964</u>	<u>\$ 26,262</u>	<u>\$ 22,702</u>	86.4 %

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
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In recent years, the Company has been successful in expanding its wealth management client base. Trust department fees continue to be a significant contributor to noninterest income. Assets under management increased \$286.2 million in the first nine months of 2019 with 238 new client relationships. With strong growth in assets under management, trust department fees increased 7%, comparing the third quarter of 2019 to the same period of the prior year. Trust department fees increased 11%, when comparing the first nine months of 2019 to the same period of the prior year. Income is generated primarily from fees charged based on assets under administration for corporate and personal trusts and for custodial services. The majority of the trust department fees are determined based on the value of the investments within the fully-managed trusts.

Investment advisory and management fees increased 68%, comparing the third quarter of 2019 to the same period of the prior year, and they increased 76% when comparing the first nine months of 2019 to the first nine months of 2018. In October 2018, the Company acquired the Bates Companies which increased assets under management by approximately \$704 million. Management has placed a stronger emphasis on growing its investment advisory and management services. Part of this initiative has been to restructure the Company's Wealth Management Division to allow for more efficient delivery of products and services through selective additions of talent as well as the leverage of and collaboration among existing resources (including the aforementioned trust department). Similar to trust department fees, investment advisory and management fees are largely determined based on the value of the investments managed.

Deposit service fees expanded 10% comparing the third quarter of 2019 to the same period of the prior year, and expanded 5% when comparing the first nine months of 2019 to the same period of the prior year. The Company continues its emphasis on shifting the mix of deposits from brokered and retail time deposits to non-maturity demand deposits across all its markets. With this continuing shift in mix, the Company has increased the number of demand deposit accounts, which tend to be lower in interest cost and higher in service fees. The Company plans to continue this shift in mix and to further focus on growing deposit service fees.

Gains on sales of residential real estate loans, net, increased 164% when comparing the third quarter of 2019 to the same period of the prior year and increased 224% when comparing the first nine months of 2019 to the same period of the prior year. The increase was due to the addition of SFC Bank which recognized gains on sales of residential real estate of \$597 thousand in the third quarter of 2019 and \$1.2 million in the first nine months of 2019.

The Company's gains on the sale of government-guaranteed portions of loans for the third quarter of 2019 increased 1028% compared to the third quarter of 2018 and increased 45% when comparing the first nine months of 2019 to the same period of the prior year. As reflected by these gains, large fluctuations can occur from quarter-to-quarter and year-to-year. The Company continues to leverage its expertise by taking advantage of programs offered by the SBA and the USDA. In some cases, it is more beneficial for the Company to sell the government-guaranteed portion on the secondary market for a premium rather than retain the loans in the Company's portfolio. Sales activity for government-guaranteed portions of loans tends to fluctuate depending on the demand for loans that fit the criteria for the government guarantee. Further, the size of the transactions can vary and, as the gain is determined as a percentage of the guaranteed amount, the resulting gain on sale can vary. Recently, competitors have been offering SBA loan candidates traditional financing without a guarantee and the Company is not willing to relax its structure for those lending opportunities.

As a result of the relatively low interest rate environment and its continued focus across all subsidiary banks, the Company was able to execute numerous interest rate swaps on select commercial loans, including tax credit project loans. The interest rate swaps allow commercial borrowers to pay a fixed interest rate while the Company receives a variable interest rate as well as an upfront fee dependent upon the pricing. Management will continue to review opportunities to execute these swaps at all of its subsidiary banks, as the circumstances are appropriate for the borrowers and the Company. An optimal interest rate swap candidate must be of a certain size and sophistication which can lead to volatility in activity from quarter to quarter. Swap fee income totaled \$9.8 million for the third quarter of 2019, compared to \$1.1 million for the third quarter of 2018. Swap fee income totaled \$20.9 million for the first nine months of 2019, compared to \$3.7 million in the first nine months of 2018. The increase in swap fee income for the first three and nine months of 2019, as compared to all prior periods, was due to both the volume and the size of the transactions executed. Future levels of swap fee income are somewhat dependent upon prevailing interest rates.

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Securities losses totaled \$3 thousand and \$56 thousand for the three and nine months ended September 30, 2019, respectively. By comparison, there were no securities losses for the three and nine months ended September 30, 2018.

Earnings on BOLI increased 3% comparing the third quarter of 2019 to the third quarter of 2018, and increased 12% comparing the first nine months of 2019 to the first nine months of 2018. There were no purchases of BOLI within the last 12 months. Notably, a portion of the Company's BOLI is variable rate whereby returns are determined by the performance of the equity market and can lead to volatility in earnings. Management intends to continue to review its BOLI investments to be consistent with policy and regulatory limits in conjunction with the rest of its earning assets in an effort to maximize returns while minimizing risk.

Debit card fees are the interchange fees paid on certain debit card customer transactions. Debit card fees increased 5% comparing the third quarter of 2019 to the third quarter of the prior year, and increased 6% comparing the first nine months of 2019 to the first nine months of 2018. This increase was primarily related to recent acquisitions. These fees can vary based on customer debit card usage, so fluctuations from period to period may occur. As an opportunity to maximize fees, the Company offers a retail deposit product with a higher interest rate that incentivizes debit card activity.

Correspondent banking fees decreased 3% comparing the third quarter of 2019 to the third quarter of the prior year and decreased 14% for the first nine months of 2019 as compared to the first nine months of 2018. The fees are generally included in the earnings credit rates which incent the correspondent bank to maintain higher levels of noninterest bearing deposits to offset the correspondent banking fees. Management will continue to evaluate earnings credit rates and the resulting impact on deposit balances and fees while balancing the ability to grow market share. Correspondent banking continues to be a core strategy for the Company, as this line of business provides a high level of deposits that can be used to fund loan growth as well as a steady source of fee income. The Company now serves approximately 195 banks in Iowa, Illinois, Missouri and Wisconsin.

Other noninterest income increased 35% comparing the third quarter of 2019 to the third quarter of the prior year, and increased 26% comparing the first nine months of 2019 to the first nine months of 2018. This increase was primarily due to fee income, equity investment income and gain on disposal of leased assets.

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**NONINTEREST EXPENSE**

The following tables set forth the various categories of noninterest expense for the three and nine months ended September 30, 2019 and 2018.

	<b>Three Months Ended</b>			
	<b>September 30, 2019</b>	<b>September 30, 2018</b>	<b>\$ Change</b>	<b>% Change</b>
	<i>(dollars in thousands)</i>			
Salaries and employee benefits	\$ 24,215	\$ 17,433	\$ 6,782	38.9 %
Occupancy and equipment expense	3,860	3,318	542	16.3
Professional and data processing fees	4,030	2,396	1,634	68.2
Acquisition costs	—	1,292	(1,292)	(100.0)
Post-acquisition compensation, transition and integration costs	884	494	390	78.9
FDIC insurance, other insurance and regulatory fees	542	933	(391)	(41.9)
Loan/lease expense	221	369	(148)	(40.1)
Net cost of (income from) and gains/losses on operations of other real estate	2,078	(50)	2,128	(4,256.0)
Advertising and marketing	1,056	984	72	7.3
Bank service charges	502	462	40	8.7
Loss on debt extinguishment, net	148	—	148	100.0
Correspondent banking expense	209	205	4	2.0
Intangibles amortization	560	542	18	3.3
Other	1,640	2,122	(482)	(22.7)
<b>Total noninterest expense</b>	<b>\$ 39,945</b>	<b>\$ 30,500</b>	<b>\$ 9,445</b>	<b>31.0 %</b>

	<b>Nine Months Ended</b>			
	<b>September 30, 2019</b>	<b>September 30, 2018</b>	<b>\$ Change</b>	<b>% Change</b>
	<i>(dollars in thousands)</i>			
Salaries and employee benefits	\$ 67,843	\$ 49,215	\$ 18,628	37.9 %
Occupancy and equipment expense	11,087	9,517	1,570	16.5
Professional and data processing fees	9,811	8,016	1,795	22.4
Acquisition costs	—	1,799	(1,799)	(100.0)
Post-acquisition compensation, transition and integration costs	1,727	659	1,068	162.1
FDIC insurance, other insurance and regulatory fees	2,432	2,529	(97)	(3.8)
Loan/lease expense	748	920	(172)	(18.7)
Net cost of (income from) and gains/losses on operations of other real estate	3,557	11	3,546	32,236.4
Advertising and marketing	2,878	2,430	448	18.4
Bank service charges	1,494	1,368	126	9.2
Losses on debt extinguishment, net	148	—	148	100.0
Correspondent banking expense	619	614	5	0.8
Intangibles amortization	1,706	1,151	555	48.2
Other	4,891	4,504	387	8.6
<b>Total noninterest expense</b>	<b>\$ 108,941</b>	<b>\$ 82,733</b>	<b>\$ 26,208</b>	<b>31.7 %</b>

Management places a strong emphasis on overall cost containment and is committed to improving the Company's general efficiency. One-time charges for post-acquisition transition and integration costs related to the core system conversion of SFC Bank are expected to impact expense throughout 2019.

Salaries and employee benefits, which is the largest component of noninterest expense, increased from the third quarter of 2019 to the third quarter of 2018 by 39%. This line item also increased 38% when comparing the first nine months of 2019 to the first nine months of 2018. This increase was primarily related to:

- Bonuses and commissions on elevated swap fee income;
- Improved financial results and the related incentives;



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- The addition of SFC Bank employees, new hires and merit increases;
- The addition of several producers to bolster growth prospects; and
- The addition to operational infrastructure and investing in additional staffing both at the corporate level and at some of the bank charters. Some of these hires are opportunistic, as the Company takes advantage of talent availability in the marketplace as a result of ongoing industry consolidation.

Occupancy and equipment expense increased 16% comparing the third quarter of 2019 to the same period of the prior year, and increased 17% comparing the first nine months of 2019 to the same period of the prior year. The increased expense was due to higher information technology service contract costs, increases in repairs and maintenance costs and the additions of SFC Bank and the Bates Companies.

Professional and data processing fees increased 68% comparing the third quarter of 2019 to the same period in 2018, and increased 22% comparing the first nine months of 2019 to the same period of the prior year. This increased expense was mostly due to recent mergers/acquisitions. Additionally, legal expense was also elevated in the third quarter 2019 due to the continued legal matter at RB&T where two employees have been charged with wrongdoing in connection with an SBA loan application. Neither RB&T nor the Company have been charged in the case. Generally, professional and data processing fees can fluctuate depending on certain one-time project costs.

There were no acquisition costs in the first nine months of 2019. Acquisition costs totaled \$1.2 million and \$1.8 million for the third quarter of 2018 and first nine months of 2018, respectively. These costs were comprised primarily of legal, accounting and investment banking costs related to mergers/acquisitions.

Post-acquisition costs totaled \$884 thousand for the third quarter of 2019 as compared to \$494 thousand for the same period of the prior year. Post-acquisition costs totaled \$1.7 thousand for the first nine months of 2019 as compared to \$659 thousand for the same period of the prior year. These costs were comprised primarily of personnel costs, IT integration and data conversion costs related to mergers/acquisitions.

FDIC insurance, other insurance and regulatory fee expense decreased 42%, comparing the third quarter of 2019 to the third quarter of 2018, and decreased 4% comparing the first nine months of 2019 to the same period of the prior year. The decrease in expense was due to the award of assessment credits by the FDIC in September 2019.

Loan/lease expense decreased 40% when comparing the third quarter of 2019 to the same quarter of 2018, and decreased 19% comparing the first nine months of 2019 to the same period of prior year. Generally, loan/lease expense has a direct relationship with the level of NPLs; however, it may deviate depending upon the individual NPLs.

Net cost of (income from) and gains/losses on operations of other real estate includes gains/losses on the sale of OREO, write-downs of OREO and all income/expenses associated with OREO. Net cost of (income from) and gains/losses on operations of other real estate totaled \$2.1 million for the third quarter of 2019, compared to \$50 thousand of net income for the third quarter of 2018. Net cost of (income from) and gains/losses on operations of other real estate totaled \$3.6 million for the first nine months of 2019 compared to \$11 thousand for the same period of the prior year. In the third quarter of 2019, the Company wrote down an OREO property by \$2.0 million. Writedowns on OREO totaled \$3.0 million for the nine months ended September 30, 2019.

Advertising and marketing expense increased 7% comparing the third quarter of 2019 to the third quarter of 2018, and increased 18% comparing the first nine months of 2019 to the same period of the prior year. The increase in expense was primarily due to the addition of SFC Bank.

Bank service charges, a large portion of which includes indirect costs incurred to provide services to QCBT's correspondent banking customer portfolio, increased 9% from the third quarter of 2018 to the third quarter of 2019, as well as comparing

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the first nine months of 2019 to the same period of the prior year. As transaction volumes continue to increase and the number of correspondent banking clients increases, the associated expenses will also increase.

Losses on debt extinguishment, net were \$148 thousand for the three and nine months ended September 30, 2019. These losses relate to the prepayment of certain FHLB advances. There were no losses on debt extinguishment for the three and nine months ended September 30, 2018.

Correspondent banking expense increased 2% when comparing the third quarter of 2019 to the third quarter of 2018 and increased 1% when comparing the first nine months of 2019 to the same period of the prior year. These are direct costs incurred to provide services to QCBT's correspondent banking customer portfolio, including safekeeping and cash management services.

Intangibles amortization expense increased 3% when comparing the third quarter of 2019 to the third quarter of 2018, and increased 48% when comparing the first nine months of 2019 to the same period of the prior year. The increase was due to the addition of SFC Bank and the Bates Companies.

Other noninterest expense was down 23% when comparing the third quarter of 2019 to the third quarter of 2018, and increased 9% when comparing the first nine months of 2019 to the same period of the prior year. Included in other noninterest expense are items such as subscriptions, sales and use tax and expenses related to wealth management. A portion of this increase is related to the addition of SFC Bank.

**INCOME TAXES**

In the third quarter of 2019, the Company incurred income tax expense of \$3.6 million. During the first nine months of the year, the Company incurred income tax expense of \$8.1 million. Following is a reconciliation of the expected income tax expense to the income tax expense included in the consolidated statements of income for the three and nine months ended September 30, 2019 and 2018.

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2019		2018		2019		2018	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
	<i>(dollars in thousands)</i>							
Computed "expected" tax expense	\$ 3,920	21.0 %	\$ 2,188	21.0 %	\$ 10,411	21.0 %	\$ 7,410	21.0 %
Tax exempt income, net	(1,169)	(6.3)	(1,047)	(10.0)	(3,344)	(6.7)	(2,946)	(8.3)
Bank-owned life insurance	(103)	(0.6)	(89)	(0.9)	(303)	(0.6)	(261)	(0.7)
State income taxes, net of federal benefit, current year	964	5.2	393	3.8	2,384	4.8	1,502	4.3
Tax credits	(39)	(0.2)	—	—	(116)	(0.2)	—	—
True-up adjustment to year-end provision	—	—	—	—	(715)	(1.4)	—	—
Excess tax benefit on stock options exercised and restricted stock awards vested	(54)	(0.3)	(9)	(0.1)	(208)	(0.4)	(342)	(1.0)
Other	54	0.3	172	1.6	(50)	(0.2)	117	0.2
Federal and state income tax expense	<u>\$ 3,573</u>	<u>19.1 %</u>	<u>\$ 1,608</u>	<u>15.4 %</u>	<u>\$ 8,059</u>	<u>16.3 %</u>	<u>\$ 5,480</u>	<u>15.5 %</u>

The effective tax rate for the quarter ended September 30, 2019 was 19.1%, which was an increase from the effective tax rate of 15.4% for the quarter ended September 30, 2018. The Company's effective tax rate increased year over year as the Company's growth in taxable income significantly outpaced the modest growth in tax exempt income. The effective tax rate for the nine months ended September 30, 2019 was 16.3%, which was an increase over the effective tax rate of 15.5% for the nine months ended September 30, 2018. During the first quarter of 2019 and in conjunction with the Company's year-end tax preparation process, the Company identified a one-time true-up adjustment of \$715 thousand. Excluding this, the Company's effective tax rate was approximately 14.9% for the nine months ended September 30, 2019.

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FINANCIAL CONDITION

Following is a table that represents the major categories of the Company's balance sheet. On August 13, 2019 the Company and RB&T entered into a definitive agreement with IB&T, a wholly owned subsidiary of Heartland Financial USA, Inc., pursuant to which IB&T will acquire certain assets and assume certain liabilities of RB&T for a cash payment. The transaction is expected to close in the fourth quarter of 2019. As a result, certain assets and liabilities of RB&T are classified as held for sale as of September 30, 2019, which impacts balance sheet comparisons to prior periods.

	As of							
	September 30, 2019		June 30, 2019		December 31, 2018		September 30, 2018	
	Amount	%	Amount	%	Amount	%	Amount	%
	<i>(dollars in thousands)</i>							
Cash, federal funds sold, and interest-bearing deposits	\$ 288,934	5 %	\$ 293,416	6 %	\$ 245,119	5 %	\$ 203,067	4 %
Securities	555,409	10 %	643,803	12 %	662,969	13 %	650,745	14 %
Net loans/leases	3,574,154	68 %	3,869,415	75 %	3,692,907	75 %	3,610,309	75 %
Other assets	408,338	8 %	388,218	7 %	348,715	7 %	328,611	7 %
Assets held for sale	465,547	9 %	—	- %	—	- %	—	- %
Total assets	<u>\$5,292,382</u>	<u>100 %</u>	<u>\$5,194,852</u>	<u>100 %</u>	<u>\$4,949,710</u>	<u>100 %</u>	<u>\$4,792,732</u>	<u>100 %</u>
Total deposits	\$3,802,241	72 %	\$4,322,510	83 %	\$3,977,031	81 %	\$3,788,277	79 %
Total borrowings	320,457	6 %	230,953	4 %	404,968	8 %	483,635	10 %
Other liabilities	179,411	3 %	137,089	3 %	94,573	2 %	63,433	1 %
Liabilities held for sale	470,530	9 %	—	- %	—	- %	—	- %
Total stockholders' equity	519,743	10 %	504,300	10 %	473,138	9 %	457,387	10 %
Total liabilities and stockholders' equity	<u>\$5,292,382</u>	<u>100 %</u>	<u>\$5,194,852</u>	<u>100 %</u>	<u>\$4,949,710</u>	<u>100 %</u>	<u>\$4,792,732</u>	<u>100 %</u>

Assets and liabilities held for sale are summarized as follows as of September 30, 2019:

	As of <u>September 30, 2019</u> <i>(dollars in thousands)</i>
<b>ASSETS</b>	
Cash and cash equivalents	\$ 13,446
Securities	66,009
Loans, net	362,011
Other assets	24,081
Assets held for sale	<u>\$ 465,547</u>
<b>LIABILITIES</b>	
Deposits	\$ 451,546
Borrowings	16,157
Other liabilities	2,827
Liabilities held for sale	<u>\$ 470,530</u>

During the third quarter of 2019, the Company's total assets increased \$97.5 million, or 2%, to a total of \$5.3 billion. The Company's net loan/lease portfolio decreased \$295.3 million, which was entirely the result of classifying RB&T's assets as held for sale. Deposits decreased \$520.3 million in the third quarter of 2019, mainly as a result of classifying RB&T's liabilities as held for sale, which included deposits of \$451.5 million as of September 30, 2019. The remaining net decline in deposits of \$69.0 million was driven primarily by a decline in higher cost public funds and brokered CDs, as the Company intentionally did not renew certain deposits as they matured. Borrowings increased \$89.5 million in the third quarter of 2019 which consisted primarily of short-term FHLB advances to offset the decline in deposits.



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INVESTMENT SECURITIES

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

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

	As of							
	September 30, 2019		June 30, 2019		December 31, 2018		September 30, 2018	
	Amount	%	Amount	%	Amount	%	Amount	%
	<i>(dollars in thousands)</i>							
U.S. govt. sponsored agency securities	\$ 21,268	4 %	\$ 35,762	6 %	\$ 36,411	5 %	\$ 36,492	5 %
Municipal securities	391,329	71 %	440,852	68 %	459,409	70 %	453,275	70 %
Residential mortgage-backed and related securities	123,880	22 %	159,228	25 %	159,249	24 %	155,733	24 %
Other securities	18,932	3 %	7,961	1 %	7,900	1 %	5,245	1 %
	<u>\$ 555,409</u>	<u>100 %</u>	<u>\$ 643,803</u>	<u>100 %</u>	<u>\$ 662,969</u>	<u>100 %</u>	<u>\$ 650,745</u>	<u>100 %</u>
Securities as a % of Total Assets	11.51 %		12.39 %		13.39 %		13.58 %	
Net Unrealized Gains (Losses) as a % of Amortized Cost	4.54 %		3.23 %		(1.01)%		(1.47)%	
Duration (in years)	6.5		6.4		6.8		7.0	
Quarterly Yield on investment securities (tax equivalent)	3.85 %		3.77 %		3.58 %		3.55 %	

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

The duration of the securities portfolio lengthened modestly with the TEY on the portfolio increasing 27 basis points in the first nine months of 2019.

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

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

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LOANS/LEASES

Excluding RB&T loans classified as held for sale, total loans/leases grew 9.1% on an annualized basis during the third quarter of 2019 and 9.4% year-to-date. The mix of the loan/lease types within the Company's loan/lease portfolio is presented in the following table.

	As of							
	September 30, 2019		June 30, 2019		December 31, 2018		September 30, 2018	
	Amount	%	Amount	%	Amount	%	Amount	%
	<i>(dollars in thousands)</i>							
C&I loans	\$ 1,469,978	41 %	\$ 1,548,657	40 %	\$ 1,429,410	38 %	\$ 1,380,543	39 %
CRE loans	1,687,922	46 %	1,837,473	46 %	1,766,111	48 %	1,727,326	47 %
Direct financing leases	92,307	3 %	101,180	3 %	117,969	3 %	126,752	3 %
Residential real estate loans	245,667	7 %	293,479	8 %	290,759	8 %	309,288	8 %
Installment and other consumer loans	106,540	3 %	120,947	3 %	119,381	3 %	100,191	3 %
Total loans/leases	\$ 3,602,414	100 %	\$ 3,901,736	100 %	\$ 3,723,630	100 %	\$ 3,644,100	100 %
Plus deferred loan/lease origination costs, net of fees	7,856		8,783		9,124		9,286	
Less allowance	(36,116)		(41,104)		(39,847)		(43,077)	
Net loans/leases	<u>\$ 3,574,154</u>		<u>\$ 3,869,415</u>		<u>\$ 3,692,907</u>		<u>\$ 3,610,309</u>	

As CRE loans have historically been the Company's largest portfolio segment, management places a strong emphasis on monitoring the composition of the Company's CRE loan portfolio. For example, management tracks the level of owner-occupied CRE loans relative to non owner-occupied loans. Owner-occupied loans are generally considered to have less risk. As of September 30, 2019 and December 31, 2018, respectively, approximately 26% and 28% of the CRE loan portfolio was owner-occupied.

Over the past several quarters, the Company has been successful in shifting the mix of its commercial loan portfolio by adding more C&I loans. C&I loans decreased \$78.7 million during the current quarter, however, excluding the impact of RB&T loans reclassified to held for sale, C&I loans grew \$47.4 million during the current quarter.

Following is a listing of significant industries within the Company's CRE loan portfolio:

	As of September 30, 2019		As of June 30, 2019		As of December 31, 2018		As of September 30, 2018	
	Amount	%	Amount	%	Amount	%	Amount	%
	<i>(dollars in thousands)</i>							
Lessors of Nonresidential Buildings	\$ 544,337	32 %	\$ 612,526	33 %	\$ 612,327	34 %	\$ 605,517	35 %
Lessors of Residential Buildings	403,766	24 %	394,235	21 %	346,270	19 %	321,357	19 %
Hotels	61,199	4 %	82,180	5 %	81,345	5 %	87,850	5 %
Nonresidential Property Managers	53,581	3 %	58,207	3 %	69,885	4 %	56,600	3 %
Land Subdivision	46,144	3 %	45,847	3 %	48,378	3 %	50,252	3 %
New Housing For-Sale Builders	45,419	3 %	43,520	2 %	47,598	3 %	37,911	2 %
Other Activities Related to Real Estate	36,212	2 %	32,652	2 %	25,345	2 %	27,802	2 %
Other *	497,264	29 %	568,306	31 %	534,963	30 %	540,037	31 %
Total CRE Loans	<u>\$ 1,687,922</u>	<u>100 %</u>	<u>\$ 1,837,473</u>	<u>100 %</u>	<u>\$ 1,766,111</u>	<u>100 %</u>	<u>\$ 1,727,326</u>	<u>100 %</u>

\* "Other" consists of all other industries. None of these had concentrations greater than \$33.8 million, or approximately 2.0% of total CRE loans in the most recent period presented.

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

- Certain loans that do not meet the criteria for sale into the secondary market. These are often structured as adjustable rate mortgages with maturities ranging from three to seven years to avoid long-term interest rate risk.
- A limited amount of 15-year and 20-year fixed rate residential real estate loans that meet certain credit guidelines.

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

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

	As of September 30, 2019		As of June 30, 2019		As of December 31, 2018		As of September 30, 2018	
	Amount	%	Amount	%	Amount	%	Amount	%
	<i>(dollars in thousands)</i>							
Trucks, Vans and Vocational Vehicles	\$ 43,489	19 %	\$ 46,650	20 %	\$ 40,588	18 %	\$ 37,942	16 %
Manufacturing - General	16,952	7 %	17,879	8 %	16,760	7 %	16,666	7 %
Construction - General	16,295	7 %	16,026	7 %	17,236	8 %	17,201	7 %
Food Processing Equipment	15,622	7 %	15,863	7 %	15,334	7 %	15,490	7 %
Marine - Travelifts	11,819	5 %	11,659	5 %	12,370	5 %	12,729	5 %
Trailers	9,603	4 %	9,303	4 %	9,842	4 %	10,016	4 %
Computer Hardware	8,350	4 %	6,282	3 %	9,166	4 %	9,656	4 %
Manufacturing - CNC	6,432	3 %	6,832	3 %	6,616	3 %	6,990	3 %
Other *	101,499	44 %	100,182	43 %	100,734	44 %	106,156	47 %
Total m2 loans and leases	\$ 230,061	100 %	\$ 230,676	100 %	\$ 228,646	100 %	\$ 232,846	100 %

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

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

ALLOWANCE FOR ESTIMATED LOSSES ON LOANS/LEASES

Changes in the allowance for the three and nine months ended September 30, 2019 and 2018 are presented as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
	<i>(dollars in thousands)</i>			
Balance, beginning	\$ 41,104	\$ 37,545	\$ 39,847	\$ 34,355
Reclassification of allowance related to held for sale loans	(6,122)	—	(6,122)	—
Provisions charged to expense	1,584	6,206	5,659	11,046
Loans/leases charged off	(741)	(991)	(3,953)	(2,951)
Recoveries on loans/leases previously charged off	291	317	685	626
Balance, ending	\$ 36,116	\$ 43,077	\$ 36,116	\$ 43,077

The adequacy of the allowance was determined by management based on factors that included the overall composition of the loan/lease portfolio, types of loans/leases, historical loss experience, loan/lease delinquencies, potential substandard and doubtful credits, economic conditions, collateral positions, government guarantees and other factors that, in management's judgment, deserved evaluation. To ensure that an adequate allowance was maintained, provisions were made based on a number of factors, including the increase in loans/leases and a detailed analysis of the loan/lease portfolio. The loan/lease portfolio is reviewed and analyzed quarterly with specific detailed reviews completed on all credits risk-rated less than "fair quality", as described in Note 1 to the Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, and carrying aggregate exposure in excess of \$250 thousand. The adequacy of the allowance is monitored by the credit administration staff and reported to management and the board of directors.

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

Internally Assigned Risk Rating *	As of			
	September 30, 2019	June 30, 2019	December 31, 2018	September 30, 2018
	<i>(dollars in thousands)</i>			
Special Mention (Rating 6)	\$ 23,195	\$ 19,913	\$ 42,058	\$ 49,230
Substandard (Rating 7)	31,386	40,935	28,593	45,676
Doubtful (Rating 8)	—	—	—	3
	<u>\$ 54,581</u>	<u>\$ 60,848</u>	<u>\$ 70,651</u>	<u>\$ 94,909</u>
Criticized Loans **	\$ 54,581	\$ 60,848	\$ 70,651	\$ 94,909
Classified Loans ***	\$ 31,386	\$ 40,935	\$ 28,593	\$ 45,679
Criticized Loans as a % of Total Loans/Leases	1.51 %	1.56 %	1.89 %	2.60 %
Classified Loans as a % of Total Loans/Leases	0.87 %	1.05 %	0.77 %	1.25 %

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

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

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

The Company's classified and criticized loans are at some of the lowest levels for the Company's history.

	As of			
	September 30, 2019	June 30, 2019	December 31, 2018	September 30, 2018
Allowance / Gross Loans/Leases	1.00 %	1.05 %	1.07 %	1.18 %
Allowance / NPLs	401.56 %	283.10 %	214.80 %	147.39 %

Although management believes that the allowance at September 30, 2019 was at a level adequate to absorb losses on existing loans/leases, there can be no assurance that such losses will not exceed the estimated amounts or that the Company will not be required to make additional provisions in the future. Unpredictable future events could adversely affect cash flows for both commercial and individual borrowers, which could cause the Company to experience increases in problem assets, delinquencies and losses on loans/leases, and require further increases in the provision. Asset quality is a priority for the Company and its subsidiaries. The ability to grow profitably is in part dependent upon the ability to maintain that quality. The Company continually focuses efforts at its subsidiary banks and leasing company with the intention to improve the overall quality of the Company's loan/lease portfolio.

See Note 4 to the Consolidated Financial Statements for additional information regarding the Company's allowance.

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NONPERFORMING ASSETS

The table below presents the amount of NPAs and related ratios.

	As of September 30, 2019	As of June 30, 2019	As of December 31, 2018	As of September 30, 2018
	<i>(dollars in thousands)</i>			
Nonaccrual loans/leases (1) (2)	\$ 8,231	\$ 13,148	\$ 14,260	\$ 23,576
Accruing loans/leases past due 90 days or more (3)	—	58	632	1,410
TDRs - accruing	763	1,313	3,659	4,240
Total NPLs	8,994	14,519	18,551	29,226
OREO	4,248	8,637	9,378	12,204
Other repossessed assets	—	—	8	150
Total NPAs	<u>\$ 13,242</u>	<u>\$ 23,156</u>	<u>\$ 27,937</u>	<u>\$ 41,580</u>
NPLs to total loans/leases	0.25 %	0.37 %	0.50 %	0.80 %
NPAs to total loans/leases plus repossessed property	0.37 %	0.59 %	0.75 %	1.13 %
NPAs to total assets	0.27 %	0.45 %	0.56 %	0.87 %

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

(2) Includes TDRs of \$933 thousand at September 30, 2019, \$902 thousand at June 30, 2019, \$1.9 million at December 31, 2018, and \$1.6 million at September 30, 2018.

(3) Includes TDRs of \$0 at September 30, 2019, \$0 at June 30, 2019, \$496 thousand at December 31, 2018, and \$0 at September 30, 2018.

NPAs at September 30, 2019 were \$13.2 million, down \$9.9 million from June 30, 2019 and down \$28.3 million from September 30, 2018. Excluding RB&T's NPAs, the Company's NPAs were down \$2.5 million on a linked-quarter basis. The improvement was primarily attributed to the \$2.0 million writedown of an OREO property.

The ratio of NPAs to total assets was 0.27% at September 30, 2019, down from 0.45% at June 30, 2019 and down from 0.87% at September 30, 2018.

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

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

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

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DEPOSITS

Excluding the impact of RB&T deposits reclassified to held for sale, deposits decreased \$68.7 million during the third quarter of 2019, primarily due to the maturity and intentional nonreplacement of higher cost public funds and brokered CDs. The table below presents the composition of the Company's deposit portfolio.

	<u>September 30, 2019</u>		<u>June 30, 2019</u>		<u>December 31, 2018</u>		<u>September 30, 2018</u>	
	Amount	%	Amount	%	Amount	%	Amount	%
	<i>(dollars in thousands)</i>							
Noninterest bearing demand deposits	\$ 782,232	21 %	\$ 795,951	18 %	\$ 791,101	20 %	\$ 802,090	21 %
Interest bearing demand deposits	2,245,557	59 %	2,505,956	58 %	2,204,206	55 %	2,094,814	56 %
Time deposits	536,352	14 %	733,135	17 %	704,903	18 %	615,323	16 %
Brokered deposits	238,100	6 %	287,468	7 %	276,821	7 %	276,050	7 %
	<u>\$3,802,241</u>	<u>100 %</u>	<u>\$4,322,510</u>	<u>100 %</u>	<u>\$3,977,031</u>	<u>100 %</u>	<u>\$3,788,277</u>	<u>100 %</u>

Quarter-end balances can greatly fluctuate due to large customer and correspondent bank activity.

Management will continue to focus on growing its core deposit portfolio, including its correspondent banking business at QCBT, as well as shifting the mix from brokered and other higher cost deposits to lower cost core deposits. With the significant success achieved by QCBT in growing its correspondent banking business, QCBT has developed procedures to proactively monitor this industry concentration of deposits and loans. Other deposit-related industry concentrations and large accounts are monitored by the internal asset liability management committees.

BORROWINGS

The subsidiary banks purchase federal funds for short-term funding needs from the FRB or from their correspondent banks. The table below presents the composition of the Company's short-term borrowings.

	<u>September 30, 2019</u>		<u>June 30, 2019</u>		<u>December 31, 2018</u>		<u>September 30, 2018</u>	
	Amount	%	Amount	%	Amount	%	Amount	%
	<i>(dollars in thousands)</i>							
Overnight repurchase agreements	\$ 2,421		\$ 2,181		\$ 2,084		\$ 3,049	
Federal funds purchased	16,105		17,010		26,690		8,670	
	<u>\$ 18,526</u>		<u>\$ 19,191</u>		<u>\$ 28,774</u>		<u>\$ 11,719</u>	

The Company's federal funds purchased fluctuates based on the short-term funding needs of the Company's subsidiary banks.

As a result of their memberships in the FHLB of Des Moines, the subsidiary banks have the ability to borrow funds for short or long-term purposes under a variety of programs. The subsidiary banks can utilize FHLB advances for loan matching as a hedge against the possibility of changing interest rates and when these advances provide a less costly or more readily available source of funds than customer deposits.

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

	As of			
	September 30, 2019	June 30, 2019	December 31, 2018	September 30, 2018
<i>(dollars in thousands)</i>				
Term FHLB advances	\$ 60,000	\$ 46,433	\$ 76,327	\$ 63,399
Overnight FHLB advances	135,800	59,300	190,165	295,730
	<u>\$ 195,800</u>	<u>\$ 105,733</u>	<u>\$ 266,492</u>	<u>\$ 359,129</u>

FHLB advances increased \$90.1 million in the current quarter, as compared to the prior quarter due to the intentional runoff of non-core deposits.

The Company had subordinated notes totaling \$68.3 million as of September 30, 2019. See Note 6 to the Company's Consolidated Financial Statements for additional information regarding our subordinated notes.

The Company renewed its revolving credit note in the second quarter of 2019. See Note 6 to the Consolidated Financial Statements for additional details regarding this renewal.

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

The table below presents the maturity schedule including weighted average interest cost for the Company's combined wholesale funding portfolio (defined as FHLB advances, brokered deposits and wholesale structured repurchase agreements).

<u>Maturity:</u>	<u>September 30, 2019</u>		<u>December 31, 2018</u>	
	<u>Amount Due</u>	<u>Weighted Average Interest Rate</u>	<u>Amount Due</u>	<u>Weighted Average Interest Rate</u>
<i>(dollars in thousands)</i>				
Year ending December 31:				
2019	\$ 284,189	2.19 %	\$ 510,736	2.35 %
2020	81,895	2.05	48,557	2.31
2021	18,476	1.88	15,050	2.31
2022	29,340	1.80	3,970	2.00
2023	20,000	1.84	—	—
<b>Total Wholesale Funding</b>	<u>\$ 433,900</u>	2.10 %	<u>\$ 578,313</u>	2.35 %

During the first nine months of 2019, wholesale funding decreased \$144.4 million. Excluding the impact of RB&T wholesale funding reclassified to held for sale, wholesale funding decreased \$79.3 million during the first nine months of 2019.

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STOCKHOLDERS' EQUITY

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

	As of			
	<u>September 30, 2019</u>	<u>June 30, 2019</u>	<u>December 31, 2018</u>	<u>September 30, 2018</u>
	<i>(dollars in thousands)</i>			
Common stock	\$ 15,790	\$ 15,773	\$ 15,718	\$ 15,674
Additional paid in capital	273,475	272,744	270,761	269,373
Retained earnings	230,892	216,741	192,203	179,826
AOCI (loss)	(414)	(958)	(5,544)	(7,486)
Total stockholders' equity	<u>\$ 519,743</u>	<u>\$ 504,300</u>	<u>\$ 473,138</u>	<u>\$ 457,387</u>
TCE / TA ratio (non-GAAP)	8.20 %	8.05 %	7.78 %	7.82 %

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

LIQUIDITY AND CAPITAL RESOURCES

Liquidity measures the ability of the Company to meet maturing obligations and its existing commitments, to withstand fluctuations in deposit levels, to fund its operations, and to provide for customers' credit needs. The Company monitors liquidity risk through contingency planning stress testing on a regular basis. The Company seeks to avoid over-concentration of funding sources and to establish and maintain contingent funding facilities that can be drawn upon if normal funding sources become unavailable. One source of liquidity is cash and short-term assets, such as interest-bearing deposits in other banks and federal funds sold, which averaged \$264.9 million during the third quarter of 2019 and \$263.2 million during the full year of 2019. The Company's on balance sheet liquidity position can fluctuate based on short-term activity in deposits and loans.

The subsidiary banks have a variety of sources of short-term liquidity available to them, including federal funds purchased from correspondent banks, FHLB advances, wholesale structured repurchase agreements, brokered deposits, lines of credit, borrowing at the Federal Reserve Discount Window, sales of securities AFS, and loan/lease participations or sales. The Company also generates liquidity from the regular principal payments and prepayments made on its loan/lease portfolio, and on the regular monthly payments on its securities portfolio.

At September 30, 2019, the subsidiary banks had 34 lines of credit totaling \$419.1 million, of which \$47.8 million was secured and \$371.3 million was unsecured. At September 30, 2019, the full \$419.1 million was available.

At December 31, 2018, the subsidiary banks had 33 lines of credit totaling \$327.7 million, of which \$1.7 million was secured and \$326.0 million was unsecured. At December 31, 2018, \$307.7 million of the \$327.7 million was available.

The Company has emphasized growing the number and amount of lines of credit in an effort to strengthen this contingent source of liquidity. Additionally, the Company maintains a \$20.0 million secured revolving credit note with a variable interest rate and a maturity of June 30, 2020. At September 30, 2019, the full \$20.0 million was available.

As of September 30, 2019, the Company had \$501.0 million in average correspondent banking deposits spread over 195 relationships. While the Company believes that these funds are relatively stable, there is the potential for large fluctuations that can impact liquidity. Seasonality and the liquidity needs of these correspondent banks can impact balances. Management closely monitors these fluctuations and runs stress scenarios to measure the impact on liquidity and interest rate risk with various levels of correspondent deposit run-off.



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Investing activities used cash of \$235.1 million during the first nine months of 2019, compared to \$209.6 million for the same period of 2018. The net decrease in federal funds sold was \$17.1 million for the first nine months of 2019, compared to a net increase of \$2.9 million for the same period of 2018. The net increase in interest-bearing deposits at financial institutions was \$57.2 million for the first nine months of 2019, compared to a net increase of \$22.1 million for the same period of 2018. Proceeds from calls, maturities, and paydowns of securities were \$45.7 million for the first nine months of 2019, compared to \$59.2 million for the same period of 2018. Purchases of securities used cash of \$28.1 million for the first nine months of 2019, compared to \$66.4 million for the same period of 2018. Proceeds from sales of securities were \$33.1 million for the first nine months of 2019, compared to \$1.9 million for the same period of 2018. The net increase in loans/leases used cash of \$237.3 million for the first nine months of 2019 compared to \$208.7 million for the same period of 2018.

Financing activities provided cash of \$206.1 million for the first nine months of 2019, compared to \$170.4 million for same period of 2018. Net increases in deposits totaled \$277.0 million for the first nine months of 2019, compared to \$82.3 million for the same period of 2018. During the first nine months of 2019, the Company's short-term borrowings decreased \$9.1 million, compared to \$2.2 million for the same period of 2018. In the first nine months of 2019, the Company decreased short-term and overnight FHLB advances by \$16.0 million. Maturities and principal payments on FHLB term advances totaled \$35.0 million and on other borrowings totaled \$20.9 million in the first nine months of 2019. Prepayments on FHLB term advances totaled \$33.2 million and on other borrowings totaled \$46.3 million in the first nine months of 2019. During the first nine months of 2019, proceeds from subordinated notes were \$63.4 million. In the first nine months of 2018, the Company increased short-term and overnight FHLB advances by \$120.3 million and increased other borrowings by \$9.0 million. Maturities and principal payments on borrowings totaled \$10.6 million in the first nine months of 2018.

Total cash provided by operating activities was \$46.1 million for the first nine months of 2019, compared to \$36.9 million for the same period of 2018.

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

The following table presents the details of the trust preferred securities outstanding as of September 30, 2019 and December 31, 2018.

Name	Date Issued	Amount	Amount	Interest Rate	Interest Rate as of	Interest Rate as of
		Outstanding September 30, 2019	Outstanding December 31, 2018		September 30, 2019	December 31, 2018
<i>(dollars in thousands)</i>						
QCR Holdings Statutory Trust II	February 2004	\$ 10,310	\$ 10,310	2.85% over 3-month LIBOR	4.95 %	5.65 %
QCR Holdings Statutory Trust III	February 2004	8,248	8,248	2.85% over 3-month LIBOR	4.95 %	5.65 %
QCR Holdings Statutory Trust V	February 2006	10,310	10,310	1.55% over 3-month LIBOR	3.85 %	3.99 %
Community National Statutory Trust II	September 2004	3,093	3,093	2.17% over 3-month LIBOR	4.33 %	4.96 %
Community National Statutory Trust III	March 2007	3,609	3,609	1.75% over 3-month LIBOR	3.87 %	4.54 %
Guaranty Bankshares Statutory Trust I	May 2005	4,640	4,640	1.75% over 3-month LIBOR	3.87 %	4.54 %
		<u>\$ 40,210</u>	<u>\$ 40,210</u>	Weighted Average Rate	<u>4.40 %</u>	<u>4.94 %</u>

As described in Note 5 to the Consolidated Financial Statements, 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 three-month LIBOR, and the interest rate swaps utilize three-month LIBOR, so the hedge is effective. The interest rate swaps are designated as a cash flow hedge in accordance with ASC 815. See Note 5 for the notional amount swapped and the related effective fixed rates.

The Company (on a consolidated basis) and the subsidiary banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and subsidiary banks' financial statements. Refer to Note 10 of the Consolidated Financial Statements for additional information regarding regulatory capital.

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SPECIAL NOTE CONCERNING FORWARD-LOOKING STATEMENTS

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

The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries include, but are not limited to, the following:

- The strength of the local, state, and national economy (including the impact of tariffs, a U.S. withdrawal from or significant renegotiation of trade agreements, trade wars and other changes in trade regulation).
- Changes in the interest rate environment.
- The economic impact of past and any future terrorist attacks, acts of war or threats thereof and the response of the United States to any such threats and attacks.
- The impact of cybersecurity risks.
- The costs, effects and outcomes of existing or future litigation.
- Changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies, the FASB, the SEC or the PCAOB.
- Unexpected results of acquisitions which may include failure to realize the anticipated benefits of the acquisition.
- The economic impact of exceptional weather occurrences such as tornadoes, floods and blizzards.
- The ability of the Company to manage the risks associated with the foregoing as well as anticipated.
- The imposition of tariffs or other governmental policies impacting the value of the agricultural or other products of our borrowers.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. For a discussion of the factors that could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries, see 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, 2018.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

In an attempt to manage the Company's exposure to changes in interest rates, management monitors the Company's interest rate risk. Each subsidiary bank has an asset/liability management committee of the board of directors that meets quarterly to review the bank's interest rate risk position and profitability, and to make or recommend adjustments for consideration by the full board of each bank.

Internal asset/liability management teams consisting of members of the subsidiary banks' management meet weekly to manage the mix of assets and liabilities to maximize earnings and liquidity and minimize interest rate and other risks. Management also reviews the subsidiary banks' securities portfolios, formulates investment strategies, and oversees the timing and implementation of transactions to assure attainment of the board's objectives in an effective manner. Notwithstanding the Company's interest rate risk management activities, the potential for changing interest rates is an uncertainty that can have an adverse effect on net income.

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

One method used to quantify interest rate risk is a short-term earnings at risk summary, which is a detailed and dynamic simulation model used to quantify the estimated exposure of net interest income to sustained interest rate changes. This simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest sensitive assets and liabilities reflected on the Company's consolidated balance sheet. This sensitivity analysis demonstrates net interest income exposure annually over a five-year horizon, assuming no balance sheet growth, no balance sheet mix change, and various interest rate scenarios including no change in rates; 100, 200, 300, and 400 basis point upward shifts; and a 100 and 200 basis point downward shifts in interest rates, where interest-bearing assets and liabilities reprice at their earliest possible repricing date.

The model assumes parallel and pro rata shifts in interest rates over a twelve-month period for the 200 basis point upward shift and 100 and 200 basis point downward shifts. For the 400 basis point upward shift, the model assumes a parallel and pro rata shift in interest rates over a twenty-four month period.

Further, in recent years, the Company added additional interest rate scenarios where interest rates experience a parallel and instantaneous shift ("shock") upward of 100, 200, 300, and 400 basis points and a parallel and instantaneous shock downward of 100 and 200 basis points. The Company will run additional interest rate scenarios on an as-needed basis.

The asset/liability management committees of the subsidiary bank boards of directors have established policy limits of a 10% decline in net interest income for the 200 basis point upward parallel shift and the 100 basis point downward parallel shift. For the 300 basis point upward shock, the established policy limit is a 25% decline in net interest income. The increased policy limit is appropriate as the shock scenario is extreme and unlikely and warrants a higher limit than the more realistic and traditional parallel/pro-rata shift scenarios.

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

INTEREST RATE SCENARIO	POLICY LIMIT	NET INTEREST INCOME EXPOSURE in YEAR 1		
		As of September 30, 2019	As of December 31, 2018	As of December 31, 2017
100 basis point downward shift	(10.0)%	0.4 %	0.7 %	0.3 %
200 basis point upward shift	(10.0)%	(1.7)%	(2.7)%	(3.7)%
300 basis point upward shock	(25.0)%	(4.0)%	(9.0)%	(8.4)%

The simulation is well within the board-established policy limits for all three scenarios. Additionally, for all of the various interest rate scenarios modeled and measured by management (as described above), the results at September 30, 2019 were within established risk tolerances as established by policy or by best practice (if the interest rate scenario didn't have a specific policy limit).

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



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Item 4

CONTROLS AND PROCEDURES

**Evaluation of disclosure controls and procedures.** An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Exchange Act of 1934) as of September 30, 2019. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective, as of the end of the period covered by this report, to ensure that information required to be disclosed in the reports filed and submitted under the Exchange Act was recorded, processed, summarized and reported as and when required.

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

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Part II

QCR HOLDINGS, INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION

Item 1 Legal Proceedings

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

Item 1A Risk Factors

There have been no material changes in the risk factors applicable to the Company from those disclosed in Part I, Item 1.A. "Risk Factors," in the Company's Annual Report on Form 10-K for the year ended December 31, 2018. Please refer to that section of the Company's Form 10-K for disclosures regarding the risks and uncertainties related to the Company's business.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3 Defaults Upon Senior Securities

None

Item 4 Mine Safety Disclosures

Not applicable

Item 5 Other Information

None

QCR HOLDINGS, INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION

Item 6 Exhibits

- 2.1 [Purchase and Assumptin Agreement by and among Illinois Bank & Trust, Rockford Bank and Trust Company and QCR Holdings, Inc. \(solely for the purposes of the sections defined therein\), dated August 13, 2019 \(incorporated by reference to Exhibit 2.1 of the Company's Form 8-K filed with the SEC on August 13, 2019.](#)
- 31.1 [Certification of Chief Executive Officer Pursuant to Rule 13a-14\(a\)/15d-14\(a\).](#)
- 31.2 [Certification of Chief Financial Officer Pursuant to Rule 13a-14\(a\)/15d-14\(a\).](#)
- 32.1 [Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 32.2 [Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of September 30, 2019 and December 31, 2018; (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2019 and September 30, 2018; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2019 and September 30, 2018; (iv) Consolidated Statements of Changes in Stockholders' Equity for the three and nine months ended September 30, 2019 and September 30, 2018; (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2019 and September 30, 2018; and (vi) Notes to the Consolidated Financial Statements.

SIGNATURES

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

QCR HOLDINGS, INC.  
(Registrant)

Date <u>November 8, 2019</u>	<u>/s/ Larry J. Helling</u> Larry J. Helling Chief Executive Officer
Date <u>November 8, 2019</u>	<u>/s/ Todd A. Gipple</u> Todd A. Gipple, President Chief Operating Officer Chief Financial Officer
Date <u>November 8, 2019</u>	<u>/s/ Nick W. Anderson</u> Nick W. Anderson Chief Accounting Officer

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## Section 2: EX-31.1 (EX-31.1)

### Exhibit 31.1

I, Larry J. Helling, certify that:

1. I have reviewed this quarterly report on Form 10-Q of QCR Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and



5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2019

/s/ Larry J. Helling  
Larry J. Helling  
Chief Executive Officer

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## Section 3: EX-31.2 (EX-31.2)

### Exhibit 31.2

I, Todd A. Gipple, certify that:

1. I have reviewed this quarterly report on Form 10-Q of QCR Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2019

/s/ Todd A. Gipple  
Todd A. Gipple  
President  
Chief Operating Officer  
Chief Financial Officer

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## Section 4: EX-32.1 (EX-32.1)

**Exhibit 32.1**

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of QCR Holdings, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Larry J. Helling, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Larry J. Helling

Larry J. Helling  
Chief Executive Officer  
November 8, 2019

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## Section 5: EX-32.2 (EX-32.2)

**Exhibit 32.2**

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of QCR Holdings, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Todd A. Gipple, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Todd A. Gipple

Todd A. Gipple  
President  
Chief Operating Officer  
Chief Financial Officer  
November 8, 2019

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