Zacks Small-Cap Research

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QCR Holdings, Inc.

(QCRH-NASDAQ)

QCRH: Second Quarter on Target; Maintaining 2013 and 2014 EPS Estimates

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	08/26/2013
Current Price (08/26/13)	$15.98
Twelve- Month Target Price	**$18.50**

OUTLOOK

QCRH reported 2013 second quarter diluted EPS of $0.59, including a number of nonrecurring items. Excluding these items, operating net income was $2.54 million, or $0.46 per diluted share, matching our estimate. We note that results included CNB for about one-half of the quarter, adding $240,000 to QCRH's bottom line, led by a net interest margin of 3.72% (which compares to a stand-alone NIM of less than 3% for QCRH). As previously announced, the CNB acquisition was completed on May 13, 2013 for a total of $19 million, $6 million of which was in cash and $13 million in common stock, adding total assets of $277.4 million, consisting primarily of loans totaling $190.7 million and a securities portfolio of $44.5 million, which were funded by $245.6 million of deposits and no borrowings. Compared to the year-ago quarter, the second quarter reflected an 8% gain in net interest income to $15.7 million, mostly due to the CNB acquisition. Results were also boosted by a 26% gain in noninterest income to $5.1 million, which was partly offset by noninterest expense that rose 13% to $14.8 million. Negatively, nonperforming loans climbed during the quarter by $10.3 million, or a whopping 52%, to $30.0 million, entirely erasing the improvement that occurred during the first quarter, driven by a few specific commercial credits moving to nonaccrual status at existing banks, as well as the addition of CNB's nonperforming assets. We are maintaining our diluted EPS estimates at $2.00 for 2013 and $2.15 for 2014. A primary driver of profitability for the combined company going forward is the opportunity for substantial cost savings, which QCRH estimates will run about $2 million annually.

SUMMARY DATA

52-Week High	**$16.84**
52-Week Low	**$12.50**
One-Year Return (%)	**18.26**
Beta	**0.32**
Average Daily Volume (sh)	**1,535**
Shares Outstanding (mil)	**5**
Market Capitalization ($mil)	**$79**
Short Interest Ratio (days)	**1.80**
Institutional Ownership (%)	**14**
Insider Ownership (%)	**19**
Annual Cash Dividend	**$0.08**
Dividend Yield (%)	**0.50**
5-Yr. Historical Growth Rates	
Net Revenue (%)	**8.0**
Earnings Per Share (%)	**12.6**
Dividend (%)	**0.0**
P/E using TTM EPS	**8.5**
P/E using 2013 Estimate	**8.0**
P/E using 2014 Estimate	**7.4**
Zacks Rank	**2**

Risk Level	**Average**
Type of Stock	**Small-Value**
Industry	**Banks-Midwest**
Zacks Rank in Industry	**11 of 36**

ZACKS ESTIMATES

Net Revenue

(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	17.3 A	18.1 A	18.1 A	18.1 A	71.6 A
2012	18.2 A	18.6 A	18.7 A	18.8 A	74.3 A
2013	19.4 A	20.8 A	21.9 E	22.0 E	84.1 E
2014					88.2 E

Earnings per Share

(EPS is operating earnings before nonrecurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	0.23 A	0.34 A	0.24 A	0.35 A	1.17 A
2012	0.48 A	0.44 A	0.44 A	0.49 A	1.85 A
2013	0.49 A	0.46 A	0.48 E	0.57 E	2.00 E
2014					2.15 E

Quarterly EPS may not add to total due to changes in shares outstanding.

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SECOND QUARTER RESULTS

QCRH reported 2013 second quarter diluted EPS of $0.59, including a number of nonrecurring items: a pretax $1.8 billion bargain-purchase gain on the CNB acquisition, a $432,000 charge for CNB acquisition costs, and inflated taxes largely due to purchase accounting adjustments. Excluding these items, operating net income was $2.54 million, or $0.46 per diluted share, matching our estimate.

We note that results included CNB for about one-half of the quarter, adding $240,000 to QCRH's bottom line, led by a net interest margin of 3.72% (which compares to a stand-alone NIM of less than 3% for QCRH). As previously announced, the CNB acquisition was completed on May 13, 2013 for a total of $19.4 million, $6.2 million of which was in cash and $13.2 million in common stock, adding total assets of $277.4 million, consisting primarily of loans totaling $190.7 million and a securities portfolio of $44.5 million, which were funded by $245.6 million of deposits and no borrowings.

The cash portion of the CNB acquisition and the repayment of $4.0 million of Community National term debt was initially funded in part by QCRH's 364-day revolving credit facility, which was later restructured into a $10 million secured 3-year term note with principal due quarterly and interest due monthly.

Significant market value adjustments that led to the $1.8 million bargain-purchase gain on the CNB acquisition included core deposit intangibles ($3.4 million) and the discount on CNB's trust preferred securities ($2.6 million).

Compared to the year-ago quarter, the second quarter reflected an 8% gain in net interest income to $15.7 million, mostly due to the CNB acquisition, which added $1.2 million to the total. Results were also boosted by a 26% gain in noninterest income to $5.1 million on the back of a strong 40%-plus increase in trust department fees to $1.2 million (which includes $164,000 from CNB), a 20%-plus jump in deposit service fees to $1.1 million (including $125,000 from CNB), and a 15% gain in loan sales to $1.0 million. In addition, there was a $0.2 million positive swing in the combined contribution from gains on securities sales plus losses from sales of OREO to a loss of $0.1 million from a loss of $0.3 million in the year-ago quarter.

These were partly offset by an 11% rise in compensation expense to $9.2 million (including $691,000 from CNB), a 16% jump in occupancy and equipment expense to $1.6 million (which includes $131,000 from CNB), and a 28% surge in professional and data processing fees to $1.4 million (including $163,000 from CNB as well as one-time undisclosed costs related to the CNB acquisition). Additionally, a 45% rise in the loan loss provision to $1.5 million principally reflected the establishment of reserves related to a few isolated commercial credits at Quad City Bank and Trust Company.

Furthermore, EPS was hurt by the issuance of 835,715 shares for the CNB acquisition, with average fully diluted shares increasing 17% to 5.5 million shares from 4.9 million shares a year ago.

Negatively, nonperforming loans climbed during the quarter by $10.3 million, or a whopping 52%, to $30.0 million, entirely erasing the improvement that occurred during the first quarter. The growth in nonperforming assets was driven by a few specific commercial credits moving to nonaccrual status at existing banks ($7.5 million, about one-half of which is guaranteed by the government through the Small Business Administration), as well as the addition of CNB's nonperforming assets as a result of the Community National acquisition ($2.9 million). Foreclosed assets inched up $0.1 million to $4.1 million. As a percentage of total loans and OREO, total nonperforming assets jumped by 39 basis points sequentially to 2.22% from 1.83% at the end of the first quarter, but tumbled 76 basis points year over year from 2.98%.

We are maintaining our 2013 diluted EPS estimate at $2.00, an 8% gain over 2012's $1.85, as well as our $2.15 estimate for 2014, also representing a gain of 8% from our 2013 estimate.

A primary driver of profitability for the combined company going forward is the opportunity for substantial cost savings, which QCRH estimates will run at 20% of CNB's cost base, or $2 million annually ($0.5 million per quarter), about 75% of which is expected to be realized in 2013's fourth quarter (about $375,000) and 100% beginning in 2014's second quarter (the full $500,000 per quarter). QCRH expects costs savings to be realized by eliminating duplicate overhead and technology expenses in addition to the sale of four CNB branches in Mason City, Iowa and Austin, Minnesota, totalling about $100 million in assets. In aggregate, QCRH estimates the CNB acquisition will add $0.11-0.13 to 2014 EPS, assuming conversion of the Series E preferred stock.

Our 2013 estimate excludes a couple of items that are part of the acquisition and offer QCRH downside protection, including a $400,000 bump-up in the CNB loan loss reserve and a $1.0 million addition to the litigation reserve at CNB, as well as a pretax $1.8 billion bargain-purchase gain on the CNB acquisition, a $432,000 charge for CNB acquisition costs, and inflated taxes largely due to purchase accounting adjustments. Moreover, an expected $1.5 million gain in 2013's fourth quarter from the sale of four CNB branches in Mason City, Iowa and Austin, Minnesota is also excluded. However, our 2013 EPS estimate includes the $858,000 gain on the sale of the credit card business and the $614,000 of expenses related to the CNB acquisition and the sale of the credit card business, both of which occurred in 2013's first quarter.

Our EPS estimates assume no conversion of the Series E preferred stock. Assuming the Series E preferred stock were converted during 2013's third quarter, our diluted EPS estimates for 2013 and 2014 would be $1.90 and $1.80, respectively.

Below, we discuss second quarter results more fully. Details of our projections are shown at the back of the report. For a full discussion of the CNB acquisition, please see our report dated February 26, 2013.

Net Interest Income

Net interest income rose $1.2 million year over year at $15.7 million, largely due to CNB's $1.2 million contribution. A 17% gain in average interest-earning assets was partly offset by a 17 basis-point decline in the net interest margin to 2.99%. This reflected a 48 basis-point decrease in the yield on average interest-earnings assets to 3.80% that was only partly offset by a 29 basis-point drop in average deposit costs to 0.54% and a 24 basis-point fall in borrowing costs to 2.20%.

The yield on the loan and lease receivables portfolio fell 70 basis points year over year to 4.67%, primarily due to competitive pricing pressures. The shift by local banks into commercial and industrial (C&I) lending away from commercial real estate lending combined with a rush to finance top-quality borrowers has resulted in margin compression. We note that the yield on the securities portfolio dropped only 6 basis points, as QCRH limited the decline in yield on the securities portfolio by increasing the allocation to higher yield residential mortgage-backed and municipal securities, away from lower yield US Agencies, enhancing diversification of the securities portfolio at the same time.

Net interest income was about $50,000 lower than our $15.8 million estimate, as the 2.99% NIM was 6 basis points short of our estimate, while higher growth in average interest-earning assets was $75 million, or 3.5%, higher.

We expect that the addition of CNB's higher margin loan portfolio (a 3.72% NIM in the second quarter) will more than offset future competitive pricing pressures. Moreover, this will be enhanced by the shift in QCRH's balance sheet into higher yield loans, away from lower yield securities. We are using a 3.03% estimate for all of 2013 (down 4 basis points from 3.07% previously) and a 3.00% estimate for 2014. This compares to the 3.10% that was actually posted in 2012.

Noninterest Income

Noninterest income jumped 26% year over year to $5.1 million (and was $0.3 million higher than our estimate due to better-than-expected gains on SBA loan sales). Results were also boosted by a strong 40%-plus increase in trust department fees to $1.2 million (which includes $164,000 from CNB), a 20%-

plus jump in deposit service fees to $1.1 million (including $125,000 from CNB), and a 15% gain in loan sales to $1.0 million. In addition, there was a $0.2 million positive swing in the combined contribution from gains on securities sales plus losses from sales of OREO to a loss of $0.1 million from a loss of $0.3 million in the year-ago quarter.

For 2013, we are maintaining our estimate of noninterest income at $20.1 million, up 21% year over year, but cutting our 2014 estimate for noninterest income by $0.8 million to $20.0 million, relatively flat with 2013. While we expect solid growth in trust department fees and deposit service fees in 2014, reduced contributions from gains on loan sales and other income (primarily due to the absence of one-time gains on the credit card business that occurred in 2013's first quarter) will be revenue drags.

Loan Loss Provision

The loan loss provision rose 45% year over year to $1.5 million (versus our $1.2 million projection), which principally reflected the surprise establishment of reserves related to a few isolated commercial credits at Quad City Bank and Trust Company.

Going forward, our estimate for the loan loss provision for 2013 is $5.1 million, which is up 16% from 2012's $4.4 million, primarily reflecting growth in the QCRH loan portfolio in 2013. We expect a very low level of loss provisions at CNB in 2013 since the loan portfolio was written down to realizable value prior to acquisition, pursuant to purchase accounting rules. In 2014, our initial estimate calls for a 6% increase in the loan loss provision to $5.4 million, mirroring our estimate of growth in the outstanding loans.

Noninterest Expense

Noninterest expense rose 13% year over year to $14.8 million, about the same as our estimate.

Most line items increased year over year, with the largest impacts stemming from an 11% rise in compensation expense to $9.2 million (including $691,000 from CNB), a 16% jump in occupancy and equipment expense to $1.6 million (which includes $131,000 from CNB), and a 28% surge in professional and data processing fees to $1.4 million (including $163,000 from CNB as well as one-time undisclosed costs related to the CNB acquisition).

The Company's efficiency ratio deteriorated moderately, increasing 30 basis points to 71.2% compared to 70.9% in 2012's second quarter.

We expect operating efficiency to worsen in 2013 primarily due to the CNB acquisition, and have estimated an efficiency ratio of 71.2% in full-year 2013, which compares to 70.5% actually reported in 2012. Once all expense cuts related to the CNB acquisition have been implemented in 2014, we estimate a 50 basis-point improvement in the efficiency ratio to 70.7%.

Income Taxes

The Company's effective tax rate was 25.5% in the second quarter (excluding one-time items), compared to 26.0% in the year-ago quarter and our 25.5% estimate. We are raising our estimated effective tax rate for 2013 to 25.5% from 25.1%, and maintaining the 25.5% rate in 2014. This compares to a 25.7% tax rate that was actually posted in 2012.

Noncontrolling Interests

In August 2012, the remaining 20% of m2 Lease Funds, LLC, the Company's leasing subsidiary, was purchased, providing for 100% equity ownership. The transaction was structured in two payments, with the first payment recorded in August 2012, and the final payment scheduled three years later in August 2015. This purchase eliminates about $2.4 million of noncontrolling interests from QCRH's balance sheet and also a $0.2 million quarterly deduction from net income. However, compensation costs will increase by an amount equivalent to the noncontrolling interest deduction. This means that there will be no impact on net income and earnings per share.

Net Income
QCRH posted second quarter net earnings, excluding one-time items, attributable to common shareholders of $2.54 million, or $0.46 per diluted share, up 19% from $2.14 million ($0.44 diluted EPS) reported in the year-ago quarter. This compares to our $2.53 million net income estimate ($0.46 diluted EPS).

Profitability
QCRH posted a 9.1% ROE and 0.58% ROA for the second quarter of 2013, compared to an 8.5% ROE and 0.61% ROA for the second quarter of 2012.

Loans and Asset Quality
Loans advanced $239 million, or 19%, sequentially to $1,531 million during the second quarter, including $191 million from the CNB acquisition and $48 million (up 3.5%) generated internally. This represents the ninth consecutive quarter of loan growth.

Including loans from the CNB acquisition, we estimate that loans will increase 22% year over year to 1,569 million for the combined company. Our initial estimate of loan growth in 2014 is 5%. This compares to year-over-year growth of 7% in 2012.

Nonperforming loans climbed during the quarter by $10.3 million, or a whopping 52%, to $30.0 million, entirely erasing the improvement that occurred during the first quarter. The growth in nonperforming assets was driven by a few specific commercial credits moving to nonaccrual status at existing banks ($7.5 million, about one-half of which is guaranteed by the government through the Small Business Administration), as well as the addition of CNB's nonperforming assets as a result of the Community National acquisition ($2.9 million). Foreclosed assets inched up $0.1 million to $4.1 million. As a percentage of total loans and OREO, total nonperforming assets jumped by 39 basis points sequentially to 2.22% from 1.83% at the end of the first quarter, but tumbled 76 basis points year over year from 2.98%.

We expect asset quality to show improvement in 2013 and 2014 as the Company works though problem assets, with the estimated NPA ratio falling from 2.29% at yearend 2012 to 2.08% by the end of 2013 and 1.85% at yearend 2014.

The loan loss allowance as a percent of nonperforming assets decreased sequentially to 62% at the end of the quarter from 88% at March 31, 2013 and 67% at December 31, 2012. This was the result of a higher loan loss allowance that changed to $21.2 million, or 1.38% of gross loans, from $20.8 million, or 1.61% of gross loans, at March 31, 2013 and $19.9 million, or 1.61% of gross loans at yearend 2012, plus a higher level of problem loans.

The CNB acquisition distorted loan loss reserve ratios as there was no allowance associated with CNB's loans at June 30, 2013 since CNB's loans were recorded at market value. As a result, the Company's allowance to total loans/leases fell to 1.38% from 1.61% at March 31, 2013 and from 1.55% at December 31, 2012. Had CNB's loans remained at their historical carrying value with the related allowance as of the acquisition, the allowance to total loans/leases would have been flat at approximately 1.60%.

Liquidity and Funding
During the second quarter, QCRH increased cash and short-investments by $9 million and increased the securities portfolio by $10 million, as additions from the CNB acquisition were partly offset by securities sales and other liquidations to fund loan growth.

Within the securities porttfolio, there were shifts from the previous quarter. Sequentially, US Agency securities declined 5% to $382 million, or 54% of the total securities portfolio (down from 58% at the end of the first quarter), while municipal securities rose 27% to $141 million, or 20% of the securities portfolio (up from 16% at the end of the first quarter), and residential mortgage-backed securities gained 1% to $177 million, or 25% of total securities (flat with the first quarter).

QCRH intends to reduce its reliance on more expensive wholesale funds, including Federal Home Loan Bank (FHLB) advances, wholesale structured repurchase agreements, and brokered time deposits, replacing these with less expensive core deposits, especially noninterest-bearing demand deposits related to QCBT's correspondent banking business. At June 30, 2013, noninterest-bearing demand deposits represented 29% of total deposits of $1.7 billion (down from 35% at March 31, 2013), while interest-bearing demand deposits were flat at 41%, time deposits were 26% (up from 21% at March 31, 2013), and brokered deposits were 3% (also unchanged). These shifts primarily reflect the changes caused by the CNB acquisition.

Capital Adequacy and Dividends

The Company's capital adequacy ratios deteriorated during the quarter, as growth in risk assets outpaced the increase in common equity following the CNB acquisition. The Tier 1 capital ratio tumbled 78 basis points to 10.82% at the end of 2013's second quarter from 11.60% at March 31, 2013, and the Total capital ratio dropped 84 basis points to 12.20% from 13.04%.

In addition, tangible common equity to tangible assets shed 49 basis points, falling to 3.44% at June 30, 2013, caused by a $13.1 million charge in accumulated other comprehensive due to mark-to-market declines in the bond portfolio, as occurred throughout the industry during the second quarter on rising interest rates. In addition, the CNB acquisition added core deposit intangibles of $3.4 million, doubling QCRH's existing intangibles account and raising the new intangibles total to $6.7 million. These items were partly offset by growth in retained earnings of $3.0 million, $13.0 million of common shares issued for the CNB acquisition, and other positive adjustments of $0.3 million.

As a result, tangible book value per share decreased during the second quarter, by $2.56 per share, falling to $14.48 from $17.04.

On May 3, 2013, QCRH announced its regular semi-annual cash dividend of $0.04 per share paid on July 8, 2013 to stockholders of record on June 21, 2013. We do not expect any increase in the common dividend for the foreseeable future as the Company expects to retain excess earnings to grow tangible common equity and redeem the balance of the SBLF preferred stock ($10 million in 2013, $10 million in 2014, and $10 million in 2015). This, plus the negative $13 million balance in accumulated other comrehensibe income, accounts for the reduction in total tangible equity ratios (including the SBLF preferred stock) in 2013. We expect tangible common equity to rise to 3.53% by the end of 2013 and to 3.76% at yearend 2014, due to growth in retained earnings.

We note that the Company's Series E Preferred Stock is perpetually convertible into shares of common stock at a per share conversion price of $12.15, subject to antidilution adjustments. In addition, QCRH can exercise a conversion option on or after the third anniversary of the issue date (i.e., June 30, 2013) at the same $12.15 conversion price if the Company's common stock price equals or exceeds $17.22 (compared to the current stock price of $15.90) for at least 20 trading days in a period of 30 consecutive trading days. Moreover, QCRH has the right, at any time after the fifth anniversary of the issuance date, to redeem all, but not less than all, of the shares of Series E Preferred Stock, for an amount per share equal to $1,000 plus any declared but unpaid dividends for the then-current dividend period. Assuming conversion of the Series E Preferred, QCRH's tangible common equity to total tangible assets would increase by about 100 basis points on a pro forma basis.

In May 2013, shareholders approved The Amended Rights Agreement, the primary purpose of which is to extend the term of the Original Rights Agreement for an additional three years to May 1, 2016, increase the trigger from 15% to 20% or more of the outstanding common stock, add additional stockholder protections, and amend certain provisions that limit the authority of the board. The Amended Rights Agreement is designed to deter the use of coercive or abusive takeover tactics by parties interested in acquiring the Company without offering fair value to all stockholders. The Rights should not interfere with any merger or other business combination that is in the best interests of the Company and its stockholders because the board may, at its option, subject to certain restrictions, redeem all of the

then outstanding Rights at the Redemption Price. In addition, if the board declines a Qualifying Offer for a merger or business combination, such offer may be presented to the stockholders at a special meeting.

Basel III

The Company feels comfortable with the recent regulatory proposals for Basel III, and believes that its long-term stratgegy of increasing tangible common equity to 6% of tangible assets through conversion of Series E preferred stock into common equity and the long period of implementation will help it meet Basel III proposals. QCRH does not intend to issue any dilutive common equity.

OVERVIEW

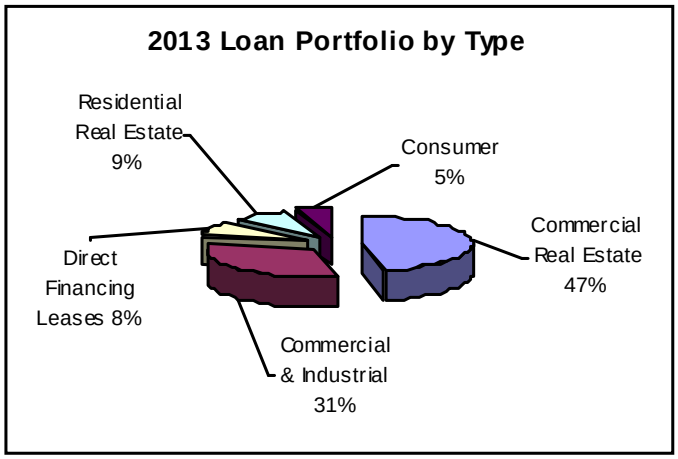
QCR Holdings, Inc. (QCRH or the Company) is a multibank holding company, which was founded in 1993 and is headquartered in Moline, Illinois, with $2.4 billion in total assets at June 30, 2013 and 16 offices. QCRH provides a broad range of business and retail lending products and investment services through four wholly owned, full-service banking subsidiaries that are located in Illinois and Iowa. These subsidiaries include Quad City Bank and Trust Company (QCBT), based in Bettendorf, Iowa; Cedar Rapids Bank and Trust Company (CRBT), based in Cedar Rapids, Iowa; Rockford Bank and Trust Company (RB&T), based in Rockford, Illinois; and Community National Bank (CNB), based in Waterloo, Iowa following the May 2013 acquisition of Parent Community National Bancorporation by QCRH.

By far the largest of these subsidiaries is QCBT, which accounts for $1.2 billion, or approximately 50%, of QCRH's total assets, and is also the oldest of its subsidiaries, having begun operations in January 1994. Its five offices are located in Bettendorf and Davenport, Iowa and Moline, Illinois. CRBT, begun in June 2001, is the next largest with $619 million of total assets, or about 25% of consolidated assets, and two offices in Cedar Rapids. RB&T began operations in September 2004. RB&T has $334 million in total assets, or roughly 14% of QCRH's total assets, and operates through two offices located in Rockford, Illinois. CNB is the final banking subsidiary, having begun operations in 1997. CNB has $277 million in total assets, or roughly 11% of QCRH's total assets, and operates through eight offices located in Waterloo, Iowa (two offices), Cedar Falls, Iowa (two), Mason City, Iowa (two), and Austin, Minnesota (two). The four offices in Mason City and Austin with about $100 million in combined total assets will be sold in 2013's fourth quarter, generating a pretax gain on sale of $1.5 million. Following this, there will be two offices each in Waterloo and Cedar Falls, having a combined total of about $175 million in assets. Ultimately, these offices will be renamed Community Bank and Trust and merged into CRBT, the Cedar Rapids, Iowa banking subsidiary.

In addition, the Company has three non-bank subsidiaries that help manage other aspects of its business. These include: (1) a 100% equity interest in m2 Lease Funds, LLC (m2), which is owned by QCBT and was acquired in August 2005. m2, which is based in Brookfield, Wisconsin and operates through one office, is engaged in the business of leasing machinery and equipment to commercial and industrial clients through full-payout direct financing leases. Accounting for $110 million, or approximately 5%, of total consolidated assets, m2 is a niche player and specializes in the key areas of marine equipment, printing, office technology, machinery/machine tools, and telecom; (2) a 100% ownership interest in Velie Plantation Holding Company, LLC (VPHC), acquired through a series of transactions beginning in 1998. VPHC manages the real estate property known as Velie Plantation Mansion in Moline, Illinois, which serves as the headquarters and Moline branch for QCRH; and (3) a 100% interest in Quad City Investment Advisors, LLC, an investment management business that was acquired in January 2008 and was formerly known as CMG Investment Advisors, LLC.

QCRH has a smaller ownership interest in Nobel Real Estate Investors, LLC (20%), though this does not contribute meaningfully to assets or net income. The Cedar Rapids Mortgage Company, LLC in which QCRH had a 50% interest, was closed in 2013's second quarter.

QCRH has disposed of several operating subsidiaries over the past few years as they did not contribute significantly to earnings and no longer fit into the Company's long-term strategic plans. These include: (1) the sale of the merchant credit card processing business and the liquidation of Quad City Bancard, Inc., a subsidiary that issued credit cards to consumers and businesses, in the third quarter of 2008, for which the Company recorded a $3.0 million aftertax gain; (2) the sale of Second Wisconsin Bank and Trust Company, QCRH's Milwaukee, Wisconsin banking subsidiary, for which the Company posted a $0.5 million aftertax gain on December 31, 2008; and (3) the sale of the $10 million credit card portfolio of QCBT, which was sold at an $0.8 million pretax gain in 2013. In 2008, these were reported as discontinued operations in the Company's financial statements (we have not adjusted prior-year financial data for these changes).

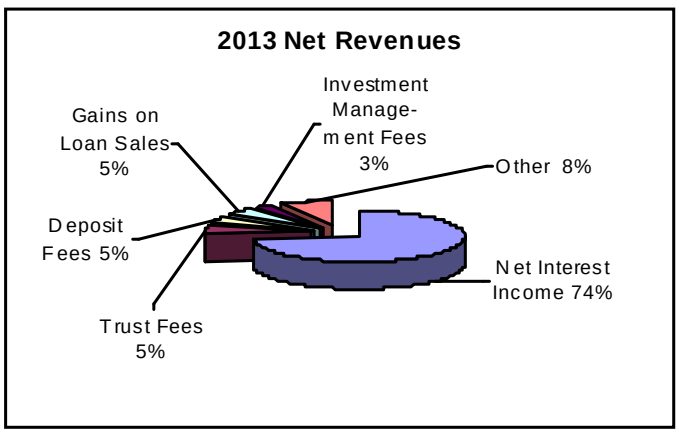


The $1.5 billion loan portfolio has a concentration in commercial real estate, accounting for 47% of total loans at June 30, 2013, of which about 56% is nonowner-occupied, 37% is owner-occupied, and 7% is construction and land development. The rest of the lending book consists of commercial and industrial (accounting for 31% of total gross loans), direct financing leases (8%), residential real estate (9%), and consumer (5%). Most loans are secured, usually by real estate, inventory, accounts receivable, equipment, machinery, or corporate assets.

The liquidity portfolio, consisting of cash, short-term investments, and US agency/residential mortgage-backed securities (RMBS) obligations, represents 27% of total assets, while gross loans and leases account for 63%. Noninterest-bearing demand deposits accounted for 29% of total deposits of $1.7 billion at June 30, 2013, with interest-bearing demand and savings deposits at 41%, time deposits at 26%, and brokered time deposits at 4%.

Through 2013's first half, net interest income contributed 74% of net revenue. Other significant revenue sources include deposit service fees (5% of net revenues), trust department fees (5%), gains on loan sales (5%), investment management and advisory fees (3%), and other (8%).

QCRH also managed $1.3 billion in trust accounts and $569 million in brokerage accounts at June 30, 2013.



The Company 's financial goals over the next thee-five years include: (1) growing tangible common equity to 6% of tangible assets from about 3.9% at the end of 2012 through growth in retained earnings and conversion of the Series E preferred to common equity; (2) funding the redemption of the remaining $30 million in SBLF preferred stock through growth in retained earnings; (3) increasing profitability as measured by the return on average assets (ROA) to the around the 70 basis-point level over the near term and to 100 basis points over the longer term from 62 basis points in 2012, by driving down the efficiency ratio to the 60%-plus area from 70% in 2012; (4) continuing to improve asset quality; (5) continuing to shift the deposit mix toward noninterest-bearing deposits from more expensive retail and wholesale borrowings, thereby expanding the net interest margin; (6) integrating the CNB acquisition as quickly possible so as to maximize cost savings and other efficiencies; (7) boosting SBA/USDA gains on loan sales; (8) growing wealth management income; and (9) improving liquidity in its common stock.

Importantly, QCRH is committed to not diluting existing shareholder interests by issuing common shares at below book value, but would consider a capital raise for accretive acquisitions, as occurred with the recent $19 million stock and cash purchase of Community National Bancorporation.

VALUATION

QCRH stock has risen 20.8% year to date and has outperformed the S&P 500's 16.2% advance by a wide margin, but is just shy of the industry's median price increase of 22.1%, as shown in the following table. Just as important, the stock was up 45.3% in 2012.

At its current price, QCRH is trading at a 44% discount to the industry median P/E, based upon our diluted EPS estimate for 2014.

Turning to Price/Tangible Book Value, QCRH is valued at 1.10X versus the industry median of 1.12X. This represents a 2% discount to the median, about 14 points better than QCRH's historical average. However, we believe a higher valuation is justified as the Company's earnings and profitability prospects are much improved and QCRH has taken a number of steps over the last few years to strengthen its balance sheet. Moreover, the CNB acquisition will provide additional growth opportunities in the future.

Applying the industry 1.12X ratio to estimated book value for QCRH twelve months out results in a price of approximately $18.50. When combined with the dividend yield, this represents a total return of roughly 16%, above our expectations for gains in the broader market index over the next year.

Thus, we are raising our recommendation on QCRH to Buy from Neutral and increasing our twelve-month target price to $18.50 from $17.50.

Industry Comparables- Small-Cap Banks

		Price / Earnings Ratios				Return on Equity		Return on Assets		
	Pr Chg YTD	TTM* EPS	2013E	2014E	Price/ Book	TTM*	5-Yr Avg	TTM*	5-Yr Avg	Div Yld
QCR Holdings	**20.8**	**8.5**	**8.0**	**7.4**	**1.10**	**7.9**	**5.9**	**0.51**	**0.36**	**0.5**
S&P 500	16.2	17.1	15.3	14.4	16.2	24.2	-----	8.5	-----	2.1
Median	**22.1**	**13.0**	**12.9**	**13.1**	**22.1**	**7.6**	**4.0**	**0.79**	**0.36**	**1.2**
Average	28.5	15.8	13.5	14.4	28.5	8.3	1.9	0.8	0.3	1.2
High	91.5	45.8	30.5	41.7	91.5	33.6	14.2	3.9	2.0	4.5
Low	(6.2)	5.7	5.7	7.3	(6.2)	(3.9)	(72.9)	(0.4)	(2.1)	-----

*Trailing twelve months

QCR Holdings, Inc.

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

Summary Financial Data	12/08	12/09	12/10	12/11	12/12	12/13 E	12/14 E
Net interest income	45.0	50.4	49.9	54.1	57.6	64.0	67.9
Non-interest income	13.6	15.6	15.4	17.5	16.7	20.1	20.0
Total net revenue	58.6	66.0	65.3	71.6	74.3	84.1	87.9
Loan loss provision	9.2	17.0	7.5	6.6	4.4	5.1	5.4
Non-interest expense	42.3	46.7	48.5	51.0	52.3	59.8	62.1
Income taxes & other	3.9	4.4	6.8	8.4	8.5	8.0	7.7
Zacks adjusted income before NRI	3.2	(2.1)	2.5	5.6	9.1	11.2	12.7
GAAP net income	4.9	(2.1)	2.5	4.4	9.1	11.9	12.7
Diluted EPS before NRI	0.69	(0.46)	0.53	1.17	1.85	2.00	2.15
Reported EPS	1.06	(0.46)	0.53	0.92	1.85	2.13	2.15
Dividends per share	0.08	0.08	0.08	0.08	0.08	0.08	0.08
Liquid assets	287.8	417.3	546.0	638.5	612.7	656.3	659.0
Loans & leases, gross	1,214.7	1,244.3	1,172.5	1,200.7	1,287.4	1,569.2	1,649.2
Total assets	1,605.6	1,779.6	1,836.6	1,966.6	2,093.7	2,508.3	2,610.2
Core deposits	711.3	761.5	844.2	960.9	1,129.5	1,504.0	1,580.6
Purchased funds	367.6	340.9	307.1	263.6	266.2	305.0	325.0
Long-term debt	310.4	378.8	388.5	358.1	355.0	355.0	350.0
Shareholders' equity	90.6	123.9	130.9	142.4	140.4	139.7	139.0
Profitability							
Return on avg assets	0.32%	0.10%	0.36%	0.51%	0.62%	0.61%	0.59%
Return on avg equity	5.66%	1.43%	5.03%	7.09%	8.90%	9.90%	11.03%
Net interest margin	3.32%	3.15%	2.92%	3.08%	3.10%	3.03%	3.00%
Loan loss provision % avg assets	0.59%	0.98%	0.41%	0.35%	0.22%	0.22%	0.21%
Noninterest income % avg assets	0.88%	0.91%	0.84%	0.92%	0.82%	0.86%	0.78%
Noninterest expense % avg assets	2.73%	2.71%	2.64%	2.67%	2.58%	2.55%	2.43%
Preprovision pretax income % avg assets	1.04%	1.12%	0.91%	1.08%	1.09%	1.03%	1.01%
Tangible efficiency ratio	73%	72%	74%	73%	70%	71%	71%
Payout ratio	8%	(18)%	15%	9%	4%	4%	4%
Asset Quality							
Net charge-offs % avg loans	0.24%	1.00%	0.79%	0.70%	0.27%	0.22%	0.24%
Allowance % loans	1.47%	1.81%	1.74%	1.56%	1.55%	1.65%	1.67%
NPAs % loans & related assets	2.08%	3.22%	4.24%	3.35%	2.29%	2.08%	1.85%
Allowance % NPAs	70%	56%	41%	46%	67%	79%	90%
Liquidity & Funding							
Liquid assets % purchased funds	78%	122%	178%	242%	230%	215%	203%
Core deposits % loans	59%	61%	72%	80%	88%	96%	96%
Liquid assets % assets	18%	23%	30%	32%	29%	26%	25%
Loans % assets	76%	70%	64%	61%	61%	63%	63%
Capital Adequacy							
Total equity % assets	5.64%	6.96%	7.13%	7.24%	6.71%	5.57%	5.32%
Tangible equity % assets	5.46%	6.79%	6.97%	7.09%	6.56%	5.32%	5.08%
Tier 1 capital ratio	8.36%	11.14%	12.12%	12.24%	11.27%		
Total capital ratio	10.39%	12.52%	13.70%	13.84%	12.71%		
Parent Company Statistics							
Interest coverage	3.1X	1.4X	0.7X	2.8X	5.5X	2.0X	2.0X
Interest & dividend coverage	1.8X	0.5X	0.3X	0.8X	1.4X	0.9X	1.0X
Short-term debt coverage	2.0X	N/A	N/A	N/A	N/A	N/A	N/A
Total debt coverage	0.2X	N/A	N/A	N/A	N/A	N/A	N/A
Double leverage	146.1%	133.4%	132.5%	128.9%	130.8%	140.0%	149.9%

QCR Holdings, Inc.

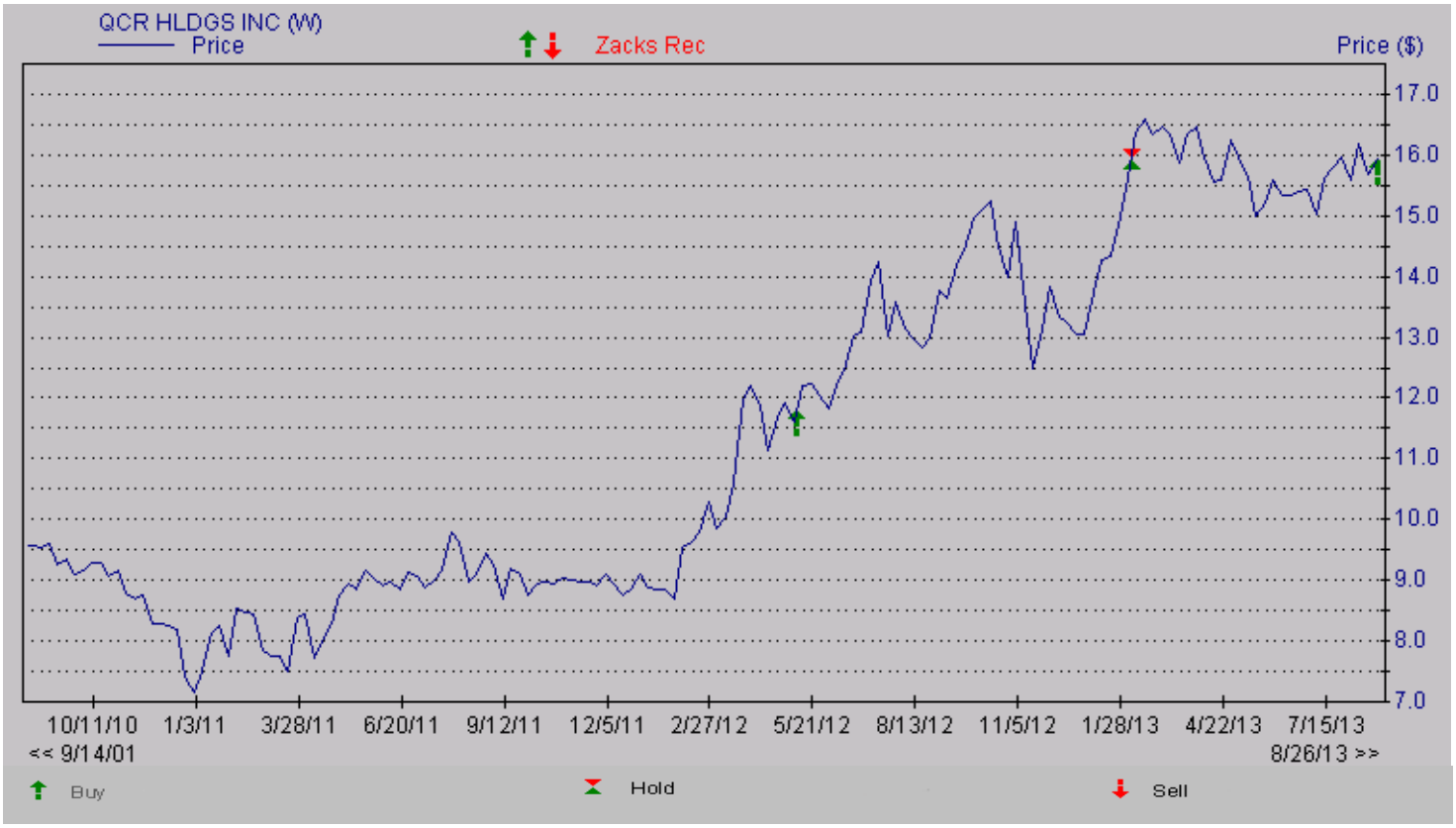
Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2012				2013			
Summary Financial Data	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 A**	**Q3 E**	**Q4 E**
Net interest income	14.2	14.5	14.6	14.3	14.2	15.7	17.0	17.1
Non-interest income	4.0	4.1	4.1	4.5	5.2	5.1	4.9	4.9
Total net revenue	18.2	18.6	18.7	18.8	19.4	20.8	21.9	22.0
Loan loss provision	0.8	1.0	1.5	1.1	1.1	1.5	1.3	1.3
Non-interest expense	12.7	13.1	13.0	13.4	14.0	14.8	15.7	15.3
Income taxes & other	2.4	2.4	2.0	1.9	1.8	2.0	2.1	2.0
Zacks adjusted income before NRI	2.3	2.1	2.2	2.4	2.5	2.5	2.8	3.4
GAAP net income	2.3	2.1	2.2	2.4	2.5	3.2	2.8	3.4
Diluted EPS before NRI	0.48	0.44	0.44	0.49	0.49	0.46	0.48	0.57
Reported EPS	0.48	0.44	0.44	0.49	0.49	0.59	0.48	0.57
Dividends per share	-----	0.04	-----	0.04	-----	0.04	-----	0.04
Liquid assets	625.4	639.1	594.7	612.7	645.7	655.0	655.7	656.3
Loans & leases, gross	1,211.7	1,213.3	1,244.3	1,287.4	1,291.8	1,530.7	1,549.9	1,569.2
Total assets	1,993.0	2,043.4	2,023.9	2,093.7	2,144.0	2,446.8	2,477.4	2,508.3
Core deposits	1,052.2	1,070.9	1,098.7	1,129.5	1,175.9	1,467.1	1,485.5	1,504.0
Purchased funds	266.2	265.2	266.2	266.2	266.2	293.8	295.0	305.0
Long-term debt	354.4	357.5	349.0	355.0	358.0	348.7	355.0	355.0
Shareholders' equity	143.5	136.9	139.0	140.4	142.2	145.4	147.5	139.7
Profitability								
Return on avg assets*	0.65%	0.61%	0.60%	0.63%	0.62%	0.58%	0.59%	0.65%
Return on avg equity *	9.00%	8.54%	8.78%	9.28%	9.25%	9.13%	9.93%	11.27%
Net interest margin	3.09%	3.16%	3.16%	3.02%	3.02%	2.99%	3.05%	3.05%
Loan loss provision % avg assets*	0.16%	0.21%	0.29%	0.22%	0.20%	0.26%	0.20%	0.20%
Noninterest income % avg assets*	0.79%	0.81%	0.81%	0.87%	0.99%	0.88%	0.80%	0.78%
Noninterest expense % avg assets*	2.54%	2.61%	2.57%	2.60%	2.65%	2.55%	2.55%	2.46%
Preprovision pretax inc.% avg assets*	1.08%	1.09%	1.13%	1.05%	1.03%	1.04%	1.00%	1.07%
Tangible efficiency ratio	70%	71%	70%	71%	72%	71%	72%	70%
Payout ratio	-----	9%	-----	8%	-----	7%	-----	7%
Asset Quality								
Net charge-offs % avg loans*	0.19%	0.44%	0.26%	0.17%	0.07%	0.32%	0.26%	0.23%
Allowance % loans	1.57%	1.54%	1.56%	1.55%	1.61%	1.38%	1.38%	1.39%
NPAs % loans & related assets	3.19%	2.98%	2.33%	2.29%	1.83%	2.22%	2.15%	2.08%
Allowance % NPAs	49%	51%	67%	67%	88%	62%	64%	66%
Liquidity & Funding								
Liquid assets % purchased funds	235%	241%	223%	230%	243%	223%	222%	215%
Core deposits % loans	87%	88%	88%	88%	91%	96%	96%	96%
Liquid assets % assets	31%	31%	29%	29%	30%	27%	26%	26%
Loans % assets	61%	59%	61%	61%	60%	63%	63%	63%
Capital Adequacy								
Total equity % assets	7.20%	6.70%	6.87%	6.71%	6.63%	5.94%	5.95%	5.57%
Tangible equity % assets	7.05%	6.55%	6.72%	6.56%	6.49%	5.69%	5.70%	5.32%
Tier 1 capital ratio	12.27%	11.52%	11.52%	11.27%	11.60%	10.82%		
Total capital ratio	13.87%	13.14%	12.98%	12.71%	13.04%	12.20%		

*Annualized.

HISTORICAL ZACKS RECOMMENDATIONS



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