Zacks Small-Cap Research

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QCR Holdings, Inc.

(QCRH-NASDAQ)

QCRH: Third Quarters EPS Beats Our Estimate by $0.03 and Series E Preferred Stock Is Being Converted to Common

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	08/26/2013
Current Price (12/13/13)	$17.60
Twelve- Month Target Price	**$20.25**

OUTLOOK

QCRH reported 2013 third quarter diluted EPS of $0.51, including a couple of offsetting items: a pretax $417,000 gain on the sales of securities and a pretax $389,000 charge for CNB acquisition costs. This beat our $0.48 diluted EPS estimate by $0.03, principally due to an effective tax rate that was about 4 points lower than the 25.5% we had expected, due to adjustments related to tax-exempt municipal securities. We note that results included the CNB acquisition for the full quarter, adding $592,000 to QCRH's bottom line. Compared to the year-ago quarter, the third quarter reflected an 18% gain in net interest income to $17.3 million, mostly due to the CNB acquisition. Results were also boosted by a 44% gain in noninterest income to $5.9 million on the back of a strong 40%-plus jump in trust department fees to $1.3 million (which includes $298,000 from CNB) and in deposit service fees to $1.2 million (including $239,000 from CNB), a 10% increase in investment management & advisory fees to $0.6 million, and a $1.2 million positive swing in the combined contribution from gains on securities sales plus losses from sales of OREO to a gain of $0.4 million from a loss of $0.8 million in the year-ago quarter. While we are increasing our 2013 diluted EPS estimate by $0.03 to $2.03 from $2.00, reflecting the overage in the third quarter, we are reducing our 2014 EPS estimate to $1.80 from $2.15 previously, due solely to the conversion of the Series E preferred stock into 2.1 million common shares, expected to be completed by the end of 2013's fourth quarter. Indeed, our 2014 net earnings estimate of $14.5 million represents a 28% gain over 2013's estimated $11.4 million in net income.

SUMMARY DATA

52-Week High	**$18.10**
52-Week Low	**$13.00**
One-Year Return (%)	**33.19**
Beta	**0.33**
Average Daily Volume (sh)	**6,666**
Shares Outstanding (mil)	**6**
Market Capitalization ($mil)	**$102**
Short Interest Ratio (days)	**0.85**
Institutional Ownership (%)	**14**
Insider Ownership (%)	**17**
Annual Cash Dividend	**$0.08**
Dividend Yield (%)	**0.45**
5-Yr. Historical Growth Rates	
Net Revenue (%)	**8.0**
Earnings Per Share (%)	**12.6**
Dividend (%)	**0.0**
P/E using TTM EPS	**9.0**
P/E using 2013 Estimate	**8.7**
P/E using 2014 Estimate	**9.8**
Zacks Rank	**3**

Risk Level	**Average**
Type of Stock	**Small-Value**
Industry	**Banks-Midwest**
Zacks Rank in Industry	**32 of 37**

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	23.2 A	22.6 E	86.0 E
2014					90.9 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	0.51 A	0.57 E	2.03 E
2014					1.80 E

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

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THIRD QUARTER RESULTS

QCRH reported 2013 third quarter diluted EPS of $0.51, including a couple of offsetting items: a pretax $417,000 gain on the sales of securities and a pretax $389,000 charge for CNB acquisition costs. This beat our $0.48 diluted EPS estimate by $0.03, principally due to an effective tax rate that was about 4 points lower than the 25.5% we had expected, due to adjustments related to tax-exempt municipal securities.

We note that results included the CNB acquisition for the full quarter, adding $592,000 to QCRH's bottom line. 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 third quarter reflected an 18% gain in net interest income to $17.3 million, mostly due to the CNB acquisition, which added $2.8 million of net interest income during the quarter, including $592,000 of net accretion on market value adjustments upon acquisition.

Results were also boosted by a 44% gain in noninterest income to $5.9 million on the back of a strong 40%-plus jump in trust department fees to $1.3 million (which includes $298,000 from CNB) and in deposit service fees to $1.2 million (including $239,000 from CNB), a 10% increase in investment management & advisory fees to $0.6 million, and a $1.2 million positive swing in the combined contribution from gains on securities sales plus losses from sales of OREO to a gain of $0.4 million from a loss of $0.8 million in the year-ago quarter.

These were partly offset by a 20% rise in compensation expense to $9.8 million (including $1.3 million from CNB), a 31% jump in occupancy and equipment expense to $1.9 million (including $253,000 from CNB), a 79% surge in professional and data processing fees to $1.9 million (including about $400,000 from legal fees related to resolution of a longstanding legal matter), and a 157% increase in other expense (including $389,000 in CNB acquisition costs).

The loan loss provision declined 8% year over year to $1.4 million.

Fully diluted EPS was hurt by the issuance of 835,715 shares for the CNB acquisition, with average fully diluted shares increasing 17% to 5.9 million shares from 5.1 million shares a year ago.

While nonperforming loans fell during the quarter by $5.0 million, or 17 %, to $24.9 million, this largely reflected the transfer of nonperforming loans into other real estate owned. Foreclosed assets, which includes $8.5 million of OREO, more than doubled to $8.8 million. As a percentage of total loans and OREO, total nonperforming assets slid by 4 basis points sequentially to 2.18% from 2.22% at the end of the second quarter, and tumbled 15 basis points year over year from 2.33%.

We are increasing our 2013 diluted EPS estimate by $0.03 to $2.03 from $2.00, reflecting the overage in the third quarter. This represents an 8% gain over 2012's $1.85.

We are reducing our 2014 EPS estimate to $1.80 from $2.15 previously, due solely to the conversion of the Series E preferred stock into 2.1 million common shares, expected to be completed by the end of 2013's fourth quarter. Indeed, our 2014 net earnings estimate of $14.5 million represents a 28% gain over 2013's estimated $11.4 million in net income.

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 $1.6-2.0 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, as well as the third quarter's pretax $417,000 gain on the sales of securities and offsetting pretax $389,000 charge for CNB acquisition costs.

Below, we discuss third 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 $3.0 million year over year to $17.3 million, largely due to CNB's $2.8 million contribution. A 21% gain in average interest-earning assets was partly offset by a 9 basis-point decline in the net interest margin to 3.07%. This reflected a 34 basis-point decrease in the yield on average interest-earnings assets to 3.87% that was only partly offset by a 19 basis-point drop in average deposit costs to 0.54% and a 3 basis-point fall in borrowing costs to 2.45%.

The yield on the loan and lease receivables portfolio fell 41 basis points year over year to 4.78%, 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 28 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 $0.4 million better than our $16.9 million estimate, as the 3.07% NIM was 2 basis points over our 3.05% estimate, aided by growth in average interest-earning assets that was $107 million, or 5%, higher.

We expect that the addition of CNB's higher margin loan portfolio will partly 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 (the same as before) and a 3.02% estimate for 2014 (up from 3.00% before). This compares to the 3.10% that was actually posted in 2012.

Noninterest Income

Results were also boosted by a strong a 44% gain in noninterest income to $5.9 million (versus our $4.9 million estimate) on the back of a strong 40%-plus jump in trust department fees to $1.3 million (which includes $298,000 from CNB) and in deposit service fees to $1.2 million (including $239,000 from CNB), a 10% increase in investment management & advisory fees to $0.6 million, and a $1.2 million positive swing in the combined contribution from gains on securities sales plus losses from sales of OREO to a gain of $0.4 million from a loss of $0.8 million in the year-ago quarter.

For 2013, we are increasing our estimate of noninterest income to $21.4 million from $20.1 million, up 29% year over year, as well as our 2014 estimate for noninterest income by $0.7 million to $20.7 million from $20.0 million, down about 3% from 2013. While we expect solid growth in trust department fees and

deposit service fees in 2014, reduced contributions from gains on loan and securities 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 declined 8% year over year to $1.4 million (versus our $1.3 million projection).

Going forward, our estimate for the loan loss provision for 2013 remains $5.1 million, which is up 18% 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 $4.0 million, or 31%, year over year to $17.0 million, $1.3 million more than our $15.7 million estimate, as certain expense items were higher than expected. Specifically, occupancy & equipment expense of $1.9 million was $0.2 million greater than our estimate, professional & data processing fees were $0.5 million larger (principally due to 400,000 of legal fees related to resolution of a longstanding legal matter), and other expense was $0.6 million more (mainly due to $389,000 in CNB acquisition costs).

Most line items increased year over year, with the largest impacts stemming from a 20% rise in compensation expense to $9.8 million (including $1.3 million from CNB), a 31% jump in occupancy and equipment expense to $1.9 million (including $253,000 from CNB), a 79% surge in professional and data processing fees to $1.9 million (including about $400,000 from legal fees related to resolution of a longstanding legal matter), and a 157% increase in other expense (including $389,000 in CNB acquisition costs).

The Company's efficiency ratio deteriorated, increasing 510 basis points to 74.6% compared to 69.5% in 2012's third quarter.

We expect operating efficiency to worsen in 2013 primarily due to the CNB acquisition, and have estimated an efficiency ratio of 72.0% in full-year 2013, which compares to 70.5% actually reported in 2012. Our estimate in 2014 is also 72.0%.

Income Taxes

The Company's effective tax rate was 21.4% in the third quarter, compared to 24.5% in the year-ago quarter and our 25.5% estimate, adding about $0.2 million, or $0.03, to the bottom line. We are lowering our estimated effective tax rate for 2013 to 24.3% from 25.5% and to 25.0% from 25.5% 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 third quarter net earnings attributable to common shareholders of $3.0 million, or $0.51 per diluted share, up 34% from $2.2 million ($0.44 diluted EPS) reported in the year-ago quarter. This compares to our $2.8 million net income estimate ($0.48 diluted EPS).

Profitability

QCRH posted a 10.4% ROE and 0.62% ROA for the third quarter of 2013, compared to an 8.8% ROE and 0.60% ROA for the third quarter of 2012.

Loans and Asset Quality

Loans advanced $9 million, or 1%, sequentially to $1,535 million during the third quarter. This represents the tenth consecutive quarter of loan growth.

Including loans from the CNB acquisition, we estimate that loans will increase 21% year over year to 1,559 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.

While nonperforming loans fell during the quarter by $5.0 million, or 17 %, to $24.9 million, this largely reflected the transfer of nonperforming loans into other real estate owned. Foreclosed assets, which includes $8.5 million of OREO, more than doubled to $8.8 million. As a percentage of total loans and OREO, total nonperforming assets slid by 4 basis points sequentially to 2.18% from 2.22% at the end of the second quarter, and tumbled 15 basis points year over year from 2.33%.

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 2.07% by the end of 2013 and 1.73% at yearend 2014.

The loan loss allowance as a percent of nonperforming assets increased sequentially to 66% at the end of the quarter from 62% at June 30, 2013, but fell slighly from 67% at December 31, 2012. This was the result of a higher loan loss allowance that increased to $22.1 million, or 1.43% of gross loans, from $21.2 million, or 1.38% of gross, at June 30, 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 acquisition since CNB's loans were recorded at market value. As a result, the Company's allowance to total loans/leases fell to 1.43% at September 30, 2013 from 1.61% at March 31, 2013 and from 1.55% at December 31, 2012, though improved from 1.38% at June 30, 2013.

Liquidity and Funding

During the third quarter, QCRH increased cash and short-investments by $27 million to $123 million, while the securities portfolio was flat at $704 million.

Within the securities portfolio, there were shifts from the previous quarter. Sequentially, US Agency securities declined 4% to $368 million, or 52% of the total securities portfolio (down from 54% at the end of the second quarter), while municipal securities rose 18% to $167 million, or 24% of the securities portfolio (up from 20% at the end of the second quarter), and residential mortgage-backed securities slid 6% to $167 million, or 24% of total securities (26% at the end of the second 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 September 30, 2013, noninterest-bearing demand deposits represented 30% of total deposits of $1.7 billion (up from 29% at June 30, 2013), while interest-bearing demand deposits were rose to 45% (up from 41% at June 30, 2013), time deposits were 22% (down from 26% at June 30, 2013), and brokered deposits were 3% (flat with June 30, 2013).

Capital Adequacy and Dividends

The Company’s capital adequacy ratios improved modestly during the quarter. The Tier 1 capital ratio inched up 2 basis points to 10.84% at the end of 2013’s third quarter from 10.82% at June 30, 2013, and the Total capital ratio gained 5 basis points to 12.25% from 12.20%.

In addition, tangible common equity to tangible assets edged up 5 basis points, rising to to 3.49% at September 30, 2013, largely due to $3.0 million growth in retained earnings, an $0.8 million loss in accumulated other comprehensive to a negative $10.0 million, and other positive adjustments of $0.3 million, all of which were parly offset by frowth in tanible assets of $39 million

As a result, tangible book value per share increased during the third quarter, by $0.41 per share, rising to $14.89 from $14.48.

On November 8, 2013, QCRH announced its regular semi-annual cash dividend of $0.04 per share payable on January 7, 2014 to stockholders of record on December 20, 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 2014's first quarter, and the $20 million balance in 2014's second quarter 2014).

On November 21, 2013, QCRH announced that its Board of Directors approved the conversion of all 25,000 outstanding shares of the Company's Series E Non-Cumulative Convertible Perpetual Preferred Stock into shares of the Company's common stock, effective on December 23, 2013. As a result, approximately 2.1 million shares of common stock will be issued. This transaction will increase tangible common equity by approximately 100 basis points and will eliminate $1.75 million in annual preferred stock dividends.

Consequently, we expect tangible common equity to rise to about 4.50% of tangible assets by the end of 2013 from 3.49% at September 30, 2013 and to 4.87% at yearend 2014, due to growth in retained earnings.

The total tangible equity ratio is estimated to drop to 5.73% of total tangible assets at yearend 2013 from 6.56% at the end of 2012, reflecting negative changes in accumulated other comprehensive income due to mark-to-market declines in the bond portfolio, as occurred throughout the industry during 2013's second and third quarters on rising interest rates. In 2014, the total tangible equity ratio is estimated to decline to 4.87% of total tangible assets at yearend 2014 from 5.73% at the end of 2013, following the full $30 million redemption of the SBLF preferred stock by mid 2014.

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

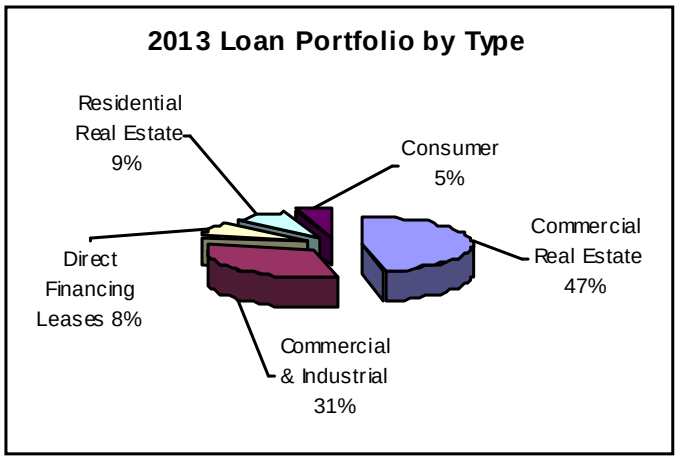
QCR Holdings, Inc. (QCRH or the Company) is a multibank holding company, which was founded in 1993 and is headquartered in Moline, Illinois, with $2.5 billion in total assets at September 30, 2013 and 14 offices. QCRH provides a broad range of business and retail lending products and investment services 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 $1.25 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 $651 million of total assets, or about 26% 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 13% 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 $276 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 were sold in early in 2013's fourth quarter, generating an aftertax gain on sale of $1.6-2.0 million. Following this, there were two offices each in Waterloo and Cedar Falls, having a combined total of about $175 million in assets. These offices were renamed Community Bank and Trust and merged into CRBT, the Cedar Rapids, Iowa banking subsidiary, in late October 2013.

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).

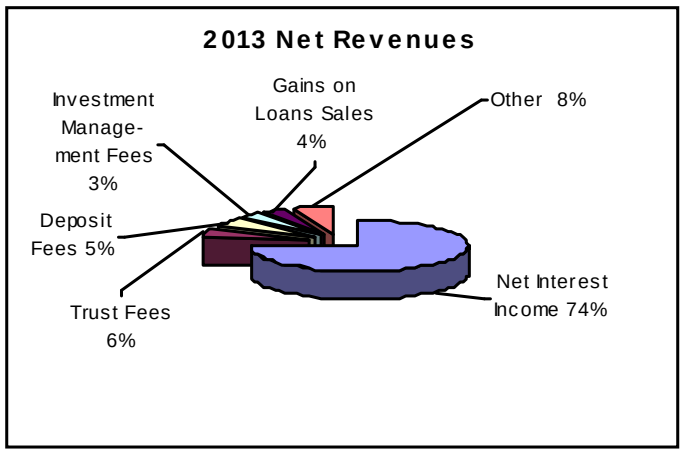


The $1.5 billion loan portfolio has a concentration in commercial real estate, accounting for 47% of total loans at September 30, 2013, of which about 56% is nonowner-occupied, 37% is owner-occupied, and 7% is construction and land development. The rest of the lending book consists of commercial and 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 26% of total assets, while gross loans and leases account for 62%. Noninterest-bearing demand deposits accounted for 30% of total deposits of $1.7 billion at September 30, 2013, with interest-bearing demand and savings deposits at 45%, time deposits at 22%, and brokered time deposits at 3%.

Through 2013's first nine months, net interest income contributed 74% of net revenue. Other significant revenue sources include trust department fees (6%), deposit service fees (5% of net revenues), gains on loan sales (4%), investment management and advisory fees (3%), and other (8%).

QCRH also managed $1.55 billion in trust accounts and $593 million in brokerage accounts at September 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 33.1% year to date and has outperformed the S&P 500's 24.5% advance by a wide margin, but is just shy of the industry's median price increase of 34.3%, 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 26% discount to the industry median P/E, based upon our diluted EPS estimate for 2014. This is 16 points worse than the five-year average historical discount of 10%. Applying the 10% historical average discount to our 2014 EPS estimate results in a price of roughly $21.50

Turning to Price/Tangible Book Value, QCRH is valued at 1.18X versus the industry median of 1.18X. While this is on par with the industry median, it is also 16 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 1.18X ratio to estimated book value for QCRH twelve months out results in a price of approximately $19.00.

Taking the midpoint of these two valuation measures results in a price of $20.25, compared to the current stock price of $17.60. When price appreciation of 15% is combined with the dividend yield, this represents a total return of almost 16%, above our expectations for gains in the broader market index over the next year.

Accordingly, we are maintaining our Buy recommendation on QCRH and increasing our twelve-month target price to $20.25 from $18.50.

Industry Comparables- Small-Cap Banks

		Price / Earnings Ratios					Return on Equity		Return on Assets		
	Pr Chg YTD	TTM* EPS	2013E	2014E	5-Yr Avg	Price/ Book	TTM*	5-Yr Avg	TTM*	5-Yr Avg	Div Yld
QCR Holdings	**33.1**	**9.0**	**8.7**	**9.8**	**14.8**	**1.18**	**10.0**	**6.2**	**0.63**	**0.39**	**0.5**
S&P 500	24.5	18.1	16.3	15.2	16.7	5.0	25.5	-----	8.4	-----	2.0
Median	**34.3**	**14.3**	**13.5**	**13.2**	**16.5**	**1.18**	**8.8**	**4.3**	**0.85**	**0.41**	**1.2**
Average	36.1	18.1	14.4	15.2	24.5	1.1	8.9	2.1	0.9	0.3	1.3
High	105.1	153.5	28.0	45.5	98.5	2.0	31.0	14.3	3.8	2.0	4.4
Low	(16.5)	4.8	4.9	7.1	6.4	0.6	(7.0)	(71.6)	(0.8)	(2.0)	-----

*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	64.6	70.2
Non-interest income	13.6	15.6	15.4	17.5	16.7	21.4	20.7
Total net revenue	58.6	66.0	65.3	71.6	74.3	86.0	90.9
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	61.6	65.4
Income taxes & other	3.9	4.4	6.8	8.4	8.5	7.9	5.6
Zacks adjusted income before NRI	3.2	(2.1)	2.5	5.6	9.1	11.4	14.5
GAAP net income	4.9	(2.1)	2.5	4.4	9.1	12.1	14.5
Diluted EPS before NRI	0.69	(0.46)	0.53	1.17	1.85	2.03	1.80
Reported EPS	1.06	(0.46)	0.53	0.92	1.85	2.16	1.80
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	657.5	660.1
Loans & leases, gross	1,214.7	1,244.3	1,172.5	1,200.7	1,287.4	1,558.6	1,638.0
Total assets	1,605.6	1,779.6	1,836.6	1,966.6	2,093.7	2,516.8	2,619.0
Core deposits	711.3	761.5	844.2	960.9	1,129.5	1,510.8	1,587.8
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	150.4	133.9
Profitability							
Return on avg assets	0.32%	0.10%	0.36%	0.51%	0.62%	0.62%	0.59%
Return on avg equity	5.66%	1.43%	5.03%	7.09%	8.90%	10.02%	11.09%
Net interest margin	3.32%	3.15%	2.92%	3.08%	3.10%	3.03%	3.02%
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%	0.91%	0.81%
Noninterest expense % avg assets	2.73%	2.71%	2.64%	2.67%	2.58%	2.62%	2.55%
Preprovision pretax income % avg assets	1.04%	1.12%	0.91%	1.08%	1.09%	1.04%	0.99%
Tangible efficiency ratio	73%	72%	74%	73%	70%	72%	72%
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%	0.19%	0.24%
Allowance % loans	1.47%	1.81%	1.74%	1.56%	1.55%	1.43%	1.47%
NPAs % loans & related assets	2.08%	3.22%	4.24%	3.35%	2.29%	2.07%	1.73%
Allowance % NPAs	70%	56%	41%	46%	67%	69%	84%
Liquidity & Funding							
Liquid assets % purchased funds	78%	122%	178%	242%	230%	216%	203%
Core deposits % loans	59%	61%	72%	80%	88%	97%	97%
Liquid assets % assets	18%	23%	30%	32%	29%	26%	25%
Loans % assets	76%	70%	64%	61%	61%	62%	63%
Capital Adequacy							
Total equity % assets	5.64%	6.96%	7.13%	7.24%	6.71%	5.97%	5.11%
Tangible equity % assets	5.46%	6.79%	6.97%	7.09%	6.56%	5.73%	4.87%
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	1.4X
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%	130.2%	157.1%

QCR Holdings, Inc.

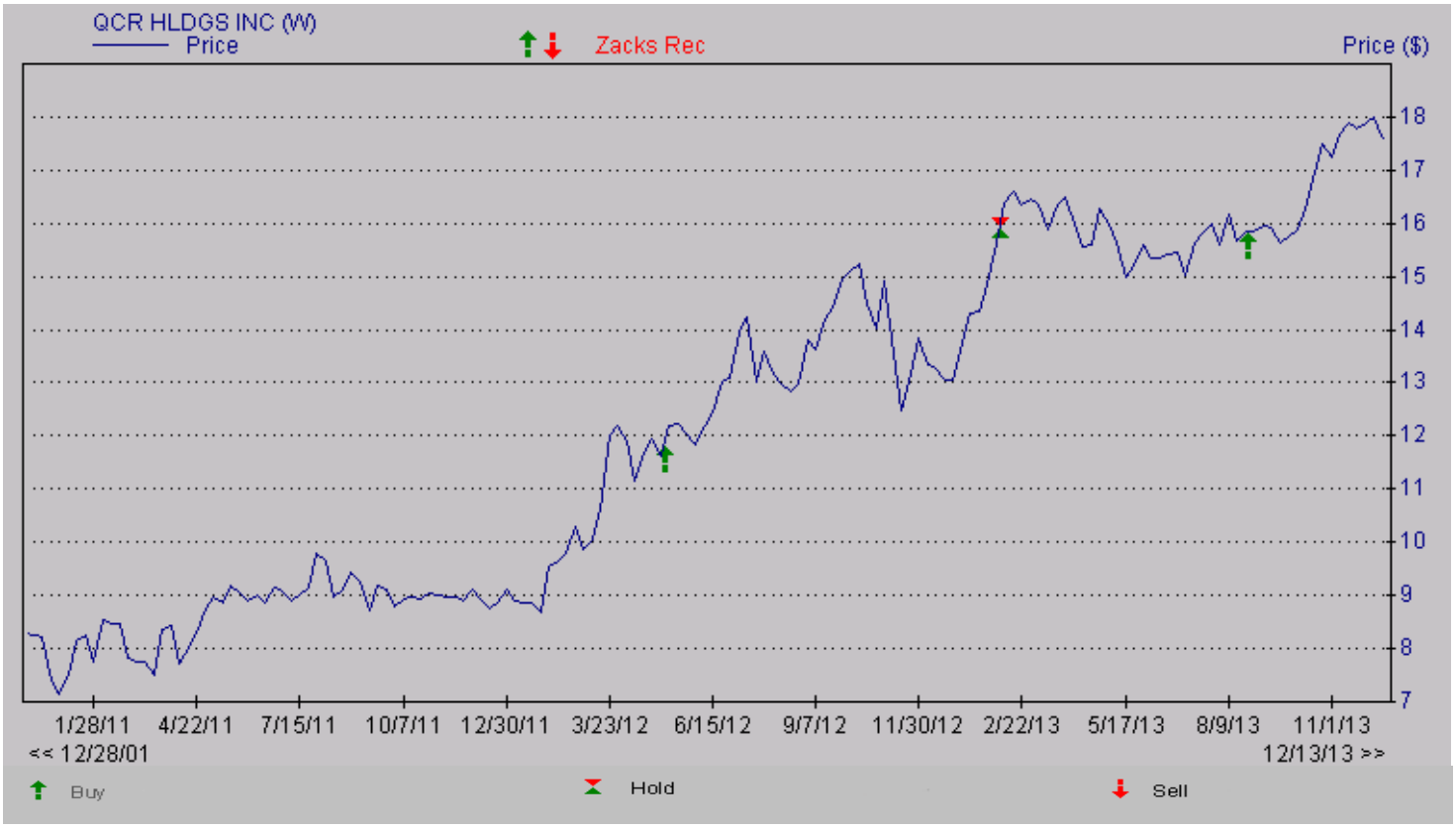
Income Statement and Balance Sheet

(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 A**	**Q4 E**
Net interest income	14.2	14.5	14.6	14.3	14.2	15.7	17.3	17.4
Non-interest income	4.0	4.1	4.1	4.5	5.2	5.1	5.9	5.2
Total net revenue	18.2	18.6	18.7	18.8	19.4	20.8	23.2	22.6
Loan loss provision	0.8	1.0	1.5	1.1	1.1	1.5	1.4	1.2
Non-interest expense	12.7	13.1	13.0	13.4	14.0	14.8	17.0	15.8
Income taxes & other	2.4	2.4	2.0	1.9	1.8	2.0	1.8	2.2
Zacks adjusted income before NRI	2.3	2.1	2.2	2.4	2.5	2.5	3.0	3.4
GAAP net income	2.3	2.1	2.2	2.4	2.5	3.2	3.0	3.4
Diluted EPS before NRI	0.48	0.44	0.44	0.49	0.49	0.46	0.51	0.57
Reported EPS	0.48	0.44	0.44	0.49	0.49	0.59	0.51	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	656.8	657.5
Loans & leases, gross	1,211.7	1,213.3	1,244.3	1,287.4	1,291.8	1,530.7	1,539.4	1,558.6
Total assets	1,993.0	2,043.4	2,023.9	2,093.7	2,144.0	2,446.8	2,485.7	2,516.8
Core deposits	1,052.2	1,070.9	1,098.7	1,129.5	1,175.9	1,467.1	1,492.2	1,510.8
Purchased funds	266.2	265.2	266.2	266.2	266.2	293.8	268.2	305.0
Long-term debt	354.4	357.5	349.0	355.0	358.0	348.7	369.8	355.0
Shareholders' equity	143.5	136.9	139.0	140.4	142.2	145.4	148.0	150.4
Profitability								
Return on avg assets*	0.65%	0.61%	0.60%	0.63%	0.62%	0.58%	0.62%	0.67%
Return on avg equity *	9.00%	8.54%	8.78%	9.28%	9.25%	9.13%	10.44%	11.21%
Net interest margin	3.09%	3.16%	3.16%	3.02%	3.02%	2.99%	3.07%	3.05%
Loan loss provision % avg assets*	0.16%	0.21%	0.29%	0.22%	0.20%	0.26%	0.22%	0.19%
Noninterest income % avg assets*	0.79%	0.81%	0.81%	0.87%	0.99%	0.88%	0.97%	0.83%
Noninterest expense % avg assets*	2.54%	2.61%	2.57%	2.60%	2.65%	2.55%	2.77%	2.53%
Preprovision pretax inc.% avg assets*	1.08%	1.09%	1.13%	1.05%	1.03%	1.04%	1.01%	1.08%
Tangible efficiency ratio	70%	71%	70%	71%	72%	71%	75%	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%	0.12%	0.23%
Allowance % loans	1.57%	1.54%	1.56%	1.55%	1.61%	1.38%	1.43%	1.43%
NPAs % loans & related assets	3.19%	2.98%	2.33%	2.29%	1.83%	2.22%	2.18%	1.81%
Allowance % NPAs	49%	51%	67%	67%	88%	62%	66%	79%
Liquidity & Funding								
Liquid assets % purchased funds	235%	241%	223%	230%	243%	223%	245%	216%
Core deposits % loans	87%	88%	88%	88%	91%	96%	97%	97%
Liquid assets % assets	31%	31%	29%	29%	30%	27%	26%	26%
Loans % assets	61%	59%	61%	61%	60%	63%	62%	62%
Capital Adequacy								
Total equity % assets	7.20%	6.70%	6.87%	6.71%	6.63%	5.94%	5.95%	5.97%
Tangible equity % assets	7.05%	6.55%	6.72%	6.56%	6.49%	5.69%	5.70%	5.73%
Tier 1 capital ratio	12.27%	11.52%	11.52%	11.27%	11.60%	10.82%	10.84%	
Total capital ratio	13.87%	13.14%	12.98%	12.71%	13.04%	12.20%	12.25%	

*Annualized.

HISTORICAL ZACKS RECOMMENDATIONS



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