QCR HOLDINGS INC
Form 10-K
March 06, 2009

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U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008.
Commission file number: 0-22208
QCR HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Delaware	42-1397595
(State of incorporation)	(I.R.S. Employer Identification No.)

3551 Seventh Street, Moline, Illinois 61265
(Address of principal executive offices)
(309) 736-3580
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Exchange Act:
Common stock, $1.00 Par Value The NASDAQ Capital Market
Securities registered pursuant to Section 12(g) of the Exchange Act:
Preferred Share Purchase Rights

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No þ
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 past 90 days. Yes þ No o
Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.
Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company þ
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ
The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the last sales price quoted on The NASDAQ Capital Market on June 30, 2008, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $52,355,814.
As of February 27, 2009, the Registrant had outstanding 4,531,366 shares of common stock, $1.00 par value per share.

Documents incorporated by reference:
Part III of Form 10-K Proxy statement for annual meeting of stockholders to be held in May 2009.

QCR HOLDINGS, INC. AND SUBSIDIARIES

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Part I

Item 1. Business

General. QCR Holdings, Inc. (the Company) is a multi-bank holding company headquartered in Moline, Illinois that was formed in February 1993 under the laws of the state of Delaware. The Company serves the Quad City, Cedar Rapids, and Rockford communities through the following three wholly-owned banking subsidiaries, which provide full-service commercial and consumer banking and trust and asset management services:

Quad City Bank and Trust Company (Quad City Bank & Trust), which is based in Bettendorf, Iowa and commenced operations in 1994;

Cedar Rapids Bank and Trust Company (Cedar Rapids Bank & Trust), which is based in Cedar Rapids, Iowa and commenced operations in 2001; and

Rockford Bank and Trust Company (Rockford Bank & Trust), which is based in Rockford, Illinois and commenced operations in 2005.

The Company also engages in cardholder credit card processing through its wholly-owned subsidiary, Quad City Bancard, Inc. (Bancard), based in Moline, Illinois, in direct financing lease contracts through its 80% equity investment in m2 Lease Funds, LLC (m2 Lease Funds), based in Brookfield, Wisconsin, and in real estate holdings through its 57% equity investment in Velie Plantation Holding Company, LLC (Velie Plantation Holding Company), based in Moline, Illinois.

During the year, Bancard sold its merchant credit card acquiring business. The resulting gain on sale, net of taxes and related expenses, was approximately $3.0 million. The current and comparative financial results associated with the merchant credit card acquiring business have been reflected as discontinued operations throughout the annual report.

On December 31, 2008, the Company sold its Milwaukee subsidiary, First Wisconsin Bank and Trust Company (First Wisconsin Bank & Trust), for $13.7 million which resulted in a pre-tax gain on sale of approximately $495,000. The current and comparative financial results associated with First Wisconsin Bank & Trust have been reflected as discontinued operations throughout the annual report.

Subsidiary Banks. Quad City Bank & Trust was capitalized on October 13, 1993 and commenced operations on January 7, 1994. Quad City Bank & Trust is an Iowa-chartered commercial bank that is a member of the Federal Reserve System with depository accounts insured by the Federal Deposit Insurance Corporation (the FDIC) to the maximum amount permitted by law. Quad City Bank & Trust provides full service commercial and consumer banking and trust and asset management services in the Quad Cities and adjacent communities through its five offices that are located in Bettendorf and Davenport, Iowa and in Moline, Illinois. Quad City Bank & Trust had total segment assets of $908.6 million and $860.7 million as of December 31, 2008 and 2007, respectively. See Financial Statement Note 21 for additional business segment information.

Cedar Rapids Bank & Trust is an Iowa-chartered commercial bank that is a member of the Federal Reserve System with depository accounts insured by the FDIC to the maximum amount permitted by law. The Company commenced operations in Cedar Rapids in June 2001 operating as a branch of Quad City Bank & Trust. The Cedar Rapids branch operation then began functioning under the Cedar Rapids Bank & Trust charter in September 2001. Cedar Rapids Bank & Trust provides full-service commercial and consumer banking and trust and asset management services to Cedar Rapids, Iowa and adjacent communities through its two facilities. The headquarters for Cedar Rapids Bank & Trust is located in downtown Cedar Rapids, and its first branch location is located in northern Cedar Rapids. Cedar Rapids Bank & Trust had total segment assets of $468.3 million and $383.9 million as of December 31, 2008 and 2007, respectively. See Financial Statement Note 21 for additional business segment information.

Rockford Bank & Trust is an Illinois-chartered commercial bank that is a member of the Federal Reserve System with depository accounts insured by the FDIC to the maximum amount permitted by law. The Company commenced operations in Rockford, Illinois in September 2004 operating as a branch of Quad City Bank & Trust, and that operation began functioning under the Rockford Bank & Trust charter in January 2005. It provides full-service commercial and consumer banking and trust and asset management services to Rockford and adjacent communities through its original office located in downtown Rockford and its branch facility located on Guilford Road at Alpine Road in Rockford. Rockford Bank & Trust had total segment assets of $228.0 million and $157.8 million as of December 31, 2008 and 2007, respectively. See Financial Statement Note 21 for additional business segment information.

Operating Subsidiaries. Bancard was capitalized in April 1995 as a Delaware corporation that provided merchant and cardholder credit card processing services. Bancard currently provides credit card processing for cardholders of the Company s three subsidiary banks and 128 agent banks.

On August 26, 2005, Quad City Bank & Trust acquired 80% of the membership units of m2 Lease Funds. John Engelbrecht, the President and Chief Executive Officer of m2 Lease Funds, retained 20% of the membership units. m2 Lease Funds, which is based in Brookfield, Wisconsin, is engaged in the business of leasing machinery and equipment to commercial and industrial businesses under direct financing lease contracts.

Since 1998, the Company had held a 20% equity investment in Velie Plantation Holding Company. In 2006, the Company acquired an additional 37% of the membership units bringing its total investment to 57% in aggregate. Velie Plantation Holding Company is engaged in holding the real estate property known as the Velie Plantation Mansion in Moline, Illinois.

On January 1, 2008, Quad City Bank & Trust acquired 100% of the membership units of CMG Investment Advisors, LLC, which is an investment management and advisory company.

Trust Preferred Subsidiaries. Following is a listing of the Company s non-consolidated subsidiaries formed for the issuance of trust preferred securities, including pertinent information as of December 31, 2008 and 2007:

Name	Date Issued	Amount Issued	Interest Rate	Interest Rate as of 12/31/08	Interest Rate as of 12/31/07
QCR Holdings Statutory Trust II	February 2004	$ 12,372,000	6.93%*	6.93%	6.93%
QCR Holdings Statutory Trust III	February 2004	8,248,000	2.85% over 3-month LIBOR	6.61%	8.08%
QCR Holdings Statutory Trust IV	May 2005	5,155,000	1.80% over 3-month LIBOR	6.62%	7.04%
QCR Holdings Statutory Trust V	February 2006	10,310,000	6.62%**	6.62%	6.62%

* Rate is fixed until March 31, 2011, then becomes variable based on 3-month

LIBOR plus 2.85%, reset quarterly.

** Rate is fixed until April 7, 2011, then becomes variable based on 3-month LIBOR plus 1.55%, reset quarterly.

Securities issued by Trust II mature in thirty years, but are callable at par anytime after seven years from issuance. Securities issued by Trust III, Trust IV, and Trust V mature in thirty years, but are callable at par anytime after five years from issuance.

Other Ownership Interests. The Company invests limited amounts of its capital in stocks of financial institutions and mutual funds. In addition to its wholly-owned and majority-owned subsidiaries, the Company owns a 20% equity position in Nobel Real Estate Investors, LLC (Nobel Real Estate). In July 2007, the Company sold its 20% equity interest in Nobel Electronic Transfer, LLC (Nobel) to TriSource Solutions, LLC (TriSource) in exchange for $500 thousand in cash and a 2.25% equity interest in TriSource, which it continues to own. In June 2005, Cedar Rapids Bank & Trust entered into a joint venture as a 50% owner of Cedar Rapids Mortgage Company, LLC (Cedar Rapids Mortgage Company).

The Company and its subsidiaries collectively employed 345 full-time equivalents at December 31, 2008.

Business. The Company s principal business consists of attracting deposits and investing those deposits in loans/leases and securities. The deposits of the subsidiary banks are insured to the maximum amount allowable by the FDIC. The Company s results of operations are dependent primarily on net interest income, which is the difference between the interest earned on its loans/leases and securities and the interest paid on deposits and borrowings. The Company s operating results are affected by economic and competitive conditions, particularly changes in interest rates, government policies and actions of regulatory authorities, as described more fully in this Form 10-K. Its operating results also can be affected by trust fees, deposit service charge fees, fees from the sale of residential real estate loans and other income. Operating expenses include employee compensation and benefits, occupancy and equipment expense, professional and data processing fees, advertising and marketing expenses, bank service charges, insurance, and other administrative expenses.

The Board of Governors of the Federal Reserve System (the Federal Reserve) is the primary federal regulator of the Company and its subsidiaries. In addition, Quad City Bank & Trust and Cedar Rapids Bank & Trust are regulated by the Iowa Superintendent of Banking (the Iowa Superintendent), and Rockford Bank & Trust is regulated by the State of Illinois Department of Financial and Professional Regulation (the Illinois DFPR). The FDIC, as administrator of the Deposit Insurance Fund, has regulatory authority over the subsidiary banks.

Lending/Leasing. The Company and its subsidiaries provide a broad range of commercial and retail lending and investment services to corporations, partnerships, individuals and government agencies. The subsidiary banks actively market their services to qualified lending customers. Lending officers actively solicit the business of new borrowers entering their market areas as well as long-standing members of the local business community. The subsidiary banks have established lending policies which include a number of underwriting factors to be considered in making a loan, including location, loan-to-value ratio, cash flow, collateral and the credit history of the borrower.

Quad City Bank & Trust s current legal lending limit is approximately $11.7 million. As of December 31, 2008, commercial loans, including commercial real estate loans, made up approximately 83% of the loan portfolio, while residential mortgages comprised approximately 8%, and consumer loans comprised approximately 9%.

Cedar Rapids Bank & Trust s current legal lending limit is approximately $5.6 million. As of December 31, 2008, commercial loans, including commercial real estate loans, made up approximately 87% of the loan portfolio, while residential mortgages comprised approximately 6% and consumer loans comprised approximately 7%.

Rockford Bank & Trust s current legal lending limit is approximately $5.2 million. As of December 31, 2008, commercial loans, including commercial real estate loans, made up approximately 88% of the loan portfolio, while residential mortgages and consumer loans each comprised approximately 6%.

As part of the loan monitoring activity at the three subsidiary banks, credit administration personnel interact closely with senior bank management. The Company has also instituted a separate loan review function to analyze credits of the subsidiary banks. Management has attempted to identify problem loans at an early stage and to aggressively seek a resolution of these situations.

As noted above, the subsidiary banks are active commercial lenders. The current areas of emphasis include loans to wholesalers, manufacturers, building contractors, business services companies, other banks, and retailers. The banks provide a wide range of business loans, including lines of credit for working capital and operational purposes, and term loans for the acquisition of facilities, equipment and other purposes. Collateral for these loans generally includes accounts receivable, inventory, equipment and real estate. In addition, the subsidiary banks often take personal guarantees to help assure repayment. Loans may be made on an unsecured basis if warranted by the overall financial condition of the borrower. Terms of commercial business loans generally range from one to five years. Some of the subsidiary banks commercial business loans have floating interest rates or reprice within one year. The banks also make commercial real estate loans. Collateral for these loans generally includes the underlying real estate and improvements, and may include additional assets of the borrower.

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The subsidiary banks sell the majority of their residential real estate loans in the secondary market. During the year ended December 31, 2008, the subsidiary banks originated $116.7 million of residential real estate loans and sold $87.9 million, or 75%, of these loans. During the year ended December 31, 2007, the subsidiary banks originated $135.0 million of residential real estate loans and sold $103.6 million, or 77%, of these loans. During the year ended December 31, 2006, the subsidiary banks originated $134.3 million of residential real estate loans and sold $84.2 million, or 63%, of these loans. Generally, the subsidiary banks residential mortgage loans conform to the underwriting requirements of Freddie Mac and Fannie Mae to allow the subsidiary banks to resell loans in the secondary market. The subsidiary banks structure most loans that will not conform to those underwriting requirements as adjustable rate mortgages that mature or adjust in one to five years, and then retain these loans in their portfolios. Servicing rights are not presently retained on the loans sold in the secondary market.

The consumer lending departments of each bank provide many types of consumer loans including motor vehicle, home improvement, home equity, signature loans and small personal credit lines.

m2 Lease Funds leases machinery and equipment to commercial and industrial customers under direct financing leases.

Competition. The Company currently operates in the highly competitive Quad City, Cedar Rapids, and Rockford markets. Competitors include not only other commercial banks, credit unions, thrift institutions, and mutual funds, but also, insurance companies, finance companies, brokerage firms, investment banking companies, and a variety of other financial services and advisory companies. Many of these competitors are not subject to the same regulatory restrictions as the Company. Many of these unregulated competitors compete across geographic boundaries and provide customers increasing access to meaningful alternatives to banking services. The Company competes in markets with a number of much larger financial institutions with substantially greater resources and larger lending limits. Additionally, if the trend toward reducing restrictions on the interstate operations of financial institutions continues, we will continue to experience increased competition as a result.

Recent Industry Developments. Recent events in the U.S. and global financial markets, including the deterioration of the worldwide credit markets, have created significant challenges for financial institutions throughout the country. Dramatic declines in the housing market during the past year, marked by falling home prices and increasing levels of mortgage foreclosures, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. In addition, many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers, including other financial institutions, as a result of concern about the stability of the financial markets and the strength of counterparties.

In response to the crises affecting the U.S. banking system and financial markets and to bolster the distressed economy and improve consumer confidence in the financial system, on October 3, 2008, the U.S. Congress passed, and the President signed into law, the Emergency Economic Stabilization Act of 2008 (the EESA). The EESA authorizes the Secretary of the United States Department of Treasury (Treasury) to implement various temporary emergency programs designed to strengthen the capital positions of financial institutions and stimulate the availability of credit within the U.S. financial system. Financial institutions participating in certain of the programs established under the EESA will be required to adopt Treasury s standards for executive compensation, as they are modified and amended from time to time by Congress, and corporate governance.

On October 14, 2008, Treasury announced that it will provide Tier 1 capital (in the form of perpetual preferred stock) to eligible financial institutions. This program, known as the TARP Capital Purchase Program (the CPP), allocates $250 billion from the $700 billion authorized by the EESA to Treasury for the purchase of senior preferred shares from qualifying financial institutions (the CPP Preferred Stock). Under the program, eligible institutions are able to sell equity interests to the Treasury in amounts equal to between 1% and 3% of the institution s risk-weighted assets. The CPP Preferred Stock will generally be non-voting and will pay dividends at a rate of 5% per annum for the first five years and thereafter at a rate of 9% per annum. In conjunction with the purchase of the CPP Preferred Stock, the Treasury will receive warrants to purchase common stock from the participating public institutions with an aggregate market price equal to 15% of the preferred stock investment. Participating financial institutions will be required to adopt Treasury s standards for executive compensation and corporate governance for the period during which Treasury

holds equity issued under the CPP.

Pursuant to the CPP, on February 13, 2009, the Company entered into a Letter Agreement with Treasury, pursuant to which the Company issued: (i) 38,237 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series D, and (ii) a warrant to purchase 521,888 shares of the Company s common stock for an aggregate purchase price of $38.237 million in cash. The Company expects that its federal regulators and the Treasury will maintain significant oversight over the Company, as a participating institution, to evaluate how it uses the capital provided and to ensure that it strengthens its efforts to help its borrowers avoid foreclosure, which is one of the core aspects of the EESA.

As another component of the EESA, Treasury has authorized the FDIC to provide a 100% guarantee of the following: (i) newly-issued senior unsecured debt and (ii) non-interest bearing transactional deposit accounts maintained at FDIC-insured institutions. This program is known as the Temporary Liquidity Guarantee Program (the TLGP), with the guarantee of senior unsecured debt referred to as the Debt Guarantee Program (the DGP) and the guarantee of non-interest bearing transactional accounts referred to as the Transaction Account Guarantee Program (the TAGP). FDIC insured institutions and their holding companies were required to opt in or out of each of the DGP and the TAGP by December 5, 2008. All insured depository institutions automatically participated in the Temporary Liquidity Guarantee Program for 30 days following the announcement of the program without charge (subsequently extended to December 5, 2008) and thereafter, unless an institution opted out, at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for noninterest-bearing transaction deposits. The Company opted to continue its participation in both the DGP and the TAGP.

On February 17, 2009, President Obama signed into law, The American Recovery and Reinvestment Act of 2009 (the ARRA), which is more commonly known as the economic stimulus or economic recovery package. The ARRA includes a wide variety of programs intended to stimulate the economy and provide for extensive infrastructure, energy, health and education needs. In addition, the ARRA imposes new executive compensation and corporate governance limits on current and future participants in the CPP, which are in addition to those previously announced by Treasury. The new limits remain in place until the participant has redeemed the CPP Preferred Stock sold to Treasury, which is now permitted under the ARRA without penalty and without the need to raise new capital, subject to Treasury s consultation with the recipient s appropriate federal regulator.

It is not clear at this time what impact the EESA, the CPP, the TLGP, or other liquidity and funding initiatives will have on the financial markets and the other difficulties described above, including the high levels of volatility and limited credit availability currently being experienced, or on the U.S. banking and financial industries and the broader U.S. global economies.

Appendices. The commercial banking business is a highly regulated business. See Appendix A for a summary of the federal and state statutes and regulations that are applicable to the Company and its subsidiaries. Supervision, regulation and examination of banks and bank holding companies by bank regulatory agencies are intended primarily for the protection of depositors rather than stockholders of bank holding companies and banks.

See Appendix B for tables and schedules that show selected comparative statistical information relating to the business of the Company required to be presented pursuant to the securities laws, Consistent with the information presented in Form 10-K, results are presented for the fiscal years ended December 31, 2008, 2007, 2006, 2005 and 2004 and have been reclassified, as appropriate, for discontinued operations comparative purposes.

Internet Site, Securities Filings and Governance Documents. The Company maintains Internet sites for itself and its three banking subsidiaries. The Company makes available free of charge through these sites its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act after it electronically files such material with, or furnishes it to, the Securities and Exchange Commission. Also available are many of our corporate governance documents, including our Code of Conduct and Ethics Policy. The sites are www.qcrh.com, www.qcbt.com, www.crbt.com, and www.rkfdbank.com.

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Item 1A. Risk Factors

In addition to the other information in this Annual Report on Form 10-K, stockholders or prospective investors should carefully consider the following risk factors:

Our business may be adversely affected by conditions in the financial markets and economic conditions generally.

The United States has been in a recession since December, 2007. Business activity across a wide range of industries and regions is greatly reduced, and many businesses and local governments are experiencing serious difficulty in remaining profitable due to the lack of consumer spending and the lack of liquidity in the credit markets. Unemployment has increased significantly. Since mid-2007, and particularly during the second half of 2008, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity.

As a result of this economic downturn, many lending institutions, including us, have experienced declines in the performance of their loans, including commercial loans, commercial real estate loans and consumer loans. Moreover, competition among depository institutions for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Bank and bank holding company stock prices have been negatively affected, and the ability of banks and bank holding companies to raise capital or borrow in the debt markets has become more difficult compared to recent years. There is also the potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations, including the expected issuance of many formal or informal enforcement actions or orders. The impact of new legislation in response to those developments, may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance or our stock price.

In addition, further negative market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial services industry.

Overall, during the past year, the general business environment has had an adverse effect on our business, and there can be no assurance that the environment will improve in the near term. Until conditions improve, we expect our business, financial condition and results of operations to be adversely affected.

Our business is concentrated in and dependent upon the continued growth and welfare of the Quad City, Cedar Rapids, and Rockford markets.

We operate primarily in the Quad City, Cedar Rapids, and Rockford markets, and as a result, our financial condition, results of operations and cash flows are subject to changes in the economic conditions in those areas. We have developed a particularly strong presence in Bettendorf, Cedar Rapids and Davenport, Iowa and Moline and Rockford, Illinois and their surrounding communities. Our success depends upon the business activity, population, income levels, deposits and real estate activity in these markets. Although our customers business and financial interests may extend well beyond these market areas, adverse economic conditions that affect these market areas could reduce our growth rate, affect the ability of our customers to repay their loans to us and generally affect our financial condition and results of operations. Because of our geographic concentration, we are less able than other regional or national financial institutions to diversify our credit risks across multiple markets.

We face intense competition in all phases of our business from other banks and financial institutions.

The banking and financial services businesses in our markets are highly competitive. Our competitors include large regional banks, local community banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market mutual funds, credit unions and other non-bank financial services providers. Many of these competitors are not subject to the same regulatory restrictions as we are. Many of our unregulated competitors compete across geographic boundaries and are able to provide customers with a feasible alternative to traditional banking services. Additionally, if the regulatory trend toward reducing restrictions on the interstate operations of financial institutions continues, we will continue to experience increased competition as a result.

Increased competition in our markets may result in a decrease in the amounts of our loans and deposits, reduced spreads between loan rates and deposit rates or loan terms that are more favorable to the borrower. Any of these results could have a material adverse effect on our ability to grow and remain profitable. If increased competition causes us to significantly discount the interest rates we offer on loans or increase the amount we pay on deposits, our net interest income could be adversely impacted. If increased competition causes us to modify our underwriting standards, we could be exposed to higher losses from lending activities. Additionally, many of our competitors are much larger in total assets and capitalization, have greater access to capital markets, have larger lending limits and offer a broader range of financial services than we can offer.

Our community banking strategy relies heavily on our subsidiaries independent management teams, and the unexpected loss of key managers may adversely affect our operations.

We rely heavily on the success of our bank subsidiaries independent management teams. Accordingly, much of our success to date has been influenced strongly by our ability to attract and to retain senior management experienced in banking and financial services and familiar with the communities in our market areas. Our ability to retain the executive officers, current management teams, branch managers and loan officers of our operating subsidiaries will continue to be important to the successful implementation of our strategy. It is also critical, as we grow, to be able to attract and retain qualified additional management and loan officers with the appropriate level of experience and knowledge about our market areas to implement our community-based operating strategy. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business, financial condition and results of operations.

Our continued pace of growth may require us to raise additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our existing capital resources, including the $38.24 million we received from Treasury under the Capital Purchase Program, will satisfy our capital requirements for the foreseeable future. However, we may at some point need to raise additional capital to support our continued growth. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth, branching, *de novo* bank formations and/or acquisitions could be materially impaired.

We may experience difficulties in managing our growth, and our growth strategy involves risks that may negatively impact our net income.

While we have no current plans, we may expand into additional communities or attempt to strengthen our position in our current markets by undertaking additional *de novo* bank formations or branch openings. Based on our experience, we believe that it generally takes several years for new banking facilities to achieve overall profitability, due to the impact of organizational and overhead expenses and the start-up phase of generating loans and deposits. If we undertake additional *de novo* bank formations and branch openings, we are likely to continue to experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. Other effects of engaging in such growth strategies may include potential diversion of our management s time and attention and general disruption to our business.

In addition to *de novo* bank formations and branching, we may acquire banks and related businesses that we believe provide a strategic fit with our business. To the extent that we grow through acquisitions, we cannot assure you that we will be able to adequately and profitably manage this growth. Acquiring other banks and businesses will involve similar risks to those commonly associated with *de novo* bank formations and branching but may also involve additional risks, including:

- potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- exposure to potential asset quality issues of the acquired bank or related business;
- difficulty and expense of integrating the operations and personnel of banks and businesses we acquire; and
- the possible loss of key employees and customers of the banks and businesses we acquire.

Interest rates and other conditions impact our results of operations.

Our profitability is in large part a function of the spread between the interest rates earned on investments and loans/leases and the interest rates paid on deposits and other interest-bearing liabilities. Like most banking institutions, our net interest spread and margin will be affected by general economic conditions and other factors, including fiscal and monetary policies of the federal government, that influence market interest rates and our ability to respond to changes in such rates. At any given time, our assets and liabilities will be such that they are affected differently by a given change in interest rates. As a result, an increase or decrease in rates, the length of loan/lease terms or the mix of adjustable and fixed rate loans/leases in our portfolio could have a positive or negative effect on our net income, capital and liquidity. We measure interest rate risk under various rate scenarios and using specific criteria and assumptions. A summary of this process, along with the results of our net interest income simulations is presented at Quantitative and Qualitative Disclosures about Market Risk included under Item 7A of Part II of this Form 10-K. Although we believe our current level of interest rate sensitivity is reasonable and effectively managed, significant fluctuations in interest rates may have an adverse effect on our business, financial condition and results of operations.

We must effectively manage our credit risk.

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of nonpayment, risks resulting from uncertainties as to the future value of collateral and risks resulting from changes in economic and industry conditions. We attempt to minimize our credit risk through prudent loan application approval procedures, careful monitoring of the concentration of our loans within specific industries and periodic independent reviews of outstanding loans by our credit review department. However, we cannot assure you that such approval and monitoring procedures will reduce these credit risks.

The majority of our subsidiary banks loan/lease portfolios are invested in commercial loans/leases, and we focus on lending to small to medium-sized businesses. The size of the loans/leases we can offer to commercial customers is less than the size of the loans/leases that our competitors with larger lending limits can offer. This may limit our ability to establish relationships with the area s largest businesses. As a result, we may assume greater lending risks than financial institutions that have a lesser concentration of such loans/leases and tend to make loans/leases to larger businesses. Collateral for these loans/leases generally includes accounts receivable, inventory, equipment and real estate. However, depending on the overall financial condition of the borrower, some loans are made on an unsecured basis. In addition to commercial loans/leases and commercial real estate loans, our subsidiary banks are also active in residential mortgage and consumer lending. Should the economic climate worsen, our borrowers may experience financial difficulties, and the level of non-performing loans, charge-offs and delinquencies could rise, which could negatively impact our business.

Commercial and industrial loans/leases make up a large portion of our loan/lease portfolio.

Commercial and industrial loans/leases were $436.7 million, or approximately 36% of our total loan/lease portfolio, as of December 31, 2008. Our commercial loans/leases are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral is accounts receivable, inventory and equipment. Credit support provided by the borrower for most of these loans/leases and the probability of repayment is based on the liquidation value of the pledged collateral and enforcement of a personal guarantee, if any exists. As a result, in the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. The collateral securing these loans/leases may depreciate over time, may be difficult to appraise

and may fluctuate in value based on the success of the business. In addition, a continued decline in the United States economy could harm or continue to harm the businesses of our commercial and industrial customers and reduce the value of the collateral securing these loans/leases.

Our loan/lease portfolio has a significant concentration of commercial real estate loans, which involve risks specific to real estate value.

Commercial real estate lending comprises a significant portion of our lending business. Specifically, commercial real estate loans were $529.1 million, or approximately 44% of our total loan/lease portfolio, as of December 31, 2008. Of this amount, $206.4 million, or approximately 39%, is owner-occupied. The market value of real estate securing our commercial real estate loans can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Although a significant portion of such loans are secured by real estate as a secondary form of collateral, adverse developments affecting real estate values in one or more of our markets could increase the credit risk associated with our loan portfolio. Additionally, real estate lending typically involves higher loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Economic events or governmental regulations outside of the control of the borrower or lender could negatively impact the future cash flow and market values of the affected properties.

If the problems that have occurred in residential real estate and mortgage markets throughout much of the United States were to spread to the commercial real estate market, particularly within one or more of our markets, the value of collateral securing our commercial real estate loans could decline. In such case, we may not be able to realize the amount of security that we anticipated at the time of originating the loan, which could cause us to increase our provision for loan losses and adversely affect our operating results, financial condition and/or capital. We generally have not experienced a downturn in credit performance by our commercial real estate loan customers, but in light of the uncertainty that exists in the economy and credit markets nationally, there can be no guarantee that we will not experience any deterioration in such performance.

Our allowance for loan/lease losses may prove to be insufficient to absorb potential losses in our loan/lease portfolio.

We established our allowance for loan/lease losses in consultation with management of our subsidiaries and maintain it at a level considered adequate by management to absorb loan/lease losses that are inherent in the portfolio. The amount of future loan/lease losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond our control, and such losses may exceed current estimates. At December 31, 2008, our allowance for loan/lease losses as a percentage of total gross loans/leases was 1.47% and as a percentage of total non-performing loans/leases was approximately 89%. Although management believes that the allowance for loan/lease losses is adequate to absorb losses on any existing loans/leases that may become uncollectible, we cannot predict loan/lease losses with certainty, and we cannot assure you that our allowance for loan/lease losses will prove sufficient to cover actual loan/lease losses in the future. Loan/lease losses in excess of our reserves may adversely affect our business, financial condition and results of operations.

We have a continuing need for technological change, and we may not have the resources to effectively implement new technology.

The financial services industry continues to undergo rapid technological changes with frequent introductions of new technology-driven products and services. In addition to enabling us to better serve our customers, the effective use of technology increases efficiency and the potential for cost reduction. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow our market share. Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage. Accordingly, we cannot provide you with assurance that we will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent such damage, there can be no assurance that these security measures will be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations.

We are subject to certain operational risks, including, but not limited to, customer or employee fraud and data processing system failures and errors.

Employee errors and employee and customer misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence.

We maintain a system of internal controls and insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud. Should our internal controls fail to prevent or detect an occurrence, and if any resulting loss is not insured or exceeds applicable insurance limits, such failure could have a material adverse effect on our business, financial condition and results of operations.

Government regulation can result in limitations on our operations.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including Treasury, the Federal Reserve, the FDIC, the Iowa Superintendent, and the Illinois DFPR. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of stockholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. These bank regulators possess broad authority to prevent or remedy unsafe or unsound practices or violations of law. The laws and regulations applicable to the banking industry could change at any time and we cannot predict the effects of these changes on our business and profitability. Increased regulation could increase our cost of compliance and adversely

affect profitability. For example, new legislation or regulation may limit the manner in which we may conduct our business, including our ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads.

Failure to pay interest on our debt or dividends on our preferred stock may adversely impact our ability to pay common stock dividends.

As of December 31, 2008, we had $36.1 million of junior subordinated debentures held by four business trusts that we control. Interest payments on the debentures, which totaled $2.4 million for 2008, must be paid before we pay dividends on our capital stock, including our common stock. We have the right to defer interest payments on the debentures for up to 20 consecutive quarters. However, if we elect to defer interest payments, all deferred interest must be paid before we may pay dividends on our capital stock. As of December 31, 2008, the Company had 568 shares of non-cumulative perpetual preferred stock issued and outstanding. Although these non-cumulative preferred shares will accrue no dividends, dividends will be payable on the preferred shares if declared, but no dividends may be declared on the Company s common stock unless and until dividends have been declared on the outstanding shares. Deferral, of either interest payments on the debentures or preferred dividends on the preferred shares, could cause a subsequent decline in the market price of our common stock because the Company would not be able to pay dividends on its common stock.

In addition, on February 13, 2009, we issued shares of perpetual senior preferred stock to Treasury as part of the Capital Purchase Program. The terms of the senior preferred stock restrict the payment of dividends on shares of our common stock. Without the prior consent of Treasury, we are prohibited from increasing common stock dividends for the first three years while Treasury holds the senior preferred stock. Further, we are prohibited from continuing to pay dividends on our common stock unless we have fully paid all required dividends on the senior preferred stock. Although we expect to be able to pay all required dividends on the senior preferred stock (and to continue to pay dividends on common stock at current levels), there is no guarantee that we will be able to do so.

There is a limited trading market for our common shares, and you may not be able to resell your shares at or above the price stockholders paid for them.

Although our common shares are listed for quotation on The NASDAQ Capital Market, the trading in our common shares has substantially less liquidity than many other companies listed on NASDAQ. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the market of willing buyers and sellers of our common shares at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. We cannot assure you that the volume of trading in our common shares will increase in the future.

Item 1B. Unresolved Staff Comments

There are no unresolved staff comments.

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Item 2. Properties

The following table is a listing of the Company s operating facilities for its subsidiary banks:

Facility Address	Facility Square Footage	Facility Owned or Leased
Quad City Bank & Trust		
2118 Middle Road in Bettendorf, IA	6,700	Owned
4500 Brady Street in Davenport, IA	36,000	Owned
3551 7th Street in Moline, IL	30,000	Owned*
5515 Utica Ridge Road in Davenport, IA	6,000	Leased
1700 Division Street in Davenport, IA	12,000	Owned
Cedar Rapids Bank & Trust		
500 1st Avenue NE, Suite 100 in Cedar Rapids, IA	36,000	Owned
5400 Council Street in Cedar Rapids, IA	5,900	Owned
Rockford Bank & Trust		
127 North Wyman Street in Rockford, IL	7,800	Leased
4571 Guilford Road in Rockford, IL	20,000	Owned

* The building is owned by Velie Plantation Holding Company, in which the Company has a 57% interest.

The subsidiary banks intend to limit their investment in premises to no more than 50% of their capital. Management believes that the facilities are of sound construction, in good operating condition, are appropriately insured and are adequately equipped for carrying on the business of the Company.

No individual real estate property or mortgage amounts to 10% or more of consolidated assets.

Item 3. Legal Proceedings

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

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to the stockholders of the Company for a vote during the fourth quarter of the fiscal year ended December 31, 2008.

Part II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information. The common stock, par value $1.00 per share, of the Company is listed on The NASDAQ Capital Market under the symbol QCRH . The stock began trading on October 6, 1993. As of December 31, 2008, there were 4,509,637 shares of common stock outstanding held by approximately 2,600 holders of record. The following table sets forth the high and low sales prices of the common stock, as reported by The NASDAQ Capital Market, for the periods indicated.

	2008 sales price		2007 sales price		2006 sales price	
	High	Low	High	Low	High	Low
First quarter	$ 17.020	$ 14.150	$ 17.900	$ 15.280	$ 19.660	$ 17.440
Second quarter	16.200	12.130	17.750	15.150	19.950	16.250
Third quarter	16.200	9.700	16.430	13.760	18.169	16.210
Fourth quarter	14.240	9.440	16.000	14.250	18.860	16.772

Dividends on Common Stock. On April 24, 2008, the Company declared a cash dividend of $0.04 per share, or $185 thousand, which was paid on July 7, 2008, to stockholders of record as of June 23, 2008. On October 23, 2008, the Company declared a cash dividend of $0.04 per share, or $185 thousand, which was paid on January 7, 2009, to stockholders of record as of December 22, 2008. In the future, it is the Company s intention to continue to consider the payment of dividends on a semi-annual basis. The Company anticipates an ongoing need to retain much of its operating income to help provide the capital for continued growth, but believes that operating results have reached a level that can sustain dividends to stockholders as well.

The Company is heavily dependent on dividend payments from its subsidiary banks to make dividend payments on the Company s preferred and common stock. Under applicable state laws, the banks are restricted as to the maximum amount of dividends that they may pay on their common stock. Iowa and Illinois law provide that state-chartered banks in those states may not pay dividends in excess of their undivided profits.

The Company s ability to pay dividends to its shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. The payment of dividends by any financial institution or its holding company is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized.

The Company also has certain contractual restrictions on its ability to pay dividends. The Company has issued junior subordinated debentures in four private placements. Under the terms of the debentures, the Company may be prohibited, under certain circumstances, from paying dividends on shares of its common stock. During the fourth quarters of 2006 and 2007, the Company issued shares of non-cumulative perpetual preferred stock. Also, under the terms of this preferred stock, the Company may be prohibited, under certain circumstances, from paying dividends on shares of its common stock. None of these circumstances currently exist.

In addition, as a result of the Company s issuance of the CPP Preferred Stock to Treasury on February 13, 2009, the ability of the Company to declare or pay dividends on its common stock is subject to restrictions, including the restriction on increasing dividends from the last semi-annual cash dividend declared prior to October 14, 2008, which was $0.04 per share. This restriction will terminate on the earlier of (a) the third anniversary of the date of issuance of the Series D Preferred Stock and (b) the date on which the CPP Preferred Stock has been redeemed in whole or Treasury has transferred all of the CPP Preferred Stock to one or more third parties. Further, the ability of the Company to declare or pay dividends on its common stock will be subject to restrictions in the event that the Company fails to declare and pay full dividends on the CPP Preferred Stock.

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Purchase of Equity Securities by the Company. On December 31, 2008, the Company repurchased 121,246 shares of its common stock. The common stock was repurchased at $13.25 per share for a total cost of $1,606,510.

Stockholder Return Performance Graph. The following graph indicates, for the period commencing December 31, 2003, a comparison of cumulative total returns for QCR Holdings, Inc., the NASDAQ Composite Index and the SNL Bank NASDAQ Index prepared by SNL Securities, Charlottesville, Virginia. The graph was prepared at the Company s request by SNL Securities.

	Period Ending					
Index	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**	**12/31/08**
QCR Holdings, Inc.	100.00	112.96	106.38	95.80	77.70	54.89
NASDAQ Composite	100.00	108.59	110.08	120.56	132.39	78.72
SNL Bank NASDAQ	100.00	114.61	111.12	124.75	97.94	71.13

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Item 6. Selected Financial Data

The following Selected Consolidated Financial Data of the Company is derived in part from, and should be read in conjunction with, our consolidated financial statements and the accompanying notes thereto. See Item 8 Financial Statements. Results for past periods are not necessarily indicative of results to be expected for any future period. All periods reported have been reclassified, as appropriate, for discontinued operations comparative purposes.

SELECTED CONSOLIDATED FINANCIAL DATA

(dollars in thousands, except per share data)

	Years Ended December 31,				
	2008	2007	2006	2005	2004
Statement of Income Data:					
Continuing Operations:					
Interest income	$ 85,467	$ 83,140	$ 68,803	$ 48,688	$ 38,017
Interest expense	40,524	48,139	38,907	21,281	13,325
Net interest income	44,943	35,001	29,896	27,407	24,692
Provision for loan/lease losses	9,222	2,336	3,284	877	1,372
Non-interest income	13,611	12,850	10,998	9,106	7,968
Non-interest expenses	42,334	35,734	34,063	28,922	23,794
Income tax expense	1,735	2,893	724	2,121	2,424
Minority interest in income of consolidated subsidiaries	288	388	266	78	
Income from continuing operations	4,975	6,500	2,557	4,515	5,070
Discontinued Operations:					
Income (loss) from discontinued operations, before taxes	2,580	(1,221)	378	456	227
Income tax expense (benefit)	846	(498)	133	161	80
Income (loss) from discontinued operations	1,734	(723)	245	295	147
Net income	6,709	5,777	2,802	4,810	5,217
Per Common Share Data:					
Income from continuing operations-basic	$ 0.69	$ 1.18	$ 0.52	$ 1.00	$ 1.20
Net income-basic	1.07	1.03	0.57	1.06	1.23
Income from continuing operations-diluted	0.69	1.18	0.51	0.98	1.17
Net income-diluted	1.06	1.02	0.57	1.04	1.20
Cash dividends declared	0.08	0.08	0.08	0.08	0.08
Dividend payout ratio	7.48%	7.77%	14.04%	7.55%	6.50%
Balance Sheet:					
Total assets	$ 1,605,629	$ 1,476,564	$ 1,271,675	$ 1,042,614	$ 870,084
Securities	256,076	220,557	194,774	182,365	149,561
Loans/leases	1,214,690	1,056,988	960,747	756,254	648,351
Allowance for estimated losses on loans/leases	17,809	11,315	10,612	8,884	9,262

Deposits	1,058,959	884,005	875,447	698,504	588,016
Stockholders equity:					
Preferred	20,158	20,158	12,884		
Common	70,479	65,908	57,999	54,467	50,774
Key Ratios:					
Return on average assets	0.43%	0.43%	0.24%	0.51%	0.65%
Return on average common equity	9.90	9.31	5.02	9.14	11.89
Return on average total equity	7.63	7.70	4.85	9.14	11.89
Net interest margin (TEY) (1)	3.32	2.92	2.87	3.25	3.41
Efficiency ratio (2)	72.30	74.68	83.30	79.21	72.85
Nonperforming assets to total assets	1.48	0.51	0.58	0.36	1.23
Allowance for estimated losses on loans/leases to total loans/leases	1.47	1.07	1.10	1.17	1.43
Net charge-offs to average loans/leases	0.24	0.14	0.18	0.25	0.13
Average total stockholders equity to average assets	5.66	5.55	5.01	5.63	5.49

(1) Interest earned and yields on nontaxable investments are determined on a tax equivalent basis using a 34% tax rate.

(2) Non-interest expenses divided by the sum of net interest income before provision for loan/lease losses and non-interest income.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides additional information regarding our operations for the twelve-month periods ending December 31, 2008, 2007, and 2006, and our financial condition at December 31, 2008 and 2007. This discussion should be read in conjunction with Selected Consolidated Financial Data and our consolidated financial statements and the accompanying notes thereto included or incorporated by reference elsewhere in this document.

OVERVIEW

The Company was formed in February 1993 for the purpose of organizing Quad City Bank & Trust. Over the past sixteen years, the Company has grown to include two additional banking subsidiaries and a number of nonbanking subsidiaries. As of December 31, 2008, the Company had $1.61 billion in consolidated assets.

The Company reported earnings of $6.7 million, or $1.07 basic earnings per share, for 2008, compared to $5.8 million, or $1.03 basic earnings per share, for 2007, and $2.8 million, or $0.57 basic earnings per share, for 2006. A significant contributor to earnings for 2008 was the gain on sale of the merchant credit card acquiring business within Bancard. The gain on sale, net of taxes and related expenses, totaled approximately $3.0 million, or $0.65 per share.

Earnings from continuing operations were $5.0 million, or $0.69 basic earnings per share, for 2008, compared to $6.5 million, or $1.18 basic earnings per share, for 2007, and $2.6 million, or $0.52 basic earnings per share, for 2006. The reduction in 2008 earnings from continuing operations was due to the significant increase in provision for loan/lease losses of $6.9 million. Throughout the year, the Company increased its qualitative reserves due to the continued weakness and uncertainty in the economy and made increased provisions for specific commercial credits. Helping to offset this increased provision expense was a dramatic improvement in net interest income totaling $9.9 million, or 28%, from $35.0 million for the year ending December 31, 2007 to $44.9 million for the year ending December 31, 2008.

As noted above, net interest income significantly increased $9.9 million, or 28%, to $44.9 million for 2008, from $35.0 million for 2007. For 2008, average earning assets increased by $148.0 million, or 12%, and average interest-bearing liabilities increased by $135.9 million, or 12%, when compared with average balances for 2007. A comparison of yields, spreads and margins from 2008 to 2007 shows the following:

- The average yield on interest-earning assets decreased 58 basis points from 6.87% to 6.29%.
- The average cost of interest-bearing liabilities decreased 108 basis points from 4.33% to 3.25%.
- The net interest spread improved 50 basis points from 2.54% to 3.04%.
- The net interest margin improved 40 basis points from 2.92% to 3.32%.

Net interest income significantly increased $4.6 million, or 15%, to $35.0 million for 2007, from $30.4 million for 2006. For 2007, average earning assets increased by $159.6 million, or 15%, and average interest-bearing liabilities increased by $149.1 million, or 15%, when compared with average balances for 2006. A comparison of yields, spreads and margins from 2007 to 2006 shows the following:

- The average yield on interest-earning assets increased 32 basis points from 6.55% to 6.87%.
- The average cost of interest-bearing liabilities increased 29 basis points from 4.04% to 4.33%.
- The net interest spread improved 3 basis points from 2.51% to 2.54%.
- The net interest margin improved 5 basis points from 2.87% to 2.92%.

The Company s management closely monitors and manages net interest margin. From a profitability standpoint, an important challenge for the Company s subsidiary banks is the improvement of their net interest margins. Management continually addresses this issue with the use of alternative funding sources and pricing strategies.

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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:

	Years Ended December 31,								
	2008			2007			2006		
	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost
	(Dollars in Thousands)								
ASSETS									
Interest earnings assets:									
Federal funds sold	$ 5,631	$ 100	1.78%	$ 5,450	$ 248	4.55%	$ 10,230	$ 475	4.64%
Interest-bearing deposits at at financial institutions	5,313	165	3.11	6,142	346	5.63	6,440	320	4.97
Investment securities (1)	230,342	12,279	5.33	204,364	10,605	5.19	185,468	8,381	4.52
Gross loans/leases receivable (2) (3)	1,124,255	73,381	6.53	1,001,633	72,446	7.23	855,872	60,098	7.02
Total interest earning assets	1,365,541	85,925	6.29	1,217,589	83,645	6.87	1,058,010	69,274	6.55
Noninterest-earning assets:									
Cash and due from banks	$ 32,651			$ 36,880			$ 35,318		
Premises and equipment, net	31,535			31,705			27,755		
Less allowance for estimated losses on loans/leases	(13,770)			(11,178)			(9,780)		
Other	136,791			76,486			42,234		
Total assets	$ 1,552,748			$ 1,351,482			$ 1,153,537		
LIABILITIES AND STOCKHOLDERS EQUITY									
Interest-bearing liabilities:									
Interest-bearing demand deposits	$ 299,417	5,709	1.91%	$ 305,699	10,790	3.53%	$ 272,484	9,082	3.33%

Savings deposits	57,955	806	1.39	31,300	651	2.08	32,065	703	2.19
Time deposits	443,122	17,379	3.92	404,544	19,786	4.89	380,524	17,280	4.54
Short-term borrowings	154,456	2,962	1.92	141,778	5,217	3.68	97,580	3,169	3.25
Federal Home Loan Bank advances	193,119	8,525	4.41	160,474	7,237	4.51	135,282	5,609	4.15
Junior subordinated debentures	36,085	2,389	6.62	36,085	2,623	7.27	34,796	2,490	7.16
Other borrowings	62,975	2,754	4.37	31,398	1,835	5.84	9,456	574	6.07
Total interest-bearing liabilities	1,247,129	40,524	3.25	1,111,278	48,139	4.33	962,187	38,907	4.04
Noninterest-bearing demand deposits	135,860			125,117			119,561		
Other noninterest-bearing liabilities	79,956			38,511			14,026		
Total liabilities	1,462,945			1,274,906			1,095,774		
Minority interest in consolidated subsidiaries	1,851			1,558					
Stockholders equity	87,952			75,018			57,763		
Total liabilities and stockholders equity	$ 1,552,748			$ 1,351,482			$ 1,153,537		
Net interest income		$ 45,401			$ 35,506			$ 30,367	
Net interest spread			3.04%			2.54%			2.51%
Net interest margin			3.32%			2.92%			2.87%
Ratio of average interest earning assets to average interest- bearing liabilities	109.49%			109.57%			109.96%		

(1) Interest earned and yields on nontaxable investment securities are

determined on a tax equivalent basis using a 34% tax rate in each year presented.

(2) Loan/lease fees are not material and are included in interest income from loans/leases receivable.

(3) Non-accrual loans are not material and are included in the average balance for gross loans/leases receivable.

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For the years ended December 31, 2008, 2007 and 2006

	Inc./(Dec.) from Prior Year	Components of Change (1) Rate	Volume
	2008 vs. 2007 (Dollars in Thousands)		
INTEREST INCOME			
Federal funds sold	$ (148)	$ (156)	$ 8
Interest-bearing deposits at other financial institutions	(181)	(139)	(42)
Investment securities (2)	1,674	296	1,378
Gross loans/leases receivable (2) (3) (4)	935	(7,453)	8,388
Total change in interest income	$ 2,280	$ (7,452)	$ 9,732
INTEREST EXPENSE			
Interest-bearing demand deposits	$ (5,081)	$ (4,863)	$ (218)
Savings deposits	155	(267)	422
Time deposits	(2,407)	(4,172)	1,765
Short-term borrowings	(2,255)	(2,687)	432
Federal Home Loan Bank advances	1,288	(156)	1,444
Junior subordinated debentures	(234)	(234)	
Other borrowings	919	(555)	1,474
Total change in interest expense	$ (7,615)	$ (12,934)	$ 5,319
Total change in net interest income	$ 9,895	$ 5,482	$ 4,413

	Inc./(Dec.) from Prior Year	Components of Change (1) Rate	Volume
	2007 vs. 2006 (Dollars in Thousands)		
INTEREST INCOME			
Federal funds sold	$ (227)	$ (9)	$ (218)
Interest-bearing deposits at other financial institutions	26	42	(16)
Investment securities (2)	2,223	1,317	906
Gross loans/leases receivable (2) (3) (4)	12,349	1,852	10,497
Total change in interest income	$ 14,371	$ 3,202	$ 11,169
INTEREST EXPENSE			

Interest-bearing demand deposits	$ 1,708	$ 557	$ 1,151
Savings deposits	(52)	(35)	(17)
Time deposits	2,506	1,377	1,129
Short-term borrowings	2,048	465	1,583
Federal Home Loan Bank advances	1,628	521	1,107
Junior subordinated debentures	133	40	93
Other borrowings	1,261	(22)	1,283
Total change in interest expense	$ 9,232	$ 2,903	$ 6,329
Total change in net interest income	$ 5,139	$ 299	$ 4,840

(1) The column increase/decrease from prior year 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 are determined on a tax equivalent basis using a 34% tax rate in each year presented.

(3) Loan/lease fees are not material and are included

in interest income from loans/leases receivable.

(4) Non-accrual loans are not material and are included in the average balance for gross loans/leases receivable.

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The Company s operating results are also affected by sources of non-interest income, including trust department fees, deposit service fees, investment advisory and management fees, gains from the sales of residential real estate loans and other income. The Company s operating results are also affected by economic and competitive conditions, particularly changes in interest rates, government policies and actions of regulatory authorities. The majority of the subsidiary banks loan portfolios are invested in commercial loans. Deposits from commercial customers represent a significant funding source, as well.

Trust department income continues to be a significant contributor to non-interest income. During 2008, trust department fees contributed $3.3 million which was a decrease of $339 thousand, or 9%, from $3.7 million for 2007. Trust department fees contributed $3.0 million to our non-interest income during 2006. Income is generated primarily from fees charged based on assets under administration for corporate and personal trusts and for custodial services. Assets under administration at December 31, 2008 totaled $811.9 million which is a decrease of $378.0 million, or 32% from $1.19 billion at December 31, 2007. The majority of trust department income consists of fees determined by the performance of the investments within the managed trusts. Due to the economic recession, the majority of these asset values have decreased significantly over the year.

The Company s operating results were also affected by non-interest expenses, which include employee compensation and benefits, occupancy and equipment expense, professional and data processing, and other administrative expenses. The Company has continued to add resources to accommodate both our historical growth and anticipated future growth. As such, overhead expenses have had a significant impact on earnings.

CRITICAL ACCOUNTING POLICIES

The Company s financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. 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 its most critical accounting policy to be that related to the allowance for loan/lease losses. The Company s allowance for loan/lease loss methodology incorporates a variety of risk considerations, both quantitative and qualitative in establishing an allowance for loan/lease loss that management believes is appropriate at each reporting date. Quantitative factors include the Company s historical loss experience, delinquency and charge-off trends, collateral values, governmental guarantees, payment status, changes in nonperforming loans/leases, and other factors. Quantitative factors also incorporate known information about individual loans/leases, including borrowers sensitivity to interest rate movements. Qualitative factors include the general economic environment in the Company s markets, including economic conditions throughout the Midwest, and in particular, the economic health of certain industries. Size and complexity of individual credits in relation to loan/lease structure, existing loan/lease policies and pace of portfolio growth are other qualitative factors that are considered in the methodology. As the Company adds new products and increases the complexity of its loan/lease portfolio, it enhances its methodology accordingly. Management may report a materially different amount for the provision for loan/lease losses in the statement of operations to change the allowance for loan/lease losses if its assessment of the above factors were different. The discussion regarding the Company s allowance for loan/lease losses should be read in conjunction with the Company s financial statements and the accompanying notes presented elsewhere in this Form 10-K, as well as the portion of this Management s Discussion and Analysis section entitled Financial Condition Allowance for Loan/Lease Losses. Although management believes the level of the allowance as of December 31, 2008 was adequate to absorb losses inherent in the loan/lease portfolio, a decline in local economic conditions, or other factors, could result in increasing losses that cannot be reasonably predicted at this time.

The Company s assessment of other-than-temporary impairment of its available-for-sale securities portfolio is another critical accounting policy as a result of the level of judgment required by management. Available-for-sale securities are evaluated to determine whether declines in fair value below their cost are other-than-temporary. In estimating other-than-temporary impairment losses management considers a number of factors including (1) the length of time and extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment for a period of time sufficient to allow for

anticipated recovery in fair value. The discussion regarding the Company s assessment of other-than-temporary impairment should be read in conjunction with the Company s financial statements and the accompanying notes presented elsewhere in this Form 10-K. As of December 31, 2008, management s evaluation determined that any declines in fair value of the available-for-sale securities were temporary.

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RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, and 2006

Overview. Net income for 2008 was $6.7 million compared to net income of $5.8 million for 2007, which is an increase of $931 thousand, or 16%. Basic earnings per share for 2008 were $1.07 compared to $1.03 for 2007. During 2008, Bancard sold its merchant credit card acquiring business resulting in a gain on sale of approximately $3.0 million, net of taxes and related expenses, or $0.65 per share. The Company was successful in improving its net interest income during 2008 as net interest income increased $9.9 million, or 28%, from 2007. Offsetting these increases, the Company s provision for loan/lease losses for 2008 increased $6.9 million, or 295%, from 2007, and noninterest expenses for 2008 increased $6.6 million, or 18%, from 2007.

Net income for 2007 was $5.8 million compared to net income of $2.8 million for 2006 for an increase of $3.0 million, or 107%. Basic earnings per share for 2007 were $1.03 compared to $0.57 for 2006. The increase in net income was comprised of an increase in net interest income after provision for loan losses of $6.1 million in combination with an increase in aggregate non-interest income of $1.9 million, offset by an increase in non-interest expenses of $1.7 million. The primary factor which contributed to the improvement in net income from 2006 to 2007 was the increase in net interest margin from 2.87% to 2.92% coupled with the growth in average earning assets and liabilities of 15%.

Interest income. Interest income increased $2.3 million, or 3%, from $83.1 million for 2007 to $85.5 million for 2008. As a result of the deteriorating economy and a significant declining interest rate environment in 2008, the majority of the increase in interest income was a result of growth in interest-earning assets, principally loans and leases.

Interest income grew $16.7 million from $68.8 million for 2006 to $85.5 million for 2007. The 24% increase in interest income was attributable to greater average outstanding balances in interest-earning assets, principally loans and leases receivable, in combination with an improved aggregate asset yield. The average yield on interest earning assets for 2007 was 6.87% compared to 6.55% for 2006.

Interest expense. Interest expense decreased $7.6 million, or 16%, from $48.1 million for 2007 to $40.5 million for 2008. With the economic recession and drop in rates during 2008, the Company was successful in managing its cost of funds as the average cost on interest bearing liabilities decreased 108 basis points from 4.33% for 2007 down to 3.25% for 2008.

Interest expense increased by $9.2 million, from $38.9 million for 2006 to $48.1 million for 2007. The 24% increase in interest expense was primarily attributable to a general increase in interest rates, in combination with greater average outstanding balances in interest-bearing liabilities, primarily customer deposits. The average cost on interest bearing liabilities was 4.33% for 2007 compared to 4.04% for 2006.