

HEARTLAND FINANCIAL USA INC  
Form 10-K  
March 10, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

**[X] ANNUAL REPORT PURSUANT TO SECTION 13 OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

Commission File Number: 0-24724

**HEARTLAND FINANCIAL USA, INC.**  
(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or  
organization)

**42-1405748**  
(I.R.S. Employer identification number)

**1398 Central Avenue, Dubuque, Iowa 52001**  
(Address of principal executive offices) (Zip  
Code)

**(563) 589-2100**  
(Registrant's telephone number, including area  
code)

Securities registered pursuant to Section 12(b) of the Act: None

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

Title of Class  
Common Stock \$1.00 par value  
Preferred Share Purchase Rights

Indicate by check mark if the Registrant is a well-know seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No ☒ X

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 No ☒ X

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ X No

Indicate by check mark if disclosure of delinquent filers pursuant 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. ( )

The index to exhibits follows the signature page.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12B-2 of the Exchange Act.

Large accelerated filer      Accelerated filer ☒      Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2).    Yes      No ☒

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 National Market System on June 30, 2005, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$246,320,156.\* Such figures include 2,672,776 shares of the Registrant's Common Stock held in a fiduciary capacity by the trust department of the Dubuque Bank and Trust Company, a wholly-owned subsidiary of the Registrant.

\* Based on the last sales price of the Registrant's common stock on June 30, 2005, and reports of beneficial ownership filed by directors and executive officers of Registrant and by beneficial owners of more than 5% of the outstanding shares of common stock of Registrant; however, such determination of shares owned by affiliates does not constitute an admission of affiliate status or beneficial interest in shares of Registrant's common stock.

As of March 9, 2006, the Registrant had issued and outstanding 16,486,310 shares of common stock, \$1.00 per value per share.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2006 Annual Meeting of Stockholders are incorporated by reference into Part III.

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**Form 10-K Annual Report**  
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**PART I.**

**ITEM 1.**

**BUSINESS**

**A. GENERAL DESCRIPTION**

Heartland Financial USA, Inc. ("Heartland"), reincorporated in the state of Delaware in 1993, is a multi-bank holding company registered under the Bank Holding Company Act of 1956, as amended ("BHCA"). Heartland has eight bank subsidiaries in the states of Iowa, Illinois, Wisconsin, New Mexico, Arizona, and Montana, collectively, the "Bank Subsidiaries"). All eight Bank Subsidiaries are members of the Federal Deposit Insurance Corporation ("FDIC"). The Bank Subsidiaries listed below operate a total of 50 banking locations.

- \* Dubuque Bank and Trust Company, Dubuque, Iowa, is chartered under the laws of the State of Iowa. Dubuque Bank and Trust Company has two wholly-owned subsidiaries: DB&T Insurance, Inc., a multi-line insurance agency and DB&T Community Development Corp., a partner in low-income housing and historic rehabilitation projects.
- \* Galena State Bank and Trust Company, Galena, Illinois, is chartered under the laws of the State of Illinois.
- \* First Community Bank, Keokuk, Iowa, is chartered under the laws of the State of Iowa.
- \* Riverside Community Bank, Rockford, Illinois, is chartered under the laws of the State of Illinois.
- \* Wisconsin Community Bank, Cottage Grove, Wisconsin, is chartered under the laws of the State of Wisconsin.
- \* New Mexico Bank & Trust, Albuquerque, New Mexico, is chartered under the laws of the State of New Mexico.
- \* Rocky Mountain Bank, Billings, Montana, is chartered under the laws of the State of Montana.
- \* Arizona Bank & Trust, Chandler, Arizona, is chartered under the laws of the State of Arizona.

Heartland has nine non-bank subsidiaries as listed below.

- \* Citizens Finance Co. is a consumer finance company with offices in Iowa, Illinois and Wisconsin.
- \* ULTEA, Inc. is a fleet leasing company headquartered in Madison, Wisconsin.
- \* HTLF Capital Corp. is an investment banking firm specializing in taxable and tax-exempt municipal financing headquartered in Denver, Colorado.
- \* Heartland Community Development Corp. is a certified community development entity with accountability to low-income communities in the Dubuque, Iowa, service area.
- \* Heartland Financial Statutory Trust II, Heartland Financial Capital Trust II, Heartland Financial Statutory Trust III, Heartland Financial Statutory Trust IV, and Rocky Mountain Statutory Trust I are special purpose trust subsidiaries of Heartland formed for the purpose of the offering of cumulative capital securities.

All of Heartland's subsidiaries are wholly-owned, except for Arizona Bank & Trust, of which Heartland owned 86% of the capital stock on December 31, 2005.

The Bank Subsidiaries provide full service retail banking in the communities in which they are located. Deposit products offered by the Bank Subsidiaries include checking and other demand deposit accounts, NOW accounts, savings accounts, money market accounts, certificates of deposit, individual retirement accounts, health savings accounts and other time deposits. The deposits in the Bank Subsidiaries are insured by the FDIC to the full extent permitted by law. Loans include commercial and industrial, agricultural, real estate mortgage, consumer, home equity, credit cards and lines of credit. Other products and services include VISA debit cards, automated teller machines, on-line banking, safe deposit boxes and trust services. The principal service of the Bank Subsidiaries consists of making loans to and accepting deposits from businesses and individuals. These loans are made at the offices of the Bank Subsidiaries. The Bank Subsidiaries also engage in activities that are closely related to banking, including investment brokerage.

### **Operating Strategy**

Heartland's operating strategy is based upon a community banking model with three major components:

1. Develop strong community banks:

- \*Establish community bank names and images
- \*Encourage community involvement and leadership
- \*Maintain active boards of directors chosen from the local community
- \*Retain local presidents and decision-making

2. Provide resources for revenue enhancement:

- \*Develop and implement a wide array of financial products and services for all Bank Subsidiaries
- \*Improve Bank Subsidiary funding costs by reducing higher-cost certificates of deposit; increasing the percentage of lower-cost transaction accounts such as checking, savings and money market accounts; emphasizing relationship banking and capitalizing on cross-selling opportunities
- \*Emphasize greater use of non-traditional sources of income, including trust and investment services, insurance, consumer finance, vehicle leasing and fleet management, and investment banking
- \*Evaluate and acquire state-of-the-art technology when the expected return justifies the cost

3. Provide customer-transparent cost savings:

- \*Centralize back office support functions so Bank Subsidiaries operate as efficiently as possible

Management believes the personal and professional service offered to customers provides an appealing alternative to the "megabanks" resulting from mergers and acquisitions in the financial services industry. While Heartland employs a community banking philosophy, management believes Heartland's size, combined with its complete line of financial products and services, is sufficient to effectively compete in the respective market areas. To remain price competitive, management also believes Heartland must manage expenses and gain economies of scale by centralizing back office support functions. Although each of Heartland's subsidiaries operates under the direction of its own board of directors, Heartland has standard operating policies regarding asset/liability management, liquidity management, investment

management, lending policies, and deposit structure management.

Another component of the operating strategy is to encourage all directors, officers and employees to maintain a strong ownership interest in Heartland. Since 1996, Heartland has provided an employee stock purchase plan. For the year ended December 31, 2005, employees purchased 14,268 shares under the plan. As of December 31, 2005, employees, officers, and directors owned approximately 25% of Heartland's outstanding common stock.

### **Acquisition and Expansion Strategy**

Heartland's strategy is to increase profitability and diversify its market area and asset base by expanding existing subsidiaries, by establishing *de novo* banks and through acquisitions. Heartland continually seeks and evaluates opportunities to establish branches, loan production offices, or other business facilities as a means of expanding its presence in current or new market areas. Heartland acquires established financial services organizations, primarily commercial banks or thrifts, when suitable candidates are identified and acceptable business terms can be negotiated. Heartland has also formed *de novo* banking institutions in locations determined to have market potential and suitable management candidates with banking expertise and a philosophy similar to Heartland's.

Heartland has focused on markets with growth potential in the Midwest and Western regions of the United States as it evaluates expansion and acquisition opportunities. In August 2003, Heartland and a group of investors opened Arizona Bank & Trust, a *de novo* banking operation, followed with a second location in 2004 and a third location in 2005. Additional expansion at Arizona Bank & Trust includes the announcement in January 2006 of an agreement to acquire Bank of the Southwest, a financial institution providing retail and commercial banking services in Phoenix and Tempe, Arizona. Heartland expects to combine the acquired assets and deposit accounts into Arizona Bank & Trust. Subject to approvals by bank regulatory authorities and shareholders, the transaction is expected to close during the second quarter of 2006. Heartland took another step toward expanding its Western presence in June of 2004 when it acquired Rocky Mountain Bancorporation, Inc., the one-bank holding company of Rocky Mountain Bank. Headquartered in Billings, Montana, Rocky Mountain Bank had assets of \$385 million at December 31, 2005, with nine branch locations throughout the state. In August of 2005, Heartland announced the addition of a loan production office in Denver, Colorado and its hopes to use this office as a springboard to opening its ninth full-service state chartered bank during the second quarter of 2006. The capital structure of this new bank, to be named Summit Bank & Trust, is anticipated to be very similar to that used when Arizona Bank & Trust was formed. Heartland's expected initial investment would be \$12.0 million, or 80% of the targeted \$15.0 million initial capital. One of Heartland's strategic goals is to expand its presence in the Western markets to 50% of Heartland's total assets, thereby balancing the growth in its Western markets with the stability of the Midwestern markets.

Heartland looks for opportunities outside the community banks and thrift categories when its board of directors and management determine the opportunities will provide a desirable strategic fit without posing undue risk. In this regard, Heartland established HTLF Capital Corp. in April 2003. HTLF Capital is an investment banking firm that specializes in taxable and tax-exempt municipal financing, either by providing direct investment on behalf of Heartland and its Bank Subsidiaries or by acting as a financial advisor for a variety of municipal transactions.

### **Lending Activities**

#### **General**

The Bank Subsidiaries provide a range of commercial and retail lending services to businesses and individuals. These credit activities include agricultural, commercial, residential real estate, consumer loans and commercial leases.

The Bank Subsidiaries aggressively market their services to qualified lending customers. Lending officers actively solicit the business of new companies entering their market areas as well as long-standing members of the Bank Subsidiaries' respective business communities. Through professional service, competitive pricing, and innovative

structure, the Bank Subsidiaries have been successful in attracting new lending customers. Heartland also actively pursues consumer lending opportunities. With convenient locations, advertising and customer communications, the Bank Subsidiaries have been successful in capitalizing on the credit needs of their market areas.

### **Commercial Loans**

The Bank Subsidiaries have a strong commercial loan base, with significant growth coming from Dubuque Bank and Trust Company, New Mexico Bank & Trust, Wisconsin Community Bank, and Arizona Bank & Trust. Dubuque Bank and Trust Company, in particular, continues to be a premier commercial lender in the tri-state area of northeast Iowa, northwest Illinois and southwest Wisconsin. The Bank Subsidiaries' current portfolios include, but are not limited to, loans to wholesalers, hospitality industry, real estate developers, manufacturers, building contractors, business services companies and retailers. The Bank Subsidiaries provide a wide range of business loans, including lines of credit for working capital and operational purposes and term loans for the acquisition of equipment and real estate. Although most loans are made on a secured basis, loans may be made on an unsecured basis where warranted by the overall financial condition of the borrower. Terms of commercial business loans generally range from one to five years.

Bank Subsidiaries continue to seek opportunities to expand the production of loans guaranteed by U.S. government agencies. Wisconsin Community Bank is designated as a Preferred Lender by the U.S. Small Business Administration (SBA). Wisconsin Community Bank is also the only lender in Wisconsin to be granted USDA Certified Lender status for the USDA Rural Development Business and Industry loan program and was one of the top ten lenders in the nation in this program for the past three years. Management believes that making these guaranteed loans helps its local communities as well as provides Heartland with a source of income and solid future lending relationships as such businesses grow and prosper.

The Bank Subsidiaries' commercial loans and leases are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The collateral support provided by the borrower for most of these loans and leases and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any exists. The primary repayment risks of commercial loans and leases are that the cash flows of the borrower may be unpredictable, and the collateral securing these loans may fluctuate in value.

Heartland understands the roles that sound credit skills and a common credit culture play in maintaining quality loan portfolios. As the credit portfolios of the Bank Subsidiaries have continued to grow, several changes have been made in their lending departments resulting in an overall increase in these departments' skill levels. In 2003, Heartland introduced the RMA Diagnostic Assessment to assess credit skills and training needs for over 80 of its credit personnel. After the initial introduction of this training tool, specific individualized training was established for existing personnel. All new lending personnel are expected to complete a similar diagnostic training program. Heartland also assists all of the member banks' commercial and agricultural lenders in the analysis and underwriting of credit through its staff in the credit administration department. This staff continues to expand as the total loans under management continue to grow.

Commercial lenders interact with their respective boards of directors each month. Heartland also utilizes an internal loan review function to analyze credits of the Bank Subsidiaries and to provide periodic reports to the respective boards of directors. Management has attempted to identify problem loans at an early date and to aggressively seek resolution of these situations.

### **Agricultural Loans**

Agricultural loans are emphasized by Dubuque Bank and Trust Company, Rocky Mountain Bank, Wisconsin Community Bank's Monroe banking center and New Mexico Bank & Trust's Clovis banking offices.

The Bank Subsidiaries that emphasize agricultural loans do so because of their location in or around rural markets. Dubuque Bank and Trust Company maintains its status as one of the largest agricultural lenders in the State of Iowa. Agricultural loans remain balanced in proportion to the rest of Heartland's loan portfolio, constituting approximately 12% of the total loan portfolio at December 31, 2005. Heartland's policies designate a primary and secondary lending area for each bank with the majority of outstanding agricultural operating and real estate loans to customers located within the primary lending area. Term loans secured by real estate are allowed within the secondary lending area.

Agricultural loans, many of which are secured by crops, machinery and real estate, are provided to finance capital improvements and farm operations as well as acquisitions of livestock and machinery. The ability of the borrower to repay may be affected by many factors outside of the borrower's control including adverse weather conditions, loss of livestock due to disease or other factors, declines in market prices for agricultural products and the impact of government regulations. The ultimate repayment of agricultural loans is dependent upon the profitable operation or management of the agricultural entity.

The agricultural loan departments work closely with all of their customers, including companies and individual farmers, and review the preparation of budgets and cash flow projections for the ensuing crop year. These budgets and cash flow projections are monitored closely during the year and reviewed with the customers at least once annually. The Bank Subsidiaries also work closely with governmental agencies, including the Farmers Home Administration, to help agricultural customers obtain credit enhancement products such as loan guarantees or interest assistance.

### **Residential Real Estate Mortgage Loans**

Mortgage lending remains a focal point for the Bank Subsidiaries as each of them continues to build real estate lending business. As long-term interest rates remained at low levels during 2005 and 2004, many customers elected mortgage loans that are fixed rate with fifteen or thirty year maturities. Heartland usually sells these loans into the secondary market but retains servicing on the majority of sold loans. Management believes that mortgage servicing on sold loans provides the Bank Subsidiaries with a relatively steady source of fee income compared to fees generated solely from mortgage origination operations. Moreover, the retention of servicing gives the Bank Subsidiaries the opportunity to maintain regular contact with mortgage loan customers.

As with agricultural and commercial loans, Heartland encourages the Bank Subsidiaries to participate in lending programs sponsored by U.S. government agencies when justified by market conditions. Beginning in 2004, Veterans Administration and Federal Home Administration loans were offered in all Bank Subsidiary markets.

### **Consumer Lending**

The Bank Subsidiaries' consumer lending departments provide all types of consumer loans including motor vehicle, home improvement, home equity, credit cards and small personal credit lines. Consumer loans typically have shorter terms, lower balances, higher yields and higher risks of default than one- to four-family residential mortgage loans. Consumer loan collections are dependent on the borrower's continuing financial stability, and are therefore more likely to be affected by adverse personal circumstances.

Citizens Finance Co. specializes in consumer lending and currently serves the consumer credit needs of approximately 5,800 customers in Iowa, Illinois and Wisconsin from its Dubuque, Iowa; Madison and Appleton, Wisconsin; and Loves Park and Crystal Lake, Illinois offices. Citizens Finance Co. typically lends to borrowers with past credit problems or limited credit histories. Heartland expects to incur a higher level of credit losses on Citizens Finance Co. loans compared to consumer loans originated by the Bank Subsidiaries. Correspondingly, returns on these loans are anticipated to be higher than those at the Bank Subsidiaries.

### **Trust and Investment Services**



Dubuque Bank and Trust Company, Galena State Bank and Trust Company and Wisconsin Community Bank have been offering trust and investment services in their respective communities for many years. In those markets which do not yet warrant a full trust department, the sales and administration is performed by Dubuque Bank and Trust Company personnel. In 2005, New Mexico Bank & Trust began offering trust and investment services. In 2003, Arizona Bank & Trust joined the list of banks offering trust and investment services. On August 31, 2004, Heartland completed its acquisition of the Wealth Management Group of Colonial Trust Company, a publicly held Arizona trust company based in Phoenix. The Wealth Management Group, Colonial Trust Company's personal trust division, had trust assets of \$154.0 million and projected annual revenues of \$1.2 million at August 31, 2004. This transaction provided a unique opportunity for Heartland to grow its trust business in the Southwestern marketplace. Colonial's seasoned management team and strong account base, combined with Heartland's strong support services, depth of expertise, and long track record of investment performance should prove to be a winning combination as we seek to elevate the profile of our newest subsidiary bank, Arizona Bank & Trust. As of December 31, 2005, total Heartland trust assets exceeded \$1.3 billion, the vast majority of which are assets under management. Collectively, the Bank Subsidiaries provide a full complement of trust and investment services for individuals and corporations. All of the Bank Subsidiaries have targeted their trust departments as primary areas for future growth.

Dubuque Bank and Trust Company is nationally recognized as a leading provider of socially responsible investment services, and it manages investment portfolios for religious and other non-profit organizations located throughout the United States. Dubuque Bank and Trust Company is also Heartland's lead bank in providing daily valuation 401(k) plans and other retirement services, including Heartland's retirement plans for its employees.

Heartland has formed a strategic alliance with Independent Financial Marketing Group, Inc. to operate independent securities offices at all of Heartland's bank subsidiaries. Through Independent Financial Marketing Group, Inc., Heartland offers a full array of investment services including mutual funds, annuities, retirement products, education savings products, brokerage services, employer sponsored plans, and insurance products. A complete line of vehicle, property and casualty, life and disability insurance and tax-free annuities are also offered by Heartland through DB&T Insurance.

## **B. MARKET AREAS**

### ***Dubuque Bank and Trust Company***

Dubuque Bank and Trust Company and Heartland are located in Dubuque County, Iowa, which encompasses the city of Dubuque and a number of surrounding rural communities. Citizens Finance Co. also operates within this market area, in addition to operating offices in Madison, Wisconsin; Appleton, Wisconsin; Loves Park, Illinois; and Crystal Lake, Illinois.

The city of Dubuque is located in northeastern Iowa, on the Mississippi River, approximately 175 miles west of Chicago, Illinois, and approximately 200 miles northeast of Des Moines, Iowa. It is strategically situated at the intersection of the state borders of Iowa, Illinois and Wisconsin. Based upon the results of the 2000 census, the city of Dubuque had a total population of approximately 58,000.

The principal offices of Heartland and Dubuque Bank and Trust Company's main bank currently occupy the same building. Due to growth in both companies, a building was acquired directly across the street from Dubuque Bank and Trust Company's main office to serve as an operations center for Heartland. Renovation of the 60,000 square foot building was completed in the second quarter of 2004.

In addition to its main banking office, Dubuque Bank and Trust Company operates seven branch offices, all of which are located in Dubuque County. In 2004 Dubuque Bank and Trust Company opened a branch facility at a strategically located intersection on the rapidly growing northwest side of Dubuque. Additionally, during 2003, Dubuque Bank and Trust Company relocated its branch facility in Farley, Iowa, to a newly constructed building that is more convenient

for its customers. As a subsidiary of Dubuque Bank and Trust Company, DB&T Insurance has substantially the same market area as the parent organization.

### ***Galena State Bank and Trust Company***

Galena State Bank and Trust Company is located in Galena, Illinois, which is less than five miles from the Mississippi River, approximately 20 miles east of Dubuque and 155 miles west of Chicago. Galena operates a second office in Stockton, Illinois. Both offices are located in Jo Daviess County, which has a population of approximately 22,000, according to the 2000 census.

### ***First Community Bank***

First Community Bank's main office is in Keokuk, Iowa, which is located in the southeast corner of Iowa near the borders of Iowa, Missouri and Illinois. Due to its location, First Community Bank serves customers in the tri-county region of Lee County, Iowa; Hancock County, Illinois; and Clark County, Missouri. First Community Bank has one branch office in Keokuk and another branch in the city of Carthage in Hancock County, Illinois. Keokuk is an industrial community with a population of approximately 11,000, and the population of Lee County is approximately 38,000.

### ***Riverside Community Bank***

Riverside Community Bank is located on the northeast edge of Rockford, Illinois, which is approximately 75 miles west of Chicago in Winnebago County. In addition to its main banking office, Riverside Community Bank has three branch offices, all of which are located in the Winnebago County area. Based on the 2000 census, the county had a population of 278,000, and the city of Rockford had a population of 150,000.

### ***Wisconsin Community Bank***

Wisconsin Community Bank's main office is located in Cottage Grove, Wisconsin, which is approximately 10 miles east of Madison in Dane County. Wisconsin Community Bank operates two branch offices in Madison suburbs. The Middleton branch opened in 1998, and an office in Fitchburg was opened in a newly constructed building in March 2003. According to the 2000 census, Dane County had a population of 427,000, and the village of Cottage Grove had a population of 3,800. Wisconsin Community Bank opened three offices in Sheboygan, DePere and Eau Claire, Wisconsin during 1999, operating under the name of Wisconsin Business Bank. The Sheboygan and DePere facilities are located in the northeastern Wisconsin counties of Sheboygan and Brown. The Eau Claire office was subsequently sold in the fourth quarter of 2002. In 2003, Wisconsin Community Bank opened a loan production office in Minneapolis, Minnesota, operating under the name of Wisconsin Business Bank. This office focuses on providing government guaranteed financing to businesses located in the Western region of the United States. During 2004, Wisconsin Business Bank changed its name to Heartland Business Bank in conjunction with its opening of a loan production office in Rockland, Massachusetts. Wisconsin Community Bank also acquired the Bank One Monroe Wisconsin banking center in July of 1999. The city of Monroe, which is approximately 50 miles southwest of Madison, is located in Green County in south central Wisconsin.

### ***New Mexico Bank & Trust***

New Mexico Bank & Trust operates seven offices in or around Albuquerque, New Mexico, in Bernalillo County. Based upon the 2000 census, the county had a population of 557,000, and the city had a population of 449,000. New Mexico Bank & Trust also operates five locations in the New Mexico communities of Clovis, Portales, and Melrose, all located in Curry County. Clovis is located in east central New Mexico, approximately 220 miles from Albuquerque, 100 miles northwest of Lubbock, Texas, and 105 miles southwest of Amarillo, Texas. In 2003 two

branch offices were opened in Santa Fe, in Santa Fe County.

### ***Arizona Bank & Trust***

Arizona Bank & Trust currently operates three offices; one in Phoenix which opened in 2005, one in Mesa, Arizona, which is located 15 miles east of Phoenix and the main office in Chandler, Arizona, which is located in the southern portion of metropolitan Phoenix. Both cities are located in Maricopa County. Chandler's current population is 218,000, as provided by the City of Chandler Office of Economic Development, compared to 177,000 reported in the 2000 census. The estimated population of Maricopa County in July 2001 was 3,029,000, according to the Arizona Department of Economic Security.

### ***Rocky Mountain Bank***

Rocky Mountain Bank operates from nine locations throughout the state of Montana. Rocky Mountain Bank's main office is in Billings which is the state's largest city and an agricultural, retail and business center. Billings is also the county seat of Yellowstone County within south-central Montana along Interstate-90. Based upon the 2000 census, the county had a population of 129,000 and the city had a population of 126,000. Six of the locations are spread primarily along the western corridor of the state of Montana. Kalispell was the most recent branch addition in 2005. Bigfork is located in Flathead County, 15 miles southeast of Kalispell along Highway 206. Bigfork is near the Big Mountain Ski Resort and Blacktail Ski Area. Bozeman is the county seat of Gallatin County and is 82 miles east of Butte on Interstate-90. Bozeman has a population of 30,000 and is the fifth largest city in Montana. Plains is located in Sanders County, on Route 200 near the Discovery Ski Basin Area. Stevensville is located in Ravalli County, 28 miles south of Missoula on Highway 93. Whitehall is located in Jefferson County, off Interstate-90 between Butte and Three Forks. Two of the locations are on the eastern side of Montana. Broadus is the county seat of Powder River County, and lies 77 miles south of Miles City close to the Wyoming state line along Highway 212. Plentywood is the county seat for Sheridan County and located 16 miles south of the Canadian border between the cities of Archer and Antelope on Highways 5 and 15.

## **C. COMPETITION**

Heartland encounters competition in all areas of its business pursuits. To compete effectively, develop its market base, maintain flexibility, and keep pace with changing economic and social conditions, Heartland continuously refines and develops its products and services. The principal methods of competing in the financial services industry are through price, service and convenience.

The Bank Subsidiaries' market areas are highly competitive. Many financial institutions based in the communities surrounding the Bank Subsidiaries actively compete for customers within Heartland's market area. The Bank Subsidiaries also face competition from finance companies, insurance companies, mortgage companies, securities brokerage firms, money market funds, loan production offices and other providers of financial services. Under the Gramm-Leach-Bliley Act, effective in 2000, securities firms and insurance companies that elect to become financial holding companies may acquire banks and other financial institutions. The Gramm-Leach-Bliley Act significantly changed the competitive environment in which Heartland and the Bank Subsidiaries conduct business. The financial services industry is also likely to become more competitive as technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties.

Heartland competes for loans principally through the range and quality of the services it provides, with an emphasis on building long-lasting relationships. Our strategy is to delight our customers through excellence in customer service and needs-based selling. We become their trusted financial advisor. Heartland believes that its long-standing presence in the community and personal service philosophy enhance its ability to compete favorably in attracting and retaining individual and business customers. Heartland actively solicits deposit-oriented clients and competes for deposits by

offering its customers personal attention, professional service and competitive interest rates.

#### **D. EMPLOYEES**

At December 31, 2005, Heartland employed 909 full-time equivalent employees. Heartland places a high priority on staff development, which involves extensive training in a variety of areas, including customer service training. New employees are selected based upon their technical skills and customer service capabilities. None of Heartland's employees are covered by a collective bargaining agreement. Heartland offers a variety of employee benefits, and management considers its employee relations to be excellent.

#### **E. INTERNET ACCESS**

Heartland maintains an Internet site at [www.htlf.com](http://www.htlf.com). Heartland offers 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 free of charge from its web site as soon as reasonably practical after meeting the electronic filing requirements of the Securities and Exchange Commission.

#### **F. SUPERVISION AND REGULATION**

##### **General**

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, the growth and earnings performance of Heartland may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory authorities, including the Iowa Superintendent of Banking (the "Iowa Superintendent"), the Illinois Department of Financial and Professional Regulation (the "Illinois DFPR"), the New Mexico Financial Institutions Division (the "New Mexico FID"), the Montana Financial Institution Division (the "Montana Division"), the Division of Banking of the Wisconsin Department of Financial Institutions (the "Wisconsin DFI"), the Arizona State Banking Department (the "Arizona Department"), the Board of Governors of the Federal Reserve System (the "Federal Reserve") and the Federal Deposit Insurance Corporation (the "FDIC"). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities and securities laws administered by the Securities and Exchange Commission (the "SEC") and state securities authorities have an impact on the business of Heartland. The effect of these statutes, regulations and regulatory policies may be significant, and cannot be predicted with a high degree of certainty.

Federal and state laws and regulations generally applicable to financial institutions regulate, among other things, the scope of business, the kinds and amounts of investments, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers and consolidations and the payment of dividends. This system of supervision and regulation establishes a comprehensive framework for the respective operations of Heartland and its subsidiaries and is intended primarily for the protection of the FDIC-insured deposits and depositors of the Bank Subsidiaries, rather than shareholders.

The following is a summary of the material elements of the regulatory framework that applies to Heartland and its subsidiaries. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. As such, the following is qualified in its entirety by reference to applicable law. Any change in statutes, regulations or regulatory policies may have a material effect on the business of Heartland and its subsidiaries.

##### **The Company**

**General.** Heartland, as the sole shareholder of Dubuque Bank and Trust Company, New Mexico Bank & Trust, Rocky Mountain Bank, Wisconsin Community Bank, Galena State Bank and Trust Company, Riverside Community Bank and First Community Bank and the controlling shareholder of Arizona Bank & Trust, is a bank holding company. As a bank holding company, Heartland is registered with, and is subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the “BHCA”). In accordance with Federal Reserve policy, Heartland is expected to act as a source of financial strength to the Bank Subsidiaries and to commit resources to support the Bank Subsidiaries in circumstances where Heartland might not otherwise do so. Under the BHCA, Heartland is subject to periodic examination by the Federal Reserve. Heartland is also required to file with the Federal Reserve periodic reports of Heartland’s operations and such additional information regarding Heartland and its subsidiaries as the Federal Reserve may require.

**Acquisitions, Activities and Change in Control.** The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including certain deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company.

The BHCA generally prohibits Heartland from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve to be “so closely related to banking ... as to be a proper incident thereto.” This authority would permit Heartland to engage in a variety of banking-related businesses, including the operation of a thrift, consumer finance, equipment leasing, the operation of a computer service bureau (including software development), and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. As of the date of this filing, Heartland has not applied for approval to operate as a financial holding company.

Federal law also prohibits any person or company from acquiring “control” of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. “Control” is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances at 10% ownership.

**Capital Requirements.** Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines. If capital levels fall below the minimum required levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (i) a risk-based requirement expressed as a percentage of total assets weighted according to risk; and (ii) a leverage requirement expressed as a percentage of total assets. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly rated companies, with a minimum requirement of 4% for all others. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders' equity less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus certain other debt and equity instruments that do not qualify as Tier 1 capital and a portion of Heartland's allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital less all intangible assets), well above the minimum levels. As of December 31, 2005, Heartland had regulatory capital in excess of the Federal Reserve's minimum requirements.

**Dividend Payments.** Heartland'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. As a Delaware corporation, Heartland is subject to the limitations of the Delaware General Corporation Law (the "DGCL"), which allows Heartland to pay dividends only out of its surplus (as defined and computed in accordance with the provisions of the DGCL) or if Heartland has no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. Additionally, policies of the Federal Reserve caution that a bank holding company should not pay cash dividends that exceed its net income or that can only be funded in ways that weaken the bank holding company's financial health, such as by borrowing. The Federal Reserve also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

**Federal Securities Regulation.** Heartland's common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Consequently, Heartland is subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

## **The Bank Subsidiaries**

**General.** Dubuque Bank and Trust Company and First Community Bank are Iowa-chartered banks. The deposit accounts of Dubuque Bank and Trust Company are insured by the FDIC's Bank Insurance Fund ("BIF"), while the deposit accounts of First Community Bank are insured by the FDIC's Savings Association Insurance Fund ("SAIF"). As Iowa-chartered banks, Dubuque Bank and Trust Company and First Community Bank are subject to the examination, supervision, reporting and enforcement requirements of the Iowa Superintendent, the chartering authority for Iowa banks, and the FDIC, designated by federal law as the primary federal regulator of state-chartered FDIC-insured banks that, like Dubuque Bank and Trust Company and First Community Bank, are not members of the Federal Reserve System ("non-member banks").

Galena State Bank and Trust Company and Riverside Community Bank are Illinois-chartered banks, the deposit accounts of which are insured by the BIF. As Illinois-chartered banks, Galena State Bank and Trust Company and Riverside Community Bank are subject to the examination, supervision, reporting and enforcement requirements of

the Illinois DFPR, the chartering authority for Illinois banks, and the FDIC, as the primary federal regulator of state-chartered FDIC-insured non-member banks.

New Mexico Bank & Trust is a New Mexico-chartered bank, the deposit accounts of which are insured by the BIF. As a New Mexico-chartered bank, New Mexico Bank & Trust is subject to the examination, supervision, reporting and enforcement requirements of the New Mexico FID, the chartering authority for New Mexico banks, and the FDIC, as the primary federal regulator of state-chartered FDIC-insured non-member banks.

Rocky Mountain Bank is a Montana-chartered bank, the deposit accounts of which are insured by the BIF. As a Montana-chartered, FDIC-insured non-member bank, Rocky Mountain Bank is subject to the examination, supervision, reporting and enforcement requirement of the Montana Division, as the chartering authority for Montana banks, and the FDIC, as the primary regulator of state-chartered FDIC-insured non-member banks.

Wisconsin Community Bank is a Wisconsin-chartered bank, the deposit accounts of which are insured by the BIF. As a Wisconsin-chartered bank, Wisconsin Community Bank is subject to the examination, supervision, reporting and enforcement requirements of the Wisconsin DFI, the chartering authority for Wisconsin banks, and the FDIC, as the primary federal regulator of state-chartered FDIC-insured non-member banks.

Arizona Bank & Trust is an Arizona-chartered bank, the deposit accounts of which are insured by the BIF. As an Arizona-chartered bank, Arizona Bank & Trust is subject to the examination, supervision, reporting and enforcement requirements of the Arizona Department, the chartering authority for Arizona banks, and the FDIC, as the primary federal regulator of state-chartered FDIC-insured non-member banks.

**Deposit Insurance.** As FDIC-insured institutions, the Bank Subsidiaries are required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system under which all insured depository institutions are placed into one of nine categories and assessed insurance premiums based upon their respective levels of capital and results of supervisory evaluations. Institutions classified as well-capitalized (as defined by the FDIC) and considered healthy pay the lowest premium while institutions that are less than adequately capitalized (as defined by the FDIC) and considered of substantial supervisory concern pay the highest premium. Risk classification of all insured institutions is made by the FDIC for each semi-annual assessment period.

During the year ended December 31, 2005, both BIF and SAIF assessments ranged from 0% of deposits to 0.27% of deposits. For the semi-annual assessment period beginning January 1, 2006, BIF and SAIF assessment rates will continue to range from 0% of deposits to 0.27% of deposits.

**FICO Assessments.** Since 1987, a portion of the deposit insurance assessments paid by members of the FDIC's SAIF has been used to cover interest payments due on the outstanding obligations of the Financing Corporation ("FICO"). FICO was created in 1987 to finance the recapitalization of the Federal Savings and Loan Insurance Corporation, the SAIF's predecessor insurance fund. As a result of federal legislation enacted in 1996, beginning as of January 1, 1997, both SAIF members and BIF members became subject to assessments to cover the interest payments on outstanding FICO obligations until the final maturity of such obligations in 2019. These FICO assessments are in addition to amounts assessed by the FDIC for deposit insurance. During the year ended December 31, 2005, the FICO assessment rate for BIF and SAIF members was approximately 0.01% of deposits.

**Supervisory Assessments.** Each of the Bank Subsidiaries is required to pay supervisory assessments to its respective state banking regulator to fund the operations of that agency. In general, the amount of the assessment is calculated on the basis of each institution's total assets. During the year ended December 31, 2005, the Bank Subsidiaries paid supervisory assessments totaling \$371 thousand.

**Capital Requirements.** Banks are generally required to maintain capital levels in excess of other businesses. Under federal regulations, the Bank Subsidiaries are subject to the following minimum capital standards: (i) a leverage

requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others; and (ii) a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. In general, the components of Tier 1 capital and total capital are the same as those for bank holding companies discussed above.

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, federal regulations provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

Further, federal law and regulations provide various incentives for financial institutions to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a financial institution that is “well-capitalized” may qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities and may qualify for expedited processing of other required notices or applications. Additionally, one of the criteria that determines a bank holding company’s eligibility to operate as a financial holding company is a requirement that all of its financial institution subsidiaries be “well-capitalized.” Under federal regulations, in order to be “well-capitalized” a financial institution must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total assets of 5% or greater.

Federal law also provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators’ powers depends on whether the institution in question is “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized,” in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators’ corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution’s asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2005: (i) none of the Bank Subsidiaries was subject to a directive from its primary federal regulator to increase its capital to an amount in excess of the minimum regulatory capital requirements; (ii) each of the Bank Subsidiaries exceeded its minimum regulatory capital requirements under applicable capital adequacy guidelines; and (iii) each of the Bank Subsidiaries was “well-capitalized,” as defined by applicable regulations.

***Liability of Commonly Controlled Institutions.*** Under federal law, institutions insured by the FDIC may be liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with the default of commonly controlled FDIC-insured depository institutions or any assistance provided by the FDIC to commonly controlled FDIC-insured depository institutions in danger of default. Because Heartland controls each of the Bank Subsidiaries, the Bank Subsidiaries are commonly controlled for purposes of these provisions of federal law.

***Dividend Payments.*** The primary source of funds for Heartland is dividends from the Bank Subsidiaries. In general, under applicable law, none of the Bank Subsidiaries may pay dividends in excess of its respective undivided profits.

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. As described above, each of the Bank Subsidiaries exceeded its minimum capital requirements under applicable guidelines as of December 31, 2005. Further, First Community Bank may not pay dividends in an amount that would reduce its capital below the amount required for the liquidation account established in connection with First Community Bank's conversion from the mutual to the stock form of ownership in 1991. As of December 31, 2005, approximately \$65.2 million was available to be paid as dividends by the Bank Subsidiaries. Notwithstanding the availability of funds for dividends, however, the FDIC may prohibit the payment of any dividends by the Bank Subsidiaries if the agency determines such payment would constitute an unsafe or unsound practice.

**Insider Transactions.** The Bank Subsidiaries are subject to certain restrictions imposed by federal law on extensions of credit to Heartland and its subsidiaries, on investments in the stock or other securities of Heartland and its subsidiaries and the acceptance of the stock or other securities of Heartland or its subsidiaries as collateral for loans made by the Bank Subsidiaries. Certain limitations and reporting requirements are also placed on extensions of credit by each of the Bank Subsidiaries to its directors and officers, to directors and officers of Heartland and its subsidiaries, to principal shareholders of Heartland and to "related interests" of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of Heartland or any of its subsidiaries or a principal shareholder of Heartland may obtain credit from banks with which the Bank Subsidiaries maintain correspondent relationships.

**Safety and Soundness Standards.** The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings. In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator's order is cured, the regulator may restrict the institution's rate of growth, require the institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal banking regulators, including cease and desist orders and civil money penalty assessments.

**Branching Authority.** Each of the Bank Subsidiaries has the authority, pursuant to the laws under which it is chartered, to establish branches anywhere in the state in which its main office is located, subject to the receipt of all required regulatory approvals.

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. The establishment of new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is permitted only in those states the laws of which expressly authorize such expansion.

**State Bank Investments and Activities.** Each of the Bank Subsidiaries generally is permitted to make investments and engage in activities directly or through subsidiaries as authorized by the laws of the state under which it is chartered. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law and FDIC regulations also prohibit FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity

would not pose a significant risk to the deposit insurance fund of which the bank is a member. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank Subsidiaries.

**Federal Reserve System.** Federal Reserve regulations, as presently in effect, require depository institutions to maintain non-interest earning reserves against their transaction accounts (primarily NOW and regular checking accounts), as follows: for transaction accounts aggregating \$48.3 million or less, the reserve requirement is 3% of total transaction accounts; and for transaction accounts aggregating in excess of \$48.3 million, the reserve requirement is \$1.215 million plus 10% of the aggregate amount of total transaction accounts in excess of \$48.3 million. The first \$7.8 million of otherwise reservable balances are exempted from the reserve requirements. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank Subsidiaries are in compliance with the foregoing requirements.

### **Recent Regulatory Developments**

On February 8, 2006, President Bush signed the Federal Deposit Insurance Reform Act of 2005 ("FDIRA") into law as part of the Deficit Reduction Act of 2005. On February 15, 2006, President Bush signed into law the technical and conforming amendments designed to implement FDIRA. FDIRA provides for legislative reforms to modernize the federal deposit insurance system.

Among other things, FDIRA: (i) merges the BIF and the SAIF of the FDIC into a new Deposit Insurance Fund (the "DIF"); (ii) allows the FDIC, after March 31, 2010, to increase deposit insurance coverage by an adjustment for inflation and requires the FDIC's Board of Directors, not later than April 1, 2010, and every five years thereafter, to consider whether such an increase is warranted; (iii) increases the deposit insurance limit for certain employee benefit plan deposits from \$100,000 to \$250,000, subject to adjustments for inflation after March 31, 2010, and provides for pass-through insurance coverage for such deposits; (iv) increases the deposit insurance limit for certain retirement account deposits from \$100,000 to \$250,000, subject to adjustments for inflation after March 31, 2010; (v) allows the FDIC's Board of Directors to set deposit insurance premium assessments in any amount the Board of Directors deems necessary or appropriate, after taking into account various factors specified in FDIRA; (vi) replaces the fixed designated reserve ratio of 1.25% with a reserve ratio range of 1.15%-1.50%, with the specific reserve ratio to be determined annually by the FDIC by regulation; (vii) permits the FDIC to revise the risk-based assessment system by regulation; (viii) requires the FDIC, at the end of any year in which the reserve ratio of the DIF exceeds 1.50% of estimated insured deposits, to declare a dividend payable to insured depository institutions in an amount equal to 100% of the amount held by the DIF in excess of the amount necessary to maintain the DIF's reserve ratio at 1.50% of estimated insured deposits or to declare a dividend equal to 50% of the amount in excess of the amount necessary to maintain the reserve ratio at 1.35% if the reserve ratio is between 1.35%-1.50% of estimated insured deposits; and (ix) provides a one-time credit based upon the assessment base of the institution on December 31, 1996, to each insured depository institution that was in existence as of December 31, 1996, and paid a deposit insurance assessment prior to that date (or a successor to any such institution).

The merger of the BIF and the SAIF will take effect no later than July 1, 2006, while the remaining provisions are not effective until the FDIC issues final regulations. FDIRA requires the FDIC to issue final regulations no later than 270 days after enactment: (i) designating a reserve ratio; (ii) implementing increases in deposit insurance coverage; (iii) implementing the dividend requirement; (iv) implementing the one-time assessment credit; and (v) providing for assessments in accordance with FDIRA.

### **G. GOVERNMENTAL MONETARY POLICY AND ECONOMIC CONDITIONS**

Heartland's earnings are affected by the policies of regulatory authorities, including the Federal Reserve System. The Federal Reserve System's monetary policies have significantly affected the operating results of commercial banks in the past and are expected to continue doing so in the future. Changing economic and money market conditions prompted by the actions of monetary and fiscal authorities may cause changes in interest rates, credit availability, and

deposit levels that are beyond Heartland's control. Future policies of the Federal Reserve System and other authorities cannot be predicted, nor can their effect on future earnings be predicted.

## 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 is concentrated in and dependent upon the continued growth and welfare of the various markets that we serve.**

We operate over a wide area, including markets in Iowa, Illinois, Wisconsin, Arizona, New Mexico and Montana and our financial condition, results of operations and cash flows are subject to changes in the economic conditions in those areas. Our success depends upon the business activity, population, income levels, deposits and real estate activity in those areas. Although our customers' business and financial interests may extend well beyond our market areas, adverse economic conditions that affect our specific market area 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.

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

As part of our general growth strategy, we may acquire banks and related businesses that we believe provide a strategic and geographic 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 risks commonly associated with acquisitions, 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;
- potential disruption to our business;
- potential diversion of our management's time and attention; and
- the possible loss of key employees and customers of the banks and businesses we acquire.

In addition to acquisitions, 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 up to two years for new banking facilities to first achieve operational profitability, due to the impact of organization and overhead expenses and the start-up phase of generating loans and deposits. To the extent that we undertake additional branching and *de novo* bank and business formations, 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.

**Our market and growth strategy relies heavily on our management team, and the unexpected loss of key managers may adversely affect our operations.**

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 different market areas. Because our service areas are spread over such a wide geographical area, our management headquartered in Dubuque, Iowa is dependent on the effective leadership and capabilities of the management in our local markets for the continued success of Heartland. Our ability to retain executive officers, the current management teams 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 area 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.

**We face intense competition in all phases of our business.**

The banking and financial services business in our markets is highly competitive. Our competitors include large regional banks, local community banks, thrifts, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market mutual funds, credit unions and other non-bank financial service providers. 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.

**Interest rates and other conditions impact our results of operations.**

Our profitability is in part a function of the spread between the interest rates earned on investments and loans 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 terms or the mix of adjustable and fixed rate loans 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.

**Commercial loans make up a significant portion of our loan portfolio.**

Commercial loans were \$1.33 billion (including \$961.7 million of commercial real estate loans), or approximately 67% of our total loan portfolio as of December 31, 2005. Our commercial loans 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, machinery or real estate. 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 other types of collateral securing these loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

**Our loan portfolio has a large concentration of commercial real estate loans, which involve risks specific to real estate value.**

Commercial real estate lending is a large portion of our commercial loan portfolio. These loans were \$961.7 million, or approximately 72% of our total commercial loan portfolio as of December 31, 2005. The market value of real estate 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 loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then 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 and financial condition.

Our commercial real estate loans also include commercial construction loans, including land acquisition and development. Construction, land acquisition and development lending involve additional risks because funds are advanced based upon estimates of costs and the estimated value of the completed project. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, commercial construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project.

**Our agricultural loans may involve a greater degree of risk than other loans, and the ability of the borrower to repay may be affected by many factors outside of the borrower's control.**

At December 31, 2005, agricultural real estate loans totaled \$230.3 million, or 12%, of our total loan and lease portfolio. Payments on agricultural real estate loans are dependent on the profitable operation or management of the farm property securing the loan. The success of the farm may be affected by many factors outside the control of the borrower, including adverse weather conditions that prevent the planting of a crop or limit crop yields (such as hail, drought and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally) and the impact of government regulations (including changes in price supports, subsidies and environmental regulations). In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower's ability to repay the loan may be impaired. The primary crops in our market areas are corn, soybeans, peanuts and wheat. Accordingly, adverse circumstances affecting these crops could have an adverse effect on our agricultural real estate loan portfolio.

We also originate agricultural operating loans. At December 31, 2005, these loans totaled \$75.7 million, or 4%, of our total loan and lease portfolio. As with agricultural real estate loans, the repayment of operating loans is dependent on the successful operation or management of the farm property. Likewise, agricultural operating loans involve a greater degree of risk than lending on residential properties, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets such as farm equipment or assets such as livestock or crops. The primary livestock in our market areas include dairy cows, hogs and feeder cattle. In these cases, any repossessed collateral for a defaulted loan

may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation.

**Our one- to four-family residential mortgage loans may result in lower yields and profitability.**

One- to four-family residential mortgage loans comprised \$219.0 million, or 11%, of our loan and lease portfolio at December 31, 2005, and are secured primarily by properties located in the Midwest. These loans result in lower yields and lower profitability for us and are generally made on the basis of the borrower's ability to make repayments from his or her employment and the value of the property securing the loan.

**Our consumer loans generally have a higher degree of risk of default than our other loans.**

At December 31, 2005, consumer loans totaled \$181.0 million, or 9%, of our total loan and lease portfolio. Consumer loans typically have shorter terms and lower balances with higher yields as compared to one- to four-family residential loans, but generally carry higher risks of default. Consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on these loans.

**Our allowance for loan losses may prove to be insufficient to absorb probable losses in our loan portfolio.**

We established our allowance for loan losses in consultation with management of our bank subsidiaries and maintain it at a level considered adequate by management to absorb probable loan losses that are inherent in the portfolio. The amount of future loan 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, 2005, our allowance for loan losses as a percentage of total loans was 1.42% and as a percentage of total non-performing loans was approximately 185.37%. Although management believes that the allowance for loan losses is adequate to absorb losses on any existing loans that may become uncollectible, we cannot predict loan losses with certainty, and we cannot assure you that our allowance for loan losses will prove sufficient to cover actual loan losses in the future. Loan losses in excess of our reserves may adversely affect 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 will satisfy our capital requirements for the foreseeable future. However, we may at some point need to raise additional capital to support continued growth, both internally and through acquisitions. 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 and acquisitions could be materially impaired.

**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 the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the various state agencies where we have a bank presence. 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.

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

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. 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 and expand our market areas. 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.

**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 or 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, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

**ITEM 1B.**

**UNRESOLVED STAFF COMMENTS**

As of December 31, 2005, Heartland had no unresolved staff comments.

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**ITEM 2.****PROPERTIES**

The following table is a listing of Heartland's principal operating facilities:

<b>Name and Main Facility Address</b>	<b>Main Facility Square Footage</b>	<b>Main Facility Owned or Leased</b>	<b>Number of Locations</b>
<b><u>Banking Subsidiaries</u></b>			
Dubuque Bank and Trust Company 1398 Central Avenue Dubuque, IA 52001	59,500	Owned	8
Galena State Bank and Trust Company 971 Gear Street Galena, IL 61036	18,000	Owned	3
Riverside Community Bank 6855 E. Riverside Blvd. Rockford, IL 60114	8,000	Owned	4
First Community Bank 320 Concert Street Keokuk, IA 52632	6,000	Owned	3
Wisconsin Community Bank 580 North Main Street Cottage Grove, WI 53527	6,000	Owned	6
New Mexico Bank & Trust 320 Gold NW Albuquerque, NM 87102	11,400	Lease term through 2006	14
Arizona Bank & Trust 1000 N. 54 <sup>th</sup> Street Chandler, AZ 85226	8,500	Owned	3
Rocky Mountain Bank 2615 King Avenue West Billings, MT 59102	16,600	Owned	9
<b><u>Non-Bank Subsidiaries</u></b>			
Citizens Finance Co. 1275 Main Street Dubuque, IA 52001		Leased from DB&T	5
ULTEA, Inc. 2976 Triverton Pike Madison, WI 53711		Leased	1

HTLF Capital Corp.  
World Trade Center  
1625 Broadway  
Denver, CO 80202

Leased 1

The principal office of Heartland is located in Dubuque Bank and Trust Company's main office.

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**ITEM 3.**

**LEGAL PROCEEDINGS**

There are certain legal proceedings pending against Heartland and its subsidiaries at December 31, 2005, that are ordinary routine litigation incidental to business. While the ultimate outcome of current legal proceedings cannot be predicted with certainty, it is the opinion of management that the resolution of these legal actions should not have a material effect on Heartland's consolidated financial position or results of operations.

**ITEM 4.**

**SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted during the fourth quarter of 2005 to a vote of security holders.

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**PART II****ITEM 5.****MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Heartland's common stock was held by approximately 1,400 stockholders of record as of March 7, 2006, and has been quoted on the Nasdaq National Market System since May 2003 under the symbol "HTLF". Prior to quotation on the Nasdaq National Market System, the common stock of Heartland was traded on the over-the-counter market.

For the periods indicated, the following table shows the range of reported prices per share of Heartland's common stock in the Nasdaq National Market System. These quotations represent inter-dealer prices without retail markups, markdowns, or commissions and do not necessarily represent actual transactions.

**Heartland  
Common  
Stock****Calendar    High   Low  
Quarter**

2005:

First	\$	\$
	21.31	18.37

Second	21.22	19.06
--------	-------	-------

Third	20.99	19.04
-------	-------	-------

Fourth	21.74	18.84
--------	-------	-------

2004:

First	\$	\$
	19.81	18.06

Second	18.95	16.75
--------	-------	-------

Third	18.99	16.73
-------	-------	-------

Fourth	22.07	18.26
--------	-------	-------

Cash dividends have been declared by Heartland quarterly during the past two years ending December 31, 2005. The following table sets forth the cash dividends per share paid on Heartland's common stock for the past two years:

**Calendar    2005 2004  
Quarter**

First	\$ .08	\$ .08
-------	--------	--------

Second	.08	.08
--------	-----	-----

Third	.08	.08
Fourth	.09	.08

Heartland's ability to pay dividends to stockholders is largely dependent upon the dividends it receives from the Bank Subsidiaries, and the banks are subject to regulatory limitations on the amount of cash dividends they may pay. See "Business - Supervision and Regulation - Heartland - Dividend Payments" and "Business - Supervision and Regulation - The Bank Subsidiaries - Dividend Payments" for a more detailed description of these limitations.

Heartland has issued junior subordination debentures in several private placements. Under the terms of the debentures, Heartland may be prohibited, under certain circumstances, from paying dividends on shares of its common stock. None of these circumstances currently exist.

The following table provides information about purchases by Heartland and its affiliated purchasers during the quarter ended December 31, 2005, of equity securities that are registered by Heartland pursuant to Section 12 of the Exchange Act:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1)</sup>
10/01/05- 10/31/05	10,895	\$19.19	10,895	\$1,265,792
11/01/05- 11/30/05	16,303	\$20.53	16,303	\$1,405,299
12/01/05- 12/31/05	1,558	\$20.40	1,558	\$1,882,483
Total:	28,756	\$20.01	28,756	N/A

(1) On October 19, 2004, Heartland's board of directors increased the dollar value of its common stock that management is authorized to acquire and hold as treasury shares from \$4.0 million to \$5.0 million at any one time.

## ITEM 6.

### SELECTED FINANCIAL DATA

For the years ended December 31, 2005, 2004, 2003, 2002 and 2001

(Dollars in thousands, except per share data)

	2005	2004	2003	2002	2001
<b>STATEMENT OF INCOME</b>					

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**DATA**

Interest income	\$	154,002	\$	121,394	\$	99,517	\$	100,012	\$	107,609
Interest expense		61,135		44,264		38,327		42,332		58,620
Net interest income		92,867		77,130		61,190		57,680		48,989
Provision for loan and lease losses		6,564		4,846		4,183		3,553		4,258
Net interest income after provision for loan and lease losses		86,303		72,284		57,007		54,127		44,731
Noninterest income		41,585		37,841		36,541		30,645		28,620
Noninterest expense		95,012		81,936		67,692		60,659		56,692
Income taxes		10,150		7,937		8,137		7,523		5,530
Income from continuing operations		22,726		20,252		17,719		16,590		11,129
Discontinued operations:										
Income from operations of discontinued branch (including gain on sale of \$2,602 in 2002)		-		-		-		3,751		469
Income taxes		-		-		-		1,474		184
Income from discontinued operations		-		-		-		2,277		285
Net income	\$	22,726	\$	20,252	\$	17,719	\$	18,867	\$	11,414

**PER  
COMMON  
SHARE  
DATA**

Net income - diluted	\$	1.38	\$	1.26	\$	1.16	\$	1.28	\$	0.78
Income from continuing operations - diluted <sup>1</sup>		1.36		1.26		1.16		1.12		0.76
Adjusted net income - diluted <sup>2</sup>		1.36		1.26		1.16		1.28		0.85
		1.36		1.26		1.16		1.12		0.84

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Adjusted  
income from  
continuing  
operations -  
diluted<sup>3</sup>

Cash dividends	0.33	0.32	0.27	0.27	0.25
Dividend payout ratio	23.82%	24.87%	23.09%	20.81%	31.19%
Book value	\$ 11.46	\$ 10.69	\$ 9.29	\$ 8.40	\$ 7.37
Weighted average shares outstanding-diluted	16,702,146	16,084,557	15,258,440	14,783,554	14,558,231

**BALANCE  
SHEET  
DATA**

Investments and federal funds sold	\$ 567,002	\$ 553,284	\$ 451,753	\$ 424,514	\$ 349,417
Loans held for sale	40,745	32,161	25,678	23,167	26,967
Total loans and leases, net of unearned	1,953,066	1,772,954	1,322,549	1,152,069	1,078,238
Allowance for loan and lease losses	27,791	24,973	18,490	16,091	14,660
Total assets	2,818,332	2,629,055	2,018,366	1,785,979	1,644,064
Total deposits	2,118,178	1,983,846	1,492,488	1,337,985	1,205,159
Long-term obligations	220,871	196,193	173,958	161,379	143,789
Stockholders' equity	187,812	175,782	140,923	124,041	107,090

**EARNINGS  
PERFORMANCE  
DATA**

Return on average total assets	0.84%	0.87%	0.95%	1.13%	0.72%
Return on average stockholders' equity	12.55	12.82	13.46	16.44	11.32
Net interest margin ratio <sup>1,4</sup>	3.99	3.87	3.80	4.04	3.67
Earnings to fixed charges: Excluding interest on deposits	2.79x	3.03x	3.37x	3.28x	2.27x

Including interest on deposits	1.53	1.63	1.67	1.57	1.28
--------------------------------	------	------	------	------	------

# **ASSET QUALITY RATIOS**

Nonperforming assets to total assets	0.60%	0.41%	0.32%	0.29%	0.52%
Nonperforming loans and leases to total loans and leases	0.77	0.56	.42	0.39	0.75
Net loan and lease charge-offs to average loans and leases	0.17	0.16	0.14	0.16	0.31
Allowance for loan and lease losses to total loans and leases	1.42	1.41	1.40	1.40	1.36
Allowance for loan and lease losses to nonperforming loans and leases	185.37	251.62	333.11	358.77	180.47

# **CAPITAL RATIOS**

Average equity to average assets	6.68%	6.77%	7.03%	6.86%	6.47%
Total capital to risk-adjusted assets	10.61	10.82	12.42	11.86	10.89
Tier 1 leverage	7.66	7.26	8.07	8.24	7.53

<sup>1</sup> Excludes the discontinued operations of our Eau Claire branch and the related gain on sale in the fourth quarter of 2002.

<sup>2</sup> Excludes goodwill amortization discontinued with the adoption of FAS 142 on January 1, 2002, and the adoption of FAS 147 on September 30, 2002.

<sup>3</sup> Excludes goodwill amortization discontinued with the adoption of FAS 142 on January 1, 2002, and the adoption of FAS 147 on September 30, 2002, and the discontinued operations of our Eau Claire branch and the related gain on sale in the fourth quarter of 2002.

<sup>4</sup> Tax equivalent using a 35% tax rate for all periods presented.





## ITEM 7.

### MANAGEMENT'S DISCUSSION AND ANALYSIS

The following presents management's discussion and analysis of the consolidated financial condition and results of operations of Heartland Financial USA, Inc. ("Heartland") as of the dates and for the periods indicated. This discussion should be read in conjunction with the Selected Financial Data, Heartland's Consolidated Financial Statements and the Notes thereto and other financial data appearing elsewhere in this report. The consolidated financial statements include the accounts of Heartland and its subsidiaries. All of Heartland's subsidiaries are wholly-owned except for Arizona Bank & Trust, of which Heartland was an 86% owner on December 31, 2005 and 2004, and WCB Mortgage, LLC, of which Heartland was a 55% owner on December 31, 2004. WCB Mortgage, LLC, ceased operations and was dissolved effective January 1, 2005.

### SAFE HARBOR STATEMENT

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

Heartland's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. The factors which could have a material adverse effect on the operations and future prospects of Heartland and its subsidiaries are detailed in the "Risk Factors" section included under Item 1A. of Part I of this Form 10-K. In addition to the risk factors described in that section, there are other factors that may impact any public company, including Heartland, which could have a material adverse effect on the operations and future prospects of Heartland and its subsidiaries. These additional factors include, but are not limited to, the following:

- \* The economic impact of past and any future terrorist attacks, acts of war or threats thereof, and the response of the United States to any such threats and attacks.
- \* The costs, effects and outcomes of existing or future litigation.
- \* Changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board.
- \* The ability of Heartland to manage the risks associated with the foregoing as well as anticipated.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

### OVERVIEW

Heartland is a diversified financial services holding company providing full-service community banking through eight banking subsidiaries with a total of 50 banking locations in Iowa, Illinois, Wisconsin, New Mexico, Arizona and Montana. In addition, Heartland has separate subsidiaries in the consumer finance, vehicle leasing/fleet management, insurance and investment management businesses. Heartland's primary strategy is to balance its focus on increasing profitability with asset growth and diversification through acquisitions, *de novo* bank formations, branch openings and expansion into non-bank subsidiary activities.

Heartland's results of operations depend primarily on net interest income, which is the difference between interest income from interest earning assets and interest expense on interest bearing liabilities. Noninterest income, which includes service charges, fees and gains on loans, rental income on operating leases and trust income, also affects Heartland's results of operations. Heartland's principal operating expenses, aside from interest expense, consist of compensation and employee benefits, occupancy and equipment costs, depreciation on equipment under operating leases and provision for loan and lease losses.

Net income for the year ended December 31, 2005, was \$22.7 million, an increase of \$2.4 million or 12%, over the \$20.3 million recorded for 2004. Earnings per diluted share was \$1.36 for 2005, compared to \$1.26 for 2004, an increase of \$.10 or 8%. Return on average equity was 12.55% and return on average assets was 0.84% for 2005, compared to 12.82% and 0.87%, respectively, for 2004. The improved earnings were primarily due to the \$15.7 million or 20% growth in net interest income. Average earning assets increased from \$2.07 billion during 2004 to \$2.41 billion during 2005. Noninterest income improved \$3.7 million or 10%, driven primarily by service charges and fees, trust fees, rental income on operating leases and other noninterest income. Partially offsetting these increases was the \$1.7 million or 35% additional provision for loan and lease losses and the \$13.1 million or 16% increase in noninterest expense during 2005. Expansion efforts completed during 2005 included the opening of one banking location at each of the following Bank Subsidiaries: Arizona Bank & Trust, New Mexico Bank & Trust, Rocky Mountain Bank and Riverside Community Bank. Also contributing to the increased earnings for 2005, compared to 2004, was a full year of earnings at the acquired Rocky Mountain Bank. This acquisition was completed on June 1, 2004, therefore only seven months of their earnings were included in the 2004 results. Rocky Mountain Bank's contribution to net income during 2005 was \$2.8 million compared to \$2.3 million during 2004.

At December 31, 2005, total assets reached \$2.82 billion, an increase of \$189.3 million or 7% since year-end 2004. Total loans and leases were \$1.95 billion at December 31, 2005, an increase of \$180.1 million or 10% since year-end 2004. All of Heartland's subsidiary banks experienced loan growth since year-end 2004, with major contributions from Dubuque Bank and Trust Company, New Mexico Bank & Trust, Arizona Bank & Trust and Galena State Bank and Trust Company. All loan categories increased during 2005, with \$142.0 million or 79% of the total loan growth in the commercial and commercial real estate category. Total deposits at December 31, 2005, were \$2.12 billion, an increase of \$134.3 million or 7% since year-end 2004. Except for Wisconsin Community Bank and First Community Bank, all of Heartland's subsidiary banks increased deposits during 2005. Demand deposit balances increased by \$29.7 million or 9% and time deposit balances increased by \$101.1 million or 11% during the year. Heartland's two newer *de novo* banks, New Mexico Bank & Trust and Arizona Bank & Trust, have been the most successful at attracting demand deposits. Also experiencing meaningful growth in demand deposits in 2005 was Rocky Mountain Bank. Over half of the growth in the time deposit category occurred at Heartland's largest subsidiary bank, Dubuque Bank and Trust Company. All of the other Heartland subsidiary banks, except for Wisconsin Community and First Community Bank, experienced growth in time deposits, with more significant growth occurring at New Mexico Bank & Trust and Rocky Mountain Bank. Of particular note is that substantially all of the growth in time deposits occurred in deposits from local markets, as total brokered deposits ended 2005 at \$145.5 million, an increase of \$4.5 million or less than 4% since year-end 2004.

Total net income was \$20.3 million during 2004 compared to \$17.7 million during 2003, an increase of \$2.5 million or 14%. Earnings per diluted share was \$1.26 during 2004 compared to \$1.16 during 2003. Return on average equity was 12.82% and return on average assets was 0.87% for 2004, compared to 13.46% and 0.95%, respectively, for 2003.

Heartland completed a number of its growth initiatives during 2004. Effective June 1, 2004, Heartland expanded into the Rocky Mountain region through the acquisition of Rocky Mountain Bank, providing banking services in eight communities throughout the state of Montana. Also in June, a majority of Heartland's operations resources moved into a new state-of-the-art operations center in Dubuque, Iowa. Expansion in the Phoenix area included Arizona Bank & Trust's opening of its second branch location in Chandler in May and the completion of the acquisition of Wealth Management Group of Colonial Trust Company effective September 1, 2004. The addition of Rocky Mountain Bank had a positive impact on earnings. Net income at Rocky Mountain Bank totaled \$2.3 million for the seven months of its operations as a Heartland subsidiary bank. At December 31, 2004, Rocky Mountain Bank had total assets of \$373.1 million, total loans of \$265.9 million and total deposits of \$290.4 million.

Net interest income during 2004 grew significantly, increasing \$15.9 million or 26% over 2003. Noninterest income experienced growth of \$1.3 million or 4% during that same period despite a reduction in gains on sale of loans of \$2.9 million as a result of less refinancing activity in mortgage loans. The two noninterest income categories recording the more significant increases for the year were service charges and fees and trust fees. Noninterest expense for 2004 increased \$14.2 million or 21%, primarily due to costs associated with expansion efforts, write off of the unamortized issuance costs on redeemed trust preferred securities and costs surrounding implementation of internal control provisions of the Sarbanes-Oxley Act of 2002.

Total assets nearly reached \$2.63 billion at December 31, 2004, up \$610.7 million or 30% since year-end 2003. Total loans and leases were \$1.77 billion at December 31, 2004, an increase of \$450.4 million or 34% since year-end 2003. Dubuque Bank and Trust Company, Wisconsin Community Bank, Arizona Bank & Trust and New Mexico Bank & Trust were major contributors to the \$184.5 million or 12% growth in loans, exclusive of the \$265.9 million in loans at Rocky Mountain Bank, primarily in the commercial and commercial real estate category. Total deposits at December 31, 2004, were \$1.98 billion, an increase of \$491.4 million or 33% since year-end 2003. Exclusive of the \$290.4 million in deposits at Rocky Mountain Bank, the \$201.0 million or 13% growth in deposits came primarily from New Mexico Bank & Trust and Arizona Bank & Trust.

## **CRITICAL ACCOUNTING POLICIES**

The process utilized by Heartland to estimate the adequacy of the allowance for loan and lease losses is considered a critical accounting policy for Heartland. The allowance for loan and lease losses represents management's estimate of identified and unidentified losses in the existing loan portfolio. Thus, the accuracy of this estimate could have a material impact on Heartland's earnings. The adequacy of the allowance for loan and lease losses is determined using factors that include the overall composition of the loan portfolio, general economic conditions, types of loans, loan collateral values, past loss experience, loan delinquencies, and potential losses from identified substandard and doubtful credits. Nonperforming loans and large non-homogeneous loans are specifically reviewed for impairment and the allowance is allocated on a loan by loan basis as deemed necessary. Homogeneous loans and loans not specifically evaluated are grouped into pools to which a loss percentage, based on historical experience, is allocated. The adequacy of the allowance for loan and lease losses is monitored on an ongoing basis by the loan review staff, senior management and the banks' boards of directors. Specific factors considered by management in establishing the allowance included the following:

- \* Heartland has continued to experience growth in more complex commercial loans as compared to relatively lower-risk residential real estate loans.
- \* During the last several years, Heartland has entered new markets in which it had little or no previous lending experience.

There can be no assurances that the allowance for loan and lease losses will be adequate to cover all loan losses, but management believes that the allowance for loan and lease losses was adequate at December 31, 2005. While management uses available information to provide for loan and lease losses, the ultimate collectibility of a substantial

portion of the loan portfolio and the need for future additions to the allowance will be based on changes in economic conditions. Even though there have been various signs of emerging strength in the economy, it is not certain that this strength will be sustainable. Should the economic climate deteriorate, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs, and delinquencies could rise and require further increases in the provision for loan and lease losses. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan and lease losses carried by the Heartland subsidiaries. Such agencies may require Heartland to make additional provisions to the allowance based upon their judgment about information available to them at the time of their examinations.

The table below estimates the theoretical range of the 2005 allowance outcomes and related changes in provision expense assuming either a reasonably possible deterioration in loan credit quality or a reasonably possible improvement in loan credit quality.

### **THEORETICAL RANGE OF ALLOWANCE FOR LOAN AND LEASE LOSSES**

(Dollars in thousands)

Allowance for loan and lease losses at December 31, 2005	\$	27,791
Assuming deterioration in credit quality:		
Addition to provision		2,481
Resultant allowance for loan and lease losses	\$	30,272
Assuming improvement in credit quality:		
Reduction in provision		(1,030)
Resultant allowance for loan and lease losses	\$	26,761

The assumptions underlying this sensitivity analysis represent an attempt to quantify theoretical changes that could occur in the total allowance for loan and lease losses given various economic assumptions that could impact inherent loss in the current loan and lease portfolio. It further assumes that the general composition of the allowance for loans and lease losses determined through Heartland's existing process and methodology remains relatively unchanged. It does not attempt to encompass extreme and/or prolonged economic downturns, systemic contractions to specific industries, or systemic shocks to the financial services sector. The addition to provision was calculated based upon the assumption that, under an economic downturn, a certain percentage of loan balances in each rating pool would migrate from its current loan grade to the next lower loan grade. The reduction in provision was calculated based upon the assumption that, under an economic upturn, a certain percentage of loan balances in each rating pool would migrate from its current loan grade to the next higher loan grade. The estimation of the percentage of loan balances that would migrate from its current rating pool to the next was based upon Heartland's experiences during previous periods of economic movement.

### **RESULTS OF OPERATIONS**

#### **NET INTEREST INCOME**

Net interest income is the difference between interest income earned on earning assets and interest expense paid on interest bearing liabilities. As such, net interest income is affected by changes in the volume and yields on earning assets and the volume and rates paid on interest bearing liabilities. Net interest margin is the ratio of tax equivalent net interest income to average earning assets.

Net interest margin, expressed as a percentage of average earning assets, was 3.99% for 2005 compared to 3.87% for 2004. This improvement was partially attributable to the \$51.9 million or 19% growth in noninterest bearing deposits. Also contributing to this improvement was management's ability to lag increases in interest rates paid on the Bank Subsidiaries' interest bearing deposit accounts as the federal funds increased throughout the year. The tax equivalent interest rate paid on earning assets increased 51 basis points while the interest rate paid on interest bearing liabilities increased 45 basis points.

Net interest margin, expressed as a percentage of average earning assets, was 3.87% for 2004 compared to 3.80% for 2003. This improvement resulted primarily from an increase in average loans as a percentage of total assets. Heartland's highest yielding assets comprised 76% of average earning assets during 2004 compared to 74% during 2003. The potential benefit to net interest margin from rising rates during 2004 was neutralized due to the fact that the yield curve flattened as short-term rates rose.

Net interest income, on a tax-equivalent basis, increased \$16.3 million or 20% during 2005 and \$16.5 million or 26% during 2004. Exclusive of net interest income at Rocky Mountain Bank totaling \$8.9 million since the acquisition, the increase for 2004 was \$7.6 million or 12%. Fluctuations in net interest income between years is related to changes in the volume of average earning assets and interest bearing liabilities, combined with changes in average yields and rates of the corresponding assets and liabilities as demonstrated in the tables at the end of this section.

Interest income, on a tax-equivalent basis, was \$157.3 million during 2005 compared to \$124.1 million during 2004, an increase of \$33.2 million or 27% during 2005. Rocky Mountain Bank's portion of this interest income was \$22.0 million in 2005 and \$12.3 million during the seven months of operations under the Heartland umbrella during 2004. The increase in interest income resulted from the \$345.5 million or 17% growth in earning assets, as well as the steady rises that have occurred in the prime interest rate since the first quarter of 2004. The national prime interest rate escalated 300 basis points during 2005, ending the year 7.25%. Over half of Heartland's commercial and commercial real estate loan portfolio is comprised of variable-rate loans that change as the prime rate changes.

Interest income, on a tax-equivalent basis, increased \$22.4 million or 22% during 2004. Exclusive of the \$12.3 million recorded at Rocky Mountain Bank since the acquisition, interest income grew by \$10.1 million or 10% during 2004. This growth in interest income was primarily a result of growth in the loan portfolio, which increased \$183.3 million or 15% in average balances, exclusive of \$161.6 million attributable to loan balances at Rocky Mountain Bank. Even though the national prime rate began to rise in July 2004 and finished the year 125 basis points higher at 5.25% than its level at year-end 2003 of 4.00%, Heartland did not experience a corresponding increase in its yield on loans. During previous periods, management was successful in the utilization of floors on its commercial loan portfolio to minimize the effect downward rates had on Heartland's interest income. It took several upward movements in rates to reach the floors in place on these loans. As rates moved above the floors, the yield began to increase in a corresponding manner.

Interest expense during 2005 was \$61.1 million compared to \$44.3 million during 2004, an increase of \$16.8 million or 38%. Rocky Mountain Bank's portion of this interest expense was \$6.7 million during 2005 and \$3.4 million during 2004. The increases in interest expense resulted from the growth in interest-bearing deposit accounts, as well as the rising rate environment. The federal funds rate increased from 1.00% during the first quarter of 2004 to 4.25% during the fourth quarter of 2005. Rates on Heartland's deposit accounts do not immediately reprice as a result of increases in the federal funds rate, but continual increases in the federal funds rate, as experienced during the last half of 2004 and throughout 2005, does place pressure on the rates paid on these products to maintain existing balances.

Interest expense during 2004 was \$44.3 million compared to \$38.3 million during 2003, an increase of \$5.9 million or 15%. Exclusive of the \$3.4 million interest expense recorded at Rocky Mountain Bank since acquisition, interest expense grew by \$2.5 million or 7%. A portion of this growth in interest expense was a result of the issuance of \$20.0 million of 8.25% cumulative trust preferred securities on October 10, 2003, and \$25.0 million of variable-rate cumulative trust preferred securities on March 17, 2004. Also causing additional interest expense during the last quarter of the year was the implementation of a \$30.0 million leverage strategy which included the purchase of mortgage-backed and municipal securities funded primarily by newly issued brokered deposits with an average maturity of 24 months.

Heartland manages its balance sheet to minimize the effect a change in interest rates has on its net interest margin. During 2006, Heartland will continue to work toward improving both its earning asset and funding mix through

targeted organic growth strategies, which we believe will result in additional net interest income. Our net interest income simulations reflect an asset sensitive posture leading to stronger earnings performance in a rising rate environment. Should the current rising rate environment reverse, net interest income would likely decline. In order to reduce the potentially negative impact a downward movement in interest rates would have on net interest income, Heartland entered into an interest rate floor transaction on July 8, 2005, at a cost of \$44 thousand. This two-year contract was acquired on prime at a strike level of 5.5% on a notional amount of \$100.0 million. Changes in the fair market value of this hedge transaction flow through Heartland's income statement in other noninterest income.

On September 19, 2005, Heartland entered into an interest rate collar transaction on a notional amount of \$50.0 million to further reduce the potentially negative impact a downward movement in interest rates would have on its net interest income. This five-year contract was acquired with Heartland as the payer on prime at a cap strike rate of 9.00% and the counterparty as the payer on prime at a floor strike rate of 6.00%. The cost of this derivative transaction was \$140 thousand. Management accounts for this derivative as a cash flow hedge under SFAS No. 133 (as amended), *Accounting for Derivative Instruments and Hedging Activities*.

The following table sets forth certain information relating to Heartland's average consolidated balance sheets and reflects the yield on average earning assets and the cost of average interest bearing liabilities for the years indicated. Dividing income or expense by the average balance of assets or liabilities derives such yields and costs. Average balances are derived from daily balances, and nonaccrual loans are included in each respective loan category.

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**ANALYSIS OF AVERAGE BALANCES, TAX EQUIVALENT YIELDS AND RATES <sup>1</sup>**

For the years ended December 31, 2005, 2004, and 2003

(Dollars in thousands)

	2005			2004			2003		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
<b>EARNING ASSETS</b>									
Securities:									
Taxable	\$ 400,993	\$ 13,896	3.47%	\$ 373,727	\$ 13,401	3.59%	\$ 316,117	\$ 9,100	2.88%
Nontaxable <sup>1</sup>	121,227	8,481	7.00	98,195	7,037	7.17	80,858	6,079	7.52
Total securities	522,220	22,377	4.28	471,922	20,438	4.33	396,975	15,179	3.82
Interest bearing									
deposits	6,994	277	3.96	6,653	227	3.41	7,462	174	2.33
Federal funds sold	13,785	475	3.45	10,412	175	1.68	34,159	355	1.04
Loans and leases:									
Commercial and									
commercial real									
estate <sup>1</sup>	1,236,324	81,411	6.58	1,039,055	61,090	5.88	793,187	48,637	6.13
Residential mortgage	233,717	14,223	6.09	196,267	11,643	5.93	157,005	9,907	6.31
Agricultural and									
agricultural real									
estate <sup>1</sup>	228,949	15,892	6.94	199,591	13,081	6.55	164,808	10,819	6.56
Consumer	178,142	15,718	8.82	150,842	12,324	8.17	124,136	11,343	9.14
Direct financing									
leases, net	18,313	1,388	7.58	13,713	819	5.97	10,540	780	7.40
Fees on loans	-	5,576	-	-	4,353	-	-	4,603	-
Less: allowance for									
loan and lease losses	(26,675)	-	-	(22,221)	-	-	(17,390)	-	-
Net loans and leases	1,868,770	134,208	7.18	1,577,247	103,310	6.55	1,232,286	86,089	6.99
Total earning assets	2,411,769	157,337	6.52	2,066,234	124,150	6.01	1,670,882	101,797	6.09
<b>NON EARNING</b>									
<b>ASSETS</b>	296,727	-	-	266,885	-	-	202,433	-	-
<b>TOTAL ASSETS</b>	<b>\$ 2,708,496</b>	<b>\$ 157,337</b>	<b>5.81%</b>	<b>\$ 2,333,119</b>	<b>\$ 124,150</b>	<b>5.32%</b>	<b>\$ 1,873,315</b>	<b>\$ 101,797</b>	<b>5.43%</b>
<b>INTEREST BEARING LIABILITIES</b>									
Interest bearing									
deposits:									
Savings	\$ 754,086	\$ 10,991	1.46%	\$ 670,758	\$ 5,890	0.88%	\$ 532,023	\$ 4,798	0.90%
Time, \$100,000 and									
over	201,377	6,505	3.23	152,787	3,957	2.59	140,834	3,720	2.64
Other time deposits	758,448	25,887	3.41	651,611	21,001	3.22	527,627	19,245	3.65
Short-term									
borrowings	233,278	6,985	2.99	185,045	3,095	1.67	152,429	2,350	1.54
Other borrowings	214,328	10,767	5.02	198,389	10,321	5.20	148,551	8,214	5.53
Total interest bearing									
liabilities	2,161,517	61,135	2.83	1,858,590	44,264	2.38	1,501,464	38,327	2.55
<b>NONINTEREST</b>									
<b>BEARING</b>									
<b>LIABILITIES</b>									



Noninterest bearing deposits	330,379	-	-	278,432	-	-	204,812	-	-
Accrued interest and other liabilities	35,564	-	-	38,184	-	-	35,416	-	-
Total noninterest bearing liabilities	365,943	-	-	316,616	-	-	240,228	-	-
<b>STOCKHOLDERS' EQUITY</b>	181,036	-	-	157,913	-	-	131,623	-	-
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>	\$ 2,708,496	\$ 61,135	2.26%	\$ 2,333,119	\$ 44,264	1.90%	\$ 1,873,315	\$ 38,327	2.05%
Net interest income <sup>1</sup>	\$ 96,202			\$ 79,886			\$ 63,470		
Net interest income to total earning assets <sup>1</sup>			3.99%			3.87%			3.80%
Interest bearing liabilities to earning assets	89.62%			89.95%			89.86%		

<sup>1</sup> Tax equivalent basis is calculated using an effective tax rate of 35%.

The following table allocates the changes in net interest income to differences in either average balances or average rates for earning assets and interest bearing liabilities. The changes have been allocated proportionately to the change due to volume and change due to rate. Interest income is measured on a tax equivalent basis using a 35% tax rate.

**ANALYSIS OF CHANGES IN NET INTEREST INCOME**

(Dollars in thousands)

	For the Years Ended December 31,								
	2005 Compared to 2004			2004 Compared to 2003			2003 Compared to 2002		
	Change Due to			Change Due to			Change Due to		
	Volume	Rate	Net	Volume	Rate	Net	Volume	Rate	Net
<b>EARNING ASSETS / INTEREST INCOME</b>									
Investment securities:									
Taxable	\$ 978	\$ (483)	\$ 495	\$ 1,658	\$ 2,643	\$ 4,301	\$ 465	\$ (4,497)	\$ (4,032)
Tax-exempt	1,651	(207)	1,444	1,303	(345)	958	2,260	(423)	1,837
Interest bearing deposits	12	38	50	(19)	72	53	(72)	(2)	(74)
Federal funds sold	57	243	300	(247)	67	(180)	206	(173)	33
Loans and leases	19,095	11,803	30,898	24,099	(6,878)	17,221	12,047	(9,671)	2,376
<b>TOTAL EARNING ASSETS</b>	21,793	11,394	33,187	26,794	(4,441)	22,353	14,906	(14,766)	140
<b>LIABILITIES / INTEREST EXPENSE</b>									
Interest bearing deposits:									
Savings	732	4,369	5,101	1,251	(159)	1,092	746	(2,478)	(1,732)
Time, \$100,000 and over	1,258	1,290	2,548	316	(79)	237	609	(1,394)	(785)
Other time deposits	3,443	1,443	4,886	4,522	(2,766)	1,756	3,012	(4,127)	(1,115)
Short-term borrowings	807	3,083	3,890	503	242	745	342	(635)	(293)
Other borrowings	829	(383)	446	2,756	(649)	2,107	808	(888)	(80)
<b>TOTAL INTEREST BEARING LIABILITIES</b>	7,069	9,802	16,871	9,348	(3,411)	5,937	5,517	(9,522)	(4,005)
<b>NET INTEREST INCOME</b>	\$ 14,724	\$ 1,592	\$ 16,316	\$ 17,446	\$ (1,030)	\$ 16,416	\$ 9,389	\$ (5,244)	\$ 4,145

**PROVISION FOR LOAN AND LEASE LOSSES**

The allowance for loan and lease losses is established through a provision charged to expense to provide, in Heartland's opinion, an adequate allowance for loan and lease losses. The provision for loan losses during 2005 was

\$6.6 million compared to \$4.8 million in 2004, an increase of \$1.8 million or 35%. The provision for loan losses during 2004 was \$4.8 million compared to \$4.2 million in 2003, an increase of \$663 thousand or 16%. These increases resulted primarily from the loan growth experienced during those periods along with an increase in nonperforming loans. Additionally, during 2005, the provision for loan losses was higher due to the downgrading of a few large credits and the higher than historical charge-offs at Citizens Finance Co. as a result of the change in bankruptcy laws. The adequacy of the allowance for loan and lease losses is determined by management using factors that include the overall composition of the loan portfolio, general economic conditions, types of loans, loan collateral values, past loss experience, loan delinquencies, substandard credits, and doubtful credits. For additional details on the specific factors considered, refer to the critical accounting policies and allowance for loan and lease losses sections of this report.

## NONINTEREST INCOME

(Dollars in thousands)

	For the years ended December 31,			% Change	
	2005	2004	2003	2005/ 2004	2004/ 2003
Service charges and fees, net	\$ 11,337	\$ 9,919	\$ 6,207	14	60
Trust fees	6,530	4,968	3,814	31	30
Brokerage commissions	856	1,100	863	(22)	27
Insurance commissions	545	757	703	(28)	8
Securities gains, net	198	1,861	1,823	(89)	2
Gain (loss) on trading account securities	(11)	54	453	120	88
Impairment loss on equity securities	-	-	(317)		100
Rental income on operating leases	15,463	13,780	13,807	12	0
Gains on sale of loans	3,528	3,410	6,339	3	(46)
Valuation adjustment on mortgage servicing rights	39	92	338	58	78
Other noninterest income	3,100	1,900	2,511	63	(24)
Total noninterest income	\$ 41,585	\$ 37,841	\$ 36,541	10	4

The table shows Heartland's noninterest income for the years indicated. Total noninterest income increased \$3.7 million or 10% during 2005 and \$1.3 million or 4% during 2004. Rocky Mountain Bank recorded noninterest income of \$2.5 million during 2005 and \$1.5 million during its seven months of operations under the Heartland umbrella of community banks during 2004. The noninterest income categories reflecting significant improvement during 2005 were service charges and fees, trust fees, rental income on operating leases and other noninterest income, while securities gains were significantly reduced. During 2004, the noninterest income categories reflecting significant improvement were service charges and fees and trust fees, which were offset by a reduction in the gains on sale of loans.

Services charges and fees increased \$1.4 million or 14% during 2005 and \$3.7 million or 60% during 2004. Rocky Mountain Bank recorded services charges and fees of \$1.3 million during 2005 compared to \$683 thousand during the seven months of 2004 of operations under the Heartland umbrella. Included in this category are service fees collected on the mortgage loans Heartland sold into the secondary market, while retaining servicing. Heartland's mortgage loan servicing portfolio grew from \$539.1 million at December 31, 2003, to \$575.2 million at December 31, 2004, and \$582.7 million at December 31, 2005, generating additional mortgage loan servicing fees of \$101 thousand for 2005 and \$260 thousand for 2004, increases of 7% and 23%, respectively. The most significant impact to service charges and fees during 2004 was the \$1.1 million or 52% reduction in the amortization on the mortgage servicing rights associated with the mortgage loan servicing portfolio. During 2004, prepayment activity in the portfolio caused by refinancing activity slowed, resulting in a lower amortization rate. Also included in this category are service charges on deposit products, which increased \$179 thousand or 3% during 2005 and \$1.1 million or 25% during 2004. Exclusive of Rocky Mountain Bank's contribution during 2004 of \$654 thousand, the increase in service charges on deposit products was \$479 thousand or 10%. The 2005 increase was affected by reduced service charges on commercial checking accounts as the earnings credit rate continually increased during the year and many of the balances in the accounts began to cover the activity charges. Also contributing to the improvement in service charges on deposit products during 2004 was an overdraft privilege feature on our checking account product line that resulted in the generation of additional service charge revenue of approximately \$563 thousand, an increase of 19%. Heartland has continued to grow its ATM network and, correspondingly, the fees generated by activity on these ATMs increased \$242 thousand or 20% during 2005 and \$220 thousand or 22% during 2004.

Trust fees increased \$1.6 million or 31% during 2005 and \$1.2 million or 30% during 2004. The trust accounts acquired from the Colonial Trust Company on August 31, 2004, accounted for \$479 thousand or 40% of the 2004 change. The remaining increases in both years were a result of focused calling efforts. Trust assets increased from \$1.2 billion at December 31, 2004, to nearly \$1.4 billion at December 31, 2005.

Brokerage commissions declined \$244 thousand or 22% during 2005 as Dubuque Bank and Trust Company experienced the loss of one sales representative and a reduction in the hours devoted to sales by another sales representative. Conversely, during 2004, brokerage commissions increased \$237 thousand or 27% as a new sales representative was hired at Dubuque Bank and Trust Company and many of Heartland's other Bank Subsidiaries began to promote brokerage services.

Insurance commissions declined \$212 thousand or 28% during 2005. The contingency bonus received during 2005 on the property and casualty policies issued through our insurance agency was \$70 thousand less than it historically had been, primarily as a result of a fire claim on a policy issued through our agency. This area also experienced the loss of one sales representative, whose primary focus was on the sale of life and long-term care policies.

Securities gains were \$198 thousand, \$1.9 million and \$1.8 million during 2005, 2004 and 2003, respectively. Nearly \$1.0 million of the gains during 2004 were recorded during the first quarter due to the active management of our bond portfolio. As the yield curve steepened, agency securities nearing maturity were sold at a gain and replaced with a combination of like-term and longer-term agency securities that provided enhanced yields. Additionally, the partial liquidation of the available for sale equity securities portfolio resulted in \$542 thousand of securities gains during the first quarter of 2004. Management elected to liquidate a majority of this portfolio and redirect those funds to its expansion efforts. Heartland's interest rate forecast changed to a rising rate bias on the long end of the yield curve during the first quarter of 2003, and therefore, longer-term agency securities were sold at a gain to shorten the portfolio. The proceeds were invested in mortgage-backed securities that were projected to outperform the agency securities in a rising rate environment. Because of the steepness of the yield curve during the remaining quarters of 2003 and the protection afforded, longer-term bullet agency securities were purchased with the proceeds on the sale of shorter-term agency securities.

The equity securities trading portfolio recorded losses of \$11 thousand during 2005 compared to gains of \$54 thousand and \$453 thousand during 2004 and 2003, respectively. The gains and losses recorded on this portfolio were

generally reflective of the overall activity in the stock market and the smaller trading portfolio in 2004 and 2005.

Impairment losses on equity securities deemed to be other than temporary totaled \$317 thousand during 2003. A majority of these losses were related to the decline in market value on the common stock held in Heartland's available for sale equity securities portfolio. All of those stocks were subsequently sold during 2004 and 2005. Additionally, during the first quarter of 2003, an impairment loss on equity securities totaling \$20 thousand was recorded on Heartland's investment in a limited partnership. The fair value of the remaining portion of Heartland's investment in this partnership at year-end 2005 was \$80 thousand.

Rental income on operating leases increased \$1.7 million or 12% during 2005 as a result of activity at ULTEA, Inc., Heartland's fleet management subsidiary. Vehicles under operating lease at ULTEA, Inc. were 3,045, 2,187 and 2,367 at December 31, 2005, 2004 and 2003, respectively.

Gains on sale of loans were slightly higher in 2005, but experienced a reduction of \$2.9 million or 46% during 2004, as refinancing activity on residential mortgage loans decreased from historically high levels during 2003. The volume of mortgage loans sold into the secondary market during 2003 resulted from the historically low rate environment. During low rate environments, customers frequently elect to take fifteen- and thirty-year, fixed-rate mortgage loans, which Heartland usually elects to sell into the secondary market.

The total valuation adjustment on mortgage servicing rights resulted in net impairment recoveries of previously recorded impairment provision totaling \$39 thousand during 2005, \$92 thousand during 2004 and \$338 thousand during 2003. Heartland utilizes the services of an independent third-party to perform a valuation analysis of its servicing portfolio each quarter. At December 31, 2005, there was no remaining valuation allowance.

Total other noninterest income was \$3.1 million, \$1.9 million and \$2.5 million during the years 2005, 2004 and 2003, respectively. The increase in other noninterest income during 2005 related primarily to the forgiveness of \$500 thousand in debt as Heartland fulfilled the job creation requirements of its Community Development Block Grant Loan Agreement with the City of Dubuque. During 2004, Dubuque Bank and Trust Company acquired a 99.9% ownership interest in a limited liability company that owned certified historic structures for which historic rehabilitation tax credits applied. Amortization of the investment in this limited liability company was recorded in the amount of \$978 thousand.

## NONINTEREST EXPENSE

(Dollars in thousands)

	For the years ended December 31,			% Change	
	2005	2004	2003	2005/ 2004	2004/ 2003
Salaries and employee benefits	\$ 46,329	\$ 39,443	\$ 33,113	17	19
Occupancy	6,017	4,978	3,880	21	28
Furniture and equipment	6,187	5,322	4,115	16	29
Depreciation expense on equipment under operating leases	12,597	11,360	11,353	11	0
Outside services	8,176	6,995	4,695	17	49
FDIC deposit insurance assessment	272	241	218	13	11
Advertising	3,265	2,658	2,354	23	13
Other intangibles amortization	1,014	764	404	33	89
Other noninterest expenses	11,155	10,175	7,560	10	35
Total noninterest expense	\$ 95,012	\$ 81,936	\$ 67,692	16	21

Efficiency ratio <sup>1</sup>	69.06%	70.72%	68.94%
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