

HEARTLAND FINANCIAL USA INC
Form 10-Q
August 09, 2012

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

FORM 10-Q
 QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For quarterly period ended June 30, 2012

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For transition period _____ to _____

Commission File Number: 001-15393

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) 589-2000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Act.

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Large accelerated .. Accelerated Filer x
filer

Non-accelerated .. Smaller reporting ..
filer company

(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined by Rule 12b-2 of the Securities Exchange Act of 1934). Yes o No x

Indicate the number of shares outstanding of each of the classes of Registrant's common stock as of the latest practicable date: As of August 8, 2012, the Registrant had outstanding 16,485,576 shares of common stock, \$1.00 par value per share.

HEARTLAND FINANCIAL USA, INC.

Form 10-Q Quarterly Report

Part I

Item 1. Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

Part II

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 2. Unregistered Sales of Issuer Securities and Use of Proceeds

Item 3. Defaults Upon Senior Securities

Item 4. Mine Safety Disclosures

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31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 Financial statements formatted in Extensible Business Reporting Language: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Cash Flows, (v) the Consolidated Statements of Changes in Equity, and (vi) the Notes to Consolidated Financial Statements.

PART I

ITEM 1. FINANCIAL STATEMENTS
HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

| | June 30, 2012 (Unaudited) | December 31, 2011 |
|---|------------------------------|----------------------|
| ASSETS | | |
| Cash and due from banks | \$75,116 | \$126,680 |
| Federal funds sold and other short-term investments | 7,715 | 3,154 |
| Cash and cash equivalents | 82,831 | 129,834 |
| Securities: | | |
| Trading, at fair value | 379 | 333 |
| Available for sale, at fair value (cost of \$1,247,961 at June 30, 2012, and \$1,242,460 at December 31, 2011) | 1,274,552 | 1,267,999 |
| Held to maturity, at cost (fair value of \$56,120 at June 30, 2012, and \$57,486 at December 31, 2011) | 56,157 | 58,260 |
| Loans held for sale | 73,284 | 53,528 |
| Loans and leases receivable: | | |
| Held to maturity | 2,629,597 | 2,481,284 |
| Loans covered by loss share agreements | 9,567 | 13,347 |
| Allowance for loan and lease losses | (41,439) | (36,808) |
| Loans and leases receivable, net | 2,597,725 | 2,457,823 |
| Premises, furniture and equipment, net | 114,823 | 110,206 |
| Other real estate, net | 37,941 | 44,387 |
| Goodwill | 25,909 | 25,909 |
| Other intangible assets, net | 14,295 | 12,960 |
| Cash surrender value on life insurance | 72,448 | 67,084 |
| FDIC indemnification asset | 1,148 | 1,343 |
| Other assets | 76,192 | 75,392 |
| TOTAL ASSETS | \$4,427,684 | \$4,305,058 |
| LIABILITIES AND EQUITY | | |
| LIABILITIES: | | |
| Deposits: | | |
| Demand | \$799,548 | \$737,323 |
| Savings | 1,734,155 | 1,678,154 |
| Time | 801,204 | 794,636 |
| Total deposits | 3,334,907 | 3,210,113 |
| Short-term borrowings | 249,485 | 270,081 |
| Other borrowings | 377,543 | 372,820 |
| Accrued expenses and other liabilities | 90,755 | 99,151 |
| TOTAL LIABILITIES | 4,052,690 | 3,952,165 |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock (par value \$1 per share; authorized 20,604 at June 30, 2012 and December 31, 2011; none issued or outstanding) | — | — |
| Series A Junior Participating preferred stock (par value \$1 per share; authorized 16,000 shares; none issued or outstanding) | — | — |

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| | | |
|--|--------------------|--------------------|
| Series C Fixed Rate Non-Cumulative Perpetual preferred stock (par value \$1 per share; liquidation value \$81.7 million at June 30, 2012 and December 31, 2011; authorized, issued and outstanding 81,698 shares at June 30, 2012 and December 31, 2011) | 81,698 | 81,698 |
| Common stock (par value \$1 per share; authorized 25,000,000 shares; issued 16,611,671 shares) | 16,612 | 16,612 |
| Capital surplus | 44,223 | 43,333 |
| Retained earnings | 219,643 | 198,182 |
| Accumulated other comprehensive income | 12,101 | 12,147 |
| Treasury stock at cost (143,782 shares at June 30, 2012, and 126,881 shares at December 31, 2011) | (1,939 |) (1,754) |
| TOTAL STOCKHOLDERS' EQUITY | 372,338 | 350,218 |
| Noncontrolling interest | 2,656 | 2,675 |
| TOTAL EQUITY | 374,994 | 352,893 |
| TOTAL LIABILITIES AND EQUITY | \$4,427,684 | \$4,305,058 |

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(Dollars in thousands, except per share data)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 30, 2012 | June 30, 2011 | June 30, 2012 | June 30, 2011 |
| INTEREST INCOME: | | | | |
| Interest and fees on loans and leases | \$39,382 | \$37,480 | \$77,781 | \$74,446 |
| Interest on securities: | | | | |
| Taxable | 5,026 | 9,305 | 12,598 | 18,526 |
| Nontaxable | 2,619 | 1,796 | 4,890 | 3,550 |
| Interest on federal funds sold | 1 | — | 1 | 1 |
| Interest on interest bearing deposits in other financial institutions | 2 | 1 | 2 | 1 |
| TOTAL INTEREST INCOME | 47,030 | 48,582 | 95,272 | 96,524 |
| INTEREST EXPENSE: | | | | |
| Interest on deposits | 5,604 | 7,675 | 11,379 | 15,701 |
| Interest on short-term borrowings | 224 | 225 | 437 | 484 |
| Interest on other borrowings | 4,025 | 4,081 | 8,086 | 8,017 |
| TOTAL INTEREST EXPENSE | 9,853 | 11,981 | 19,902 | 24,202 |
| NET INTEREST INCOME | 37,177 | 36,601 | 75,370 | 72,322 |
| Provision for loan and lease losses | 3,000 | 3,845 | 5,354 | 13,854 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES | 34,177 | 32,756 | 70,016 | 58,468 |
| NONINTEREST INCOME: | | | | |
| Service charges and fees | 3,712 | 3,599 | 7,296 | 6,960 |
| Loan servicing income | 3,056 | 1,298 | 4,816 | 2,847 |
| Trust fees | 2,660 | 2,656 | 5,273 | 5,135 |
| Brokerage and insurance commissions | 939 | 856 | 1,849 | 1,704 |
| Securities gains, net | 4,951 | 4,756 | 8,894 | 6,845 |
| Gain on trading account securities | 49 | 81 | 46 | 297 |
| Impairment loss on securities | — | — | (981) |) — |
| Gains on sale of loans | 12,689 | 1,308 | 21,191 | 2,710 |
| Valuation adjustment on mortgage servicing rights | (194) |) — | (181) |) — |
| Income on bank owned life insurance | 267 | 331 | 749 | 734 |
| Other noninterest income | 149 | (216) |) 2,714 | 45 |
| TOTAL NONINTEREST INCOME | 28,278 | 14,669 | 51,666 | 27,277 |
| NONINTEREST EXPENSES: | | | | |
| Salaries and employee benefits | 25,384 | 17,480 | 49,380 | 35,666 |
| Occupancy | 2,534 | 2,213 | 5,016 | 4,599 |
| Furniture and equipment | 1,517 | 1,360 | 2,963 | 2,769 |
| Professional fees | 3,961 | 3,053 | 6,721 | 6,072 |
| FDIC insurance assessments | 807 | 786 | 1,671 | 2,131 |
| Advertising | 1,304 | 1,113 | 2,375 | 1,963 |
| Intangible assets amortization | 122 | 144 | 253 | 290 |
| Net loss on repossessed assets | 1,307 | 2,511 | 4,211 | 4,143 |
| Other noninterest expenses | 4,523 | 3,683 | 9,009 | 7,597 |

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| | | | | |
|--|----------|----------|----------|----------|
| TOTAL NONINTEREST EXPENSES | 41,459 | 32,343 | 81,599 | 65,230 |
| INCOME BEFORE INCOME TAXES | 20,996 | 15,082 | 40,083 | 20,515 |
| Income taxes | 7,032 | 4,870 | 13,304 | 6,082 |
| NET INCOME | 13,964 | 10,212 | 26,779 | 14,433 |
| Net (income) loss available to noncontrolling interest, net of tax | (7 |) 9 | 19 | 25 |
| NET INCOME ATTRIBUTABLE TO HEARTLAND | 13,957 | 10,221 | 26,798 | 14,458 |
| Preferred dividends and discount | (1,021 |) (1,336 |) (2,042 |) (2,672 |
| NET INCOME AVAILABLE TO COMMON STOCKHOLDERS | \$12,936 | \$8,885 | \$24,756 | \$11,786 |
| EARNINGS PER COMMON SHARE - BASIC | \$0.79 | \$0.54 | \$1.50 | \$0.72 |
| EARNINGS PER COMMON SHARE - DILUTED | \$0.77 | \$0.54 | \$1.48 | \$0.71 |
| CASH DIVIDENDS DECLARED PER COMMON SHARE | \$0.10 | \$0.10 | \$0.20 | \$0.20 |

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in thousands)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------|------------------|-----------|
| | 6/30/2012 | 6/30/2011 | 6/30/2012 | 6/30/2011 |
| NET INCOME | \$ 13,964 | \$ 10,212 | \$ 26,779 | \$ 14,433 |
| OTHER COMPREHENSIVE INCOME | | | | |
| Securities: | | | | |
| Net change in unrealized gain (loss) on securities available for sale | 2,113 | 14,544 | 8,965 | 13,479 |
| Reclassification adjustment for net gains realized in net income | (4,951) | (4,756) | (7,913) | (6,845) |
| Net change in non-credit related other than temporary impairment | 23 | — | (660) | — |
| Income taxes | 1,039 | (3,679) | (161) | (2,503) |
| Other comprehensive income on securities available for sale | (1,776) | 6,109 | 231 | 4,131 |
| Derivatives used in cash flow hedging relationships: | | | | |
| Unrealized gain on derivatives | (1,380) | (2,206) | (1,453) | (1,968) |
| Reclassification adjustment for net losses on derivatives realized in net income | 491 | 447 | 985 | 892 |
| Income taxes | 329 | 631 | 172 | 398 |
| Other comprehensive income on cash flow hedges | (560) | (1,128) | (296) | (678) |
| Other comprehensive income | (2,336) | 4,981 | (65) | 3,453 |
| Comprehensive income | 11,628 | 15,193 | 26,714 | 17,886 |
| Less: comprehensive (income) loss attributable to noncontrolling interest | (7) | 9 | 19 | 25 |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO HEARTLAND | \$ 11,621 | \$ 15,202 | \$ 26,733 | \$ 17,911 |

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands, except per share data)

| | Six Months Ended | |
|---|------------------|----------------|
| | June 30, 2012 | June 30, 2011 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$26,779 | \$14,433 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,533 | 3,869 |
| Provision for loan and lease losses | 5,354 | 13,854 |
| Net amortization of premium on securities | 9,576 | 6,301 |
| Securities gains, net | (8,894) | (6,845) |
| Increase in trading account securities | (46) | (297) |
| Impairment loss on securities | 981 | — |
| Stock based compensation | 1,184 | 620 |
| Loss on sale of OREO and other repossessed property | 2,683 | 2,883 |
| Loans originated for sale | (625,194) | (153,574) |
| Proceeds on sales of loans held for sale | 626,629 | 148,150 |
| Net gains on sales of loans held for sale | (21,191) | (2,710) |
| (Increase) decrease in accrued interest receivable | (661) | 956 |
| (Increase) decrease in prepaid expenses | 2,572 | 2,302 |
| Decrease in accrued interest payable | (1,305) | (132) |
| Valuation adjustment on mortgage servicing rights | 181 | — |
| Other, net | (3,883) | 7,310 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 18,298 | 37,120 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from the sale of securities available for sale | 341,151 | 321,053 |
| Proceeds from the maturity of and principal paydowns on securities available for sale | 161,109 | 165,237 |
| Proceeds from the maturity of and principal paydowns on securities held to maturity | 764 | 601 |
| Purchase of securities available for sale | (517,773) | (408,333) |
| Net increase in loans and leases | (159,895) | (22,805) |
| Purchase of bank owned life insurance policies | (4,571) | (3,140) |
| Capital expenditures | (7,776) | (2,352) |
| Proceeds on sale of OREO and other repossessed assets | 18,585 | 7,215 |
| NET CASH (USED) PROVIDED BY INVESTING ACTIVITIES | (168,406) | 57,476 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase in demand deposits and savings accounts | 118,226 | 66,989 |
| Net increase (decrease) in time deposit accounts | 6,568 | (20,352) |
| Net decrease in short-term borrowings | (20,596) | (67,843) |
| Proceeds from other borrowings | 10,695 | 18,102 |
| Repayments of other borrowings | (5,972) | (911) |
| Purchase of treasury stock | (1,222) | (305) |
| Proceeds from issuance of common stock | 667 | 793 |
| Excess tax benefits on exercised stock options | 76 | 68 |
| Dividends paid | (5,337) | (5,321) |
| NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES | 103,105 | (8,780) |

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| | | |
|---|-----------------|------------------|
| Net increase (decrease) in cash and cash equivalents | (47,003 |) 85,816 |
| Cash and cash equivalents at beginning of year | 129,834 | 62,572 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$82,831 | \$148,388 |
| Supplemental disclosures: | | |
| Cash paid for income/franchise taxes | \$4,090 | \$1,067 |
| Cash paid for interest | \$20,284 | \$24,334 |
| Loans transferred to OREO | \$14,562 | \$19,940 |
| Purchases of securities available for sale, accrued, not paid | \$46,338 | \$— |

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (Unaudited)

(Dollars in thousands, except per share data)

| | Heartland Financial USA, Inc. Stockholders' Equity | | | | | | | |
|---|--|-----------------|--------------------|----------------------|---|-------------------|-----------------------------|-----------------|
| | Preferred Stock | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income | Treasury Stock | Non-controlling Interest | Total Equity |
| Balance at January 1, 2011 | \$78,483 | \$16,612 | \$44,628 | \$184,525 | \$8,517 | \$(3,674) | \$2,693 | \$331,784 |
| Comprehensive income | | | | 14,458 | 3,478 | | (25) | 17,911 |
| Cumulative preferred dividends accrued and discount accretion | 630 | | | (630) | | | | — |
| Cash dividends declared: | | | | | | | | |
| Preferred, \$25.00 per share | | | | (2,042) | | | | (2,042) |
| Common, \$0.20 per share | | | | (3,279) | | | | (3,279) |
| Purchase of 49,298 shares of common stock | | | | | | (305) | | (305) |
| Issuance of 66,680 shares of common stock | | | (520) | | | 1,381 | | 861 |
| Commitments to issue common stock | | | 620 | | | | | 620 |
| Balance at June 30, 2011 | \$79,113 | \$16,612 | \$44,728 | \$193,032 | \$11,995 | \$(2,598) | \$2,668 | \$345,550 |
| Balance at January 1, 2012 | \$81,698 | \$16,612 | \$43,333 | \$198,182 | \$12,147 | \$(1,754) | \$2,675 | \$352,893 |
| Comprehensive income | | | | 26,798 | (46) | | (19) | 26,733 |
| Cash dividends declared: | | | | | | | | |
| Preferred, \$25.00 per share | | | | (2,042) | | | | (2,042) |
| Common, \$0.20 per share | | | | (3,295) | | | | (3,295) |
| Purchase of 66,415 shares of common stock | | | | | | (1,222) | | (1,222) |
| Issuance of 49,514 shares of common stock | | | (294) | | | 1,037 | | 743 |

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| | | | | | | | | |
|---|----------|----------|----------|-----------|----------|-----------|---------|-----------|
| Commitments to issue common stock | | | 1,184 | | | | | 1,184 |
| Balance at June 30, 2012 | \$81,698 | \$16,612 | \$44,223 | \$219,643 | \$12,101 | \$(1,939) | \$2,656 | \$374,994 |

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION

The interim unaudited consolidated financial statements contained herein should be read in conjunction with the audited consolidated financial statements and accompanying notes to the consolidated financial statements for the fiscal year ended December 31, 2011, included in the Form 10-K of Heartland Financial USA, Inc. ("Heartland") filed with the Securities and Exchange Commission on March 15, 2012. Accordingly, footnote disclosures, which would substantially duplicate the disclosure contained in the audited consolidated financial statements, have been omitted.

The financial information of Heartland included herein has been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and has been prepared pursuant to the rules and regulations for reporting on Form 10-Q and Rule 10-01 of Regulation S-X. Such information reflects all adjustments (consisting of normal recurring adjustments), that are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of the interim period ended June 30, 2012, are not necessarily indicative of the results expected for the year ending December 31, 2012.

Earnings Per Share

Basic earnings per share is determined using net income available to common stockholders and weighted average common shares outstanding. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average common shares and assumed incremental common shares issued. Amounts used in the determination of basic and diluted earnings per share for the three-month and six-month periods ended June 30, 2012 and 2011, are shown in the table below:

| (Dollars and number of shares in thousands, except per share data) | Three Months Ended | |
|---|--------------------|---------------|
| | June 30, 2012 | June 30, 2011 |
| Net income attributable to Heartland | \$13,957 | \$10,221 |
| Preferred dividends and discount | (1,021 |) (1,336 |
| Net income available to common stockholders | \$12,936 | \$8,885 |
| Weighted average common shares outstanding for basic earnings per share | 16,474 | 16,427 |
| Assumed incremental common shares issued upon exercise of stock options | 244 | 142 |
| Weighted average common shares for diluted earnings per share | 16,718 | 16,569 |
| Earnings per common share — basic | \$0.79 | \$0.54 |
| Earnings per common share — diluted | \$0.77 | \$0.54 |
| Number of antidilutive stock options excluded from diluted earnings per share computation | 500 | 537 |
| | Six Months Ended | |
| | June 30, 2012 | June 30, 2011 |
| Net income attributable to Heartland | \$26,798 | \$14,458 |
| Preferred dividends and discount | (2,042 |) (2,672 |
| Net income available to common stockholders | \$24,756 | \$11,786 |
| Weighted average common shares outstanding for basic earnings per share | 16,482 | 16,417 |
| Assumed incremental common shares issued upon exercise of stock options | 240 | 144 |
| Weighted average common shares for diluted earnings per share | 16,722 | 16,561 |
| Earnings per common share — basic | \$1.50 | \$0.72 |
| Earnings per common share — diluted | \$1.48 | \$0.71 |
| | \$500 | 537 |

Number of antidilutive stock options excluded from diluted earnings per share
computation

Stock-Based Compensation

Prior to 2009, options were typically granted annually with an expiration date 10 years after the date of grant. Vesting was generally over a five-year service period with portions of a grant becoming exercisable at three years, four years and five years after the date of grant. A summary of the status of the stock options as of June 30, 2012 and 2011, and changes during the six months ended June 30, 2012 and 2011, follows:

| | 2012 | | 2011 | |
|--------------------------------|---------|---------------------------------|---------|---------------------------------|
| | Shares | Weighted-Average Exercise Price | Shares | Weighted-Average Exercise Price |
| Outstanding at January 1 | 570,762 | \$21.06 | 672,721 | \$20.27 |
| Granted | — | — | — | — |
| Exercised | (33,333 |) 11.38 | (38,125 |) 9.75 |
| Forfeited | (7,667 |) 21.72 | (25,334 |) 22.7 |
| Outstanding at June 30 | 529,762 | \$21.66 | 609,262 | \$20.83 |
| Options exercisable at June 30 | 482,712 | \$21.96 | 470,078 | \$20.55 |

At June 30, 2012, the vested options totaled 482,712 shares with a weighted average exercise price of \$21.96 per share and a weighted average remaining contractual life of 3.76 years. The intrinsic value for the vested options as of June 30, 2012, was \$1.9 million. The intrinsic value for the total of all options exercised during the six months ended June 30, 2012, was \$421 thousand. The total fair value of shares under stock options and awards that vested during the six months ended June 30, 2012, was \$1.2 million.

On May 16, 2012, Heartland stockholders approved adoption of the 2012 Long-Term Incentive Plan. The maximum number of shares of Heartland common stock that may be delivered to participants under the 2012 Long-Term Incentive Plan is 500,000 shares, subject to permitted adjustments for certain corporate transactions and for forfeited shares. Effective May 16, 2012, no additional awards will be granted under the 2005 Long-Term Incentive Plan. At June 30, 2012, shares available for issuance under the 2012 Long-Term Incentive Plan totaled 496,550.

No options were granted during the first six months of 2012 and 2011. Cash received from options exercised for the six months ended June 30, 2012, was \$379 thousand, with a related tax benefit of \$76 thousand. Cash received from options exercised for the six months ended June 30, 2011, was \$372 thousand, with a related tax benefit of \$68 thousand.

Under both the 2005 Long-Term Incentive Plan and the 2012 Long-Term Incentive Plan, stock awards may be granted as determined by the Heartland Compensation Committee. On January 17, 2012, restricted stock units (“RSUs”) totaling 94,001 were granted to key policy-making employees. On January 18, 2011, RSUs totaling 101,150 were granted to key policy-making employees. The RSUs were granted at no cost to the employee. The RSUs granted in 2012 represent the right to receive shares of Heartland common stock at a specified date in the future based on specific vesting conditions; vest over five years in three equal installments on the third, fourth and fifth anniversaries of the grant date; will be settled in common stock upon vesting; will not be entitled to dividends until vested; will terminate upon termination of employment, but will continue to vest after retirement if retirement occurs after the second anniversary of the grant date and the employee has attained age 62 and provided five years of service to Heartland. The RSUs granted in 2011 contain the same terms as the RSUs granted in 2012 except that vesting after retirement is conditioned on ten years of service to Heartland.

In addition to the RSUs referenced in the preceding paragraph, performance-based RSUs totaling 49,801 were granted to key policy-making employees on January 17, 2012, and 21,200 on October 11, 2011. These RSUs were granted at no cost to the employee and represent the right to receive shares of Heartland common stock at a specified date in the future based first on performance measures tied to Heartland's earnings and assets on December 31 of the grant year,

and then on time-based vesting conditions. For the grants in 2011, vesting occurs on December 31, 2013, and for the grants in 2012, vesting occurs on December 31, 2014. The performance-based RSUs will be settled in common stock upon vesting; will not be entitled to dividends until vested; will terminate upon termination of employment, but will continue to vest after retirement if the employee has attained age 62 and has provided ten years of service to Heartland for those granted in 2011 and five years of service for those granted in 2012.

Total compensation costs recorded for stock options, RSUs and restricted stock awards were \$1.2 million and \$620 thousand for the six months ended June 30, 2012 and 2011, respectively. As of June 30, 2012, there were \$3.9 million of total unrecognized compensation costs related to the 2005 Long-Term Incentive Plan for stock options, RSUs and restricted stock awards which are expected to be recognized through 2016.

Effect of New Financial Accounting Standards

In April 2011, the FASB issued ASU No. 2011-03, "Reconsideration of Effective Control for Repurchase Agreements," which removes the collateral maintenance provision that is currently required when determining whether a transfer of a financial instrument is accounted for as a sale or a secured borrowing. This accounting standard was subsequently codified into ASC Topic 860. Heartland adopted this standard on January 1, 2012, and the adoption did not have an impact on the results of operations, financial position and liquidity.

In May 2011, the FASB issued ASU No. 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS," which is a joint effort between the FASB and IASB to converge fair value measurement and disclosure guidance. This accounting standard was subsequently codified into ASC Topic 820. This standard permits measuring financial assets and liabilities on a net credit risk basis, if certain criteria are met. This standard also increases disclosure surrounding company-determined market prices (Level 3) financial instruments and requires the fair value hierarchy disclosure of financial assets and liabilities that are not recognized at fair value in the statement of financial position for which fair values are disclosed. Heartland adopted this standard on January 1, 2012, and the adoption did not have a material impact on the results of operations, financial position and liquidity. See Note 8 for the fair value of financial instruments disclosure.

In June 2011, the FASB issued ASU No. 2011-05, "Presentation of Comprehensive Income," which requires companies to report total net income, each component of comprehensive income, and total comprehensive income on the face of the income statement, or as two consecutive statements. This statement was subsequently codified into ASC Topic 220. The components of comprehensive income were not changed, nor did the standard affect how earnings per share is calculated or reported. The adoption of this standard was required for Heartland's first quarter 2012 Form 10-Q, and did not have an impact on the results of operations, financial position and liquidity.

In September 2011, the FASB issued ASU No. 2011-08, "Intangibles-Goodwill and Other (Topic 350): Testing Goodwill For Impairment," which allows an entity to make an initial qualitative evaluation as to whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The results of this qualitative assessment determine if it is necessary to perform the currently required two-step impairment test. ASU 2011-08 also expands upon the examples of events and circumstances that an entity should consider between annual impairment tests in determining if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Heartland adopted this standard on January 1, 2012, and the adoption did not have a material impact on the results of operations, financial position and liquidity.

In July 2012, the FASB issued ASU No. 2012-02, "Testing Indefinite-Lived Intangible Assets for Impairment," which permits an entity to make a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. This accounting standard was subsequently codified into ASC Topic 350. Currently, entities are required to quantitatively test indefinite-lived intangible assets for impairment at least annually and more frequently if indicators of impairment exist. Under the new standard, if an entity concludes, based on an evaluation of all relevant qualitative factors, that it is not more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, it will not be required to perform the quantitative impairment test for that asset. The standard is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted, and is not expected to have a material impact on the consolidated financial statements.

NOTE 2: SECURITIES

The amortized cost, gross unrealized gains and losses and estimated fair values of securities available for sale as of June 30, 2012, and December 31, 2011, are summarized in the table below, in thousands:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| June 30, 2012 | | | | |
| Securities available for sale: | | | | |
| U.S. government corporations and agencies | \$47,100 | \$1,557 | \$— | \$48,657 |
| Mortgage-backed securities | 809,040 | 12,455 | (3,925) |) 817,570 |
| Obligations of states and political subdivisions | 344,564 | 19,247 | (1,346) |) 362,465 |
| Corporate debt securities | 26,330 | 129 | (2,146) |) 24,313 |
| Total debt securities | 1,227,034 | 33,388 | (7,417) |) 1,253,005 |
| Equity securities | 20,927 | 620 | — | 21,547 |
| Total | \$1,247,961 | \$34,008 | \$(7,417) |) \$1,274,552 |
| December 31, 2011 | | | | |
| Securities available for sale: | | | | |
| U.S. government corporations and agencies | \$104,719 | \$2,428 | \$— | \$107,147 |
| Mortgage-backed securities | 815,408 | 14,643 | (4,997) |) 825,054 |
| Obligations of states and political subdivisions | 272,660 | 14,983 | (973) |) 286,670 |
| Corporate debt securities | 26,284 | 29 | (1,060) |) 25,253 |
| Total debt securities | 1,219,071 | 32,083 | (7,030) |) 1,244,124 |
| Equity securities | 23,389 | 486 | — | 23,875 |
| Total | \$1,242,460 | \$32,569 | \$(7,030) |) \$1,267,999 |

At June 30, 2012, the amortized cost of the available for sale securities is net of \$184 thousand of credit related other-than temporary impairment ("OTTI"). At December 31, 2011, no other-than-temporary impairment was recorded.

The amortized cost, gross unrealized gains and losses and estimated fair values of held to maturity securities as of June 30, 2012, and December 31, 2011, are summarized in the table below, in thousands:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| June 30, 2012 | | | | |
| Securities held to maturity: | | | | |
| Mortgage-backed securities | \$7,222 | \$99 | \$(125) |) \$7,196 |
| Obligations of states and political subdivisions | 48,935 | — | (11) |) 48,924 |
| Total | \$56,157 | \$99 | \$(136) |) \$56,120 |
| December 31, 2011 | | | | |
| Securities held to maturity: | | | | |
| Mortgage-backed securities | \$9,131 | \$40 | \$(1,532) |) \$7,639 |
| Obligations of states and political subdivisions | 49,129 | 730 | (12) |) 49,847 |
| Total | \$58,260 | \$770 | \$(1,544) |) \$57,486 |

At June 30, 2012, the amortized cost of the held to maturity securities is net of \$797 thousand of credit related other-than temporary impairment and \$660 thousand of non-credit related other-than-temporary impairments. At

December 31, 2011, no other-than-temporary impairment was recorded.

Approximately 84% of Heartland's mortgage-backed securities are issuances of government-sponsored enterprises.

The following table summarizes, in thousands, the amount of unrealized losses, defined as the amount by which cost or amortized cost exceeds fair value, and the related fair value of investments with unrealized losses in Heartland's securities portfolio as of June 30, 2012, and December 31, 2011. The investments were segregated into two categories: those that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months. The reference point for determining how long an investment was in an unrealized loss position was June 30, 2011, and December 31, 2010, respectively. Securities for which Heartland has taken credit-related OTTI write-downs are categorized as being "less than 12 months" or "12 months or longer" in a continuous loss position based on the point in time that the fair value declined to below the cost basis and not the period of time since the credit-related OTTI write-down.

| | Less than 12 months | | 12 months or longer | | Total | |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| June 30, 2012 | | | | | | |
| U.S. government corporations and agencies | \$— | \$— | \$— | \$— | \$— | \$— |
| Mortgage-backed securities | 266,527 | (2,007) | 41,396 | (1,918) | 307,923 | (3,925) |
| Obligations of states and political subdivisions | 78,889 | (923) | 2,906 | (423) | 81,795 | (1,346) |
| Corporate debt securities | 4,876 | (514) | 14,542 | (1,632) | 19,418 | (2,146) |
| Total debt securities | 350,292 | (3,444) | 58,844 | (3,973) | 409,136 | (7,417) |
| Equity securities | — | — | — | — | — | — |
| Total temporarily impaired securities | \$350,292 | \$(3,444) | \$58,844 | \$(3,973) | \$409,136 | \$(7,417) |
| December 31, 2011 | | | | | | |
| U.S. government corporations and agencies | \$— | \$— | \$— | \$— | \$— | \$— |
| Mortgage-backed securities | 133,538 | (1,794) | 71,231 | (3,203) | 204,769 | (4,997) |
| Obligations of states and political subdivisions | 13,139 | (284) | 4,010 | (689) | 17,149 | (973) |
| Corporate debt securities | 5,147 | (243) | 15,346 | (817) | 20,493 | (1,060) |
| Total debt securities | 151,824 | (2,321) | 90,587 | (4,709) | 242,411 | (7,030) |
| Equity securities | — | — | — | — | — | — |
| Total temporarily impaired securities | \$151,824 | \$(2,321) | \$90,587 | \$(4,709) | \$242,411 | \$(7,030) |

Heartland reviews the investment securities portfolio on a quarterly basis to monitor its exposure to other-than-temporary impairment. A determination as to whether a security's decline in fair value is other-than-temporary takes into consideration numerous factors and the relative significance of any single factor can vary by security. Some factors Heartland may consider in the other-than-temporary impairment analysis include, the length of time the security has been in an unrealized loss position, changes in security ratings, financial condition of the issuer, as well as security and industry specific economic conditions. In addition, with regard to debt securities, Heartland may also evaluate payment structure, whether there are defaulted payments or expected defaults, prepayment speeds, and the value of any underlying collateral. For certain debt securities in unrealized loss positions, Heartland prepares cash flow analysis to compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. During the first quarter of 2012, Heartland experienced deterioration in the credit support on three private label mortgage-backed securities which resulted in a credit-related other-than-temporary impairment loss. The underlying collateral on these securities experienced an increased level of defaults and a slowing of voluntary prepayments causing the present value of the forward expected cash flows, using

prepayment and default vectors, to be below the amortized cost basis of the securities. Based on Heartland's evaluation, a \$981 thousand other-than-temporary impairment on three private label mortgage-backed securities attributable to credit-related losses was recorded in March 2012. The other-than-temporary credit-related losses were \$797 thousand in the held to maturity category and \$184 thousand in the available for sale category. Heartland has not previously recorded an other-than-temporary impairment loss on debt securities.

The remaining unrealized losses on Heartland's mortgage-backed securities are the result of changes in market interest rates or widening of market spreads subsequent to the initial purchase of the securities and not related to concerns regarding the underlying credit of the issuers or the underlying collateral. It is expected that the securities will not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates or

widening market spreads and not credit quality, and because Heartland has the intent and ability to hold these investments until a market price recovery or to maturity and does not believe it will be required to sell the securities before maturity, these investments are not considered other-than-temporarily impaired.

Unrealized losses on Heartland's obligations of states and political subdivisions are the result of changes in market interest rates or widening of market spreads subsequent to the initial purchase of the securities. Management monitors the published credit ratings of these securities and has noted credit rating reductions in a number of these securities, primarily due to the downgrade in the credit ratings of the insurance companies providing credit enhancement to that of the issuing municipalities. Because the decline in fair value is attributable to changes in interest rates or widening market spreads due to insurance company downgrades and not underlying credit quality, and because Heartland has the intent and ability to hold these investments until a market price recovery or to maturity and does not believe it will be required to sell the securities before maturity, these investments are not considered other-than-temporarily impaired.

There were no gross realized gains or losses on the sale of available for sale securities with OTTI write-downs for the periods ended June 30, 2012 or December 31, 2011.

The following table shows the detail of total OTTI write-downs included in earnings for debt securities, in thousands:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------|------------------|------|
| | June 30, | | June 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| OTTI write-downs included in earnings: | | | | |
| Available for sale debt securities: | | | | |
| Mortgage backed securities | \$— | \$— | \$184 | \$— |
| Held to maturity debt securities: | | | | |
| Mortgage backed securities | — | — | 797 | — |
| Total debt security OTTI write-downs included in earnings | \$— | \$— | \$981 | \$— |

The following table shows the detail of OTTI write-downs on debt securities included in earnings and the related changes in other accumulated comprehensive income (AOCI) for the same securities, in thousands:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------|------------------|------|
| | June 30, | | June 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| OTTI on debt securities | | | | |
| Recorded as part of gross realized losses: | | | | |
| Credit related OTTI | \$— | \$— | \$981 | \$— |
| Intent to sell OTTI | — | — | — | — |
| Total recorded as part of gross realized losses | — | — | 981 | — |
| Recorded directly to AOCI for non-credit related impairment: | | | | |
| Residential mortgage backed securities | — | — | 683 | — |
| Accretion of non-credit related impairment | (23 |) — | (23 |) — |
| Total recorded directly to AOCI for increase in non-credit related impairment | (23 |) — | 660 | — |
| Total OTTI losses recorded on debt securities | \$ (23 |) \$— | \$1,641 | \$— |

The following table presents a rollforward of the credit loss component of OTTI recognized in earnings for debt securities still owned by Heartland. The credit loss component of the amortized cost represents the difference between the present value of expected future cash flows discounted using the security's current effective interest rate and the

amortized cost basis of the security prior to considering credit losses. OTTI recognized in earnings for credit impaired debt securities is presented as additions and is classified into one of two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or if the debt security was previously credit impaired (subsequent credit impairments). The credit loss component is reduced if Heartland sells, intends to sell, or if management believes they will be required to sell previously credit impaired debt securities. Additionally, the credit loss component is reduced if Heartland

receives, expects to receive cash flows in excess of what was previously expected to be received over the remaining life of the credit impaired debt security, the security matures or is fully written down.

Changes in the credit loss component of the credit impaired debt securities that Heartland does not intend to sell were, in thousands:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------|------------------|------|
| | June 30, | | June 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| Credit loss component, beginning of period | \$981 | \$— | \$— | \$— |
| Additions: | | | | |
| Initial credit impairments | — | — | 981 | — |
| Subsequent credit impairments | — | — | — | — |
| Total additions | — | — | 981 | — |
| Reductions: | | | | |
| For securities sold | — | — | — | — |
| Due to change in intent to sell or requirement to sell | — | — | — | — |
| For recoveries of previous credit impairments | — | — | — | — |
| Total reductions | — | — | — | — |
| Credit loss component, end of period | \$981 | \$— | \$981 | \$— |

NOTE 3: LOANS AND LEASES

Loans and leases as of June 30, 2012, and December 31, 2011, were as follows, in thousands:

| | June 30, 2012 | December 31, 2011 |
|--|---------------|-------------------|
| Loans and leases receivable held to maturity: | | |
| Commercial | \$667,251 | \$645,666 |
| Commercial real estate | 1,236,745 | 1,163,784 |
| Agricultural and agricultural real estate | 279,285 | 262,975 |
| Residential real estate | 220,084 | 194,436 |
| Consumer | 230,594 | 220,099 |
| Gross loans receivable held to maturity | 2,633,959 | 2,486,960 |
| Net direct financing leases held to maturity | 290 | 450 |
| Gross loans and leases receivable held to maturity | 2,634,249 | 2,487,410 |
| Unearned discount | (1,382) | (2,463) |
| Deferred loan fees | (3,270) | (3,663) |
| Total net loans and leases receivable held to maturity | 2,629,597 | 2,481,284 |
| Loans covered under loss share agreements: | | |
| Commercial and commercial real estate | 4,497 | 6,380 |
| Agricultural and agricultural real estate | 858 | 1,659 |
| Residential real estate | 3,309 | 4,158 |
| Consumer | 903 | 1,150 |
| Total loans covered under loss share agreements | 9,567 | 13,347 |
| Allowance for loan and lease losses | (41,439) | (36,808) |
| Loans and leases receivable, net | \$2,597,725 | \$2,457,823 |

Heartland has certain lending policies and procedures in place that are designed to provide for an acceptable level of credit risk. The board of directors reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management and the board with frequent reports related to loan

production, loan quality, concentrations of credit, loan delinquencies and non-performing loans and potential problem loans. Diversification in the loan

portfolio is also a means of managing risk associated with fluctuations in economic conditions.

The commercial and commercial real estate loan portfolio includes 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. 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 for most of these loans and leases is based upon a discount from its market value. The primary repayment risks of commercial loans and leases are that the cash flow of the borrowers may be unpredictable, and the collateral securing these loans may fluctuate in value. Heartland seeks to minimize these risks in a variety of ways. The underwriting analysis includes credit verification, analysis of global cash flows, appraisals and a review of the financial condition of the borrower. Personal guarantees are frequently required as a tertiary form of repayment. In addition, when underwriting loans for commercial real estate, careful consideration is given to the property's operating history, future operating projections, current and projected occupancy, location and physical condition. Heartland also utilizes government guaranteed lending through the U.S. Small Business Administration and the USDA Rural Development Business and Industry Program to assist customers with longer-term funding and to reduce risk.

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. Agricultural loans present unique credit risks relating to 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. In underwriting agricultural loans, lending personnel work closely with their customers to review 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 annually. Lending personnel also work closely with governmental agencies to help agricultural customers obtain credit enhancement products such as loan guarantees or interest assistance.

Heartland originates first-lien, adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a single family residential property. These loans are principally collateralized by owner-occupied properties and are amortized over 10 to 30 years. Heartland typically sells longer-term, low-rate, residential mortgage loans in the secondary market with servicing rights retained. This practice allows Heartland to better manage interest rate risk and liquidity risk. The Heartland bank subsidiaries participate in lending programs sponsored by U.S. government agencies such as Veterans Administration and Federal Home Administration when justified by market conditions.

Consumer lending includes motor vehicle, home improvement, home equity 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. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Heartland's policy is to discontinue the accrual of interest income on any loan or lease when, in the opinion of management, there is a reasonable doubt as to the timely collection of the interest and principal, normally when a loan or lease is 90 days past due. When interest accruals are deemed uncollectible, interest credited to income in the current year is reversed and interest accrued in prior years is charged to the allowance for loan and lease losses. Nonaccrual loans and leases are returned to an accrual status when, in the opinion of management, the

financial position of the borrower indicates that there is no longer any reasonable doubt as to the timely payment of interest and principal.

Under Heartland's credit practices, all nonaccrual and loans meeting the criteria of a troubled debt restructuring are defined as impaired loans. Loan impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except where more practical, at the observable market price of the loan or the fair value of the collateral if the loan is collateral dependent.

The following table shows the balance in the allowance for loan and lease losses at June 30, 2012, and December 31, 2011, and the related loan balances, disaggregated on the basis of impairment methodology, in thousands. Loans evaluated under ASC 310-10-35 include loans on nonaccrual status, which are individually evaluated for impairment, and other impaired loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment under ASC 450-20. Heartland has made no changes to the accounting for the allowance for loan and lease losses policy during 2012.

| | Allowance For Loan and Lease Losses | | | Gross Loans and Leases Receivable Held to Maturity | | |
|---|-------------------------------------|---------------------------------|-----------|---|--|--------------|
| | Ending Balance Under ASC 310-10-35 | Ending Balance Under ASC 450-20 | Total | Ending Balance Evaluated for Impairment Under ASC 310-10-35 | Ending Balance Evaluated for Impairment Under ASC 450-20 | Total |
| June 30, 2012 | | | | | | |
| Commercial | \$ 1,241 | \$ 9,046 | \$ 10,287 | \$ 8,220 | \$ 659,031 | \$ 667,251 |
| Commercial real estate | 3,513 | 13,544 | 17,057 | 54,109 | 1,182,636 | 1,236,745 |
| Agricultural and agricultural real estate | 10 | 1,992 | 2,002 | 13,447 | 265,838 | 279,285 |
| Residential real estate | 720 | 3,179 | 3,899 | 6,594 | 213,490 | 220,084 |
| Consumer | 2,152 | 6,041 | 8,193 | 5,474 | 225,120 | 230,594 |
| Lease financing | — | 1 | 1 | — | 290 | 290 |
| Total | \$ 7,636 | \$ 33,803 | \$ 41,439 | \$ 87,844 | \$ 2,546,405 | \$ 2,634,249 |
| December 31, 2011 | | | | | | |
| Commercial | \$ 1,990 | \$ 8,557 | \$ 10,547 | \$ 9,293 | \$ 636,373 | \$ 645,666 |
| Commercial real estate | 1,929 | 12,692 | 14,621 | 66,467 | 1,097,317 | 1,163,784 |
| Agricultural and agricultural real estate | — | 1,763 | 1,763 | 14,385 | 248,590 | 262,975 |
| Residential real estate | 464 | 2,537 | 3,001 | 5,905 | 188,531 | 194,436 |
| Consumer | 1,097 | 5,777 | 6,874 | 4,391 | 215,708 | 220,099 |
| Lease financing | — | 2 | 2 | — | 450 | 450 |
| Total | \$ 5,480 | \$ 31,328 | \$ 36,808 | \$ 100,441 | \$ 2,386,969 | \$ 2,487,410 |

The following table presents nonaccrual loans, accruing loans past due 90 days or more and troubled debt restructured loans not covered under loss share agreements at June 30, 2012, and December 31, 2011, in thousands. There were no nonaccrual leases, accruing leases past due 90 days or more or restructured leases at June 30, 2012, and December 31, 2011.

| | June 30, 2012 | December 31, 2011 |
|---|---------------|-------------------|
| Nonaccrual loans | \$ 37,529 | \$ 48,587 |
| Nonaccrual troubled debt restructured loans | 7,316 | 8,848 |
| Total nonaccrual loans | \$ 44,845 | \$ 57,435 |
| Accruing loans past due 90 days or more | — | — |
| Performing troubled debt restructured loans | \$ 24,715 | \$ 25,704 |

Heartland had \$32.0 million of troubled debt restructured loans at June 30, 2012, of which \$7.3 million were classified as nonaccrual and \$24.7 million were accruing according to the restructured terms. Heartland had \$34.6 million of troubled debt restructured loans at December 31, 2011, of which \$8.8 million were classified as nonaccrual and \$25.7 million were accruing according to the restructured terms.

The following tables provide information on troubled debt restructured loans that were modified during the three and six months ended June 30, 2012, and June 30, 2011, in thousands:

| | Three Months Ended June 30, 2012 | | | Three Months Ended June 30, 2011 | | |
|---|-------------------------------------|--|---|-------------------------------------|--|---|
| | Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment |
| Commercial | — | \$ — | \$ — | 3 | \$ 129 | \$ 129 |
| Commercial real estate | 1 | 1,380 | 1,380 | 15 | 8,510 | 8,510 |
| Total commercial and commercial real estate | 1 | 1,380 | 1,380 | 18 | 8,639 | 8,639 |
| Agricultural and agricultural real estate | 3 | 1,014 | 1,014 | — | — | — |
| Residential real estate | 1 | 1,005 | 1,005 | 1 | 323 | 323 |
| Consumer | — | — | — | — | — | — |
| Total Troubled Debt Restructured Loans | 5 | \$ 3,399 | \$ 3,399 | 19 | \$ 8,962 | \$ 8,962 |

| | Six Months Ended June 30, 2012 | | | Six Months Ended June 30, 2011 | | |
|---|-----------------------------------|--|---|-----------------------------------|--|---|
| | Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment |
| Commercial | — | \$ — | \$ — | 3 | \$ 129 | \$ 129 |
| Commercial real estate | 2 | 1,398 | 1,398 | 18 | 9,662 | 9,662 |
| Total commercial and commercial real estate | 2 | 1,398 | 1,398 | 21 | 9,791 | 9,791 |
| Agricultural and agricultural real estate | 3 | 1,014 | 1,014 | — | — | — |
| Residential real estate | 1 | 1,005 | 1,005 | 4 | 821 | 821 |
| Consumer | — | — | — | — | — | — |
| Total Troubled Debt Restructured Loans | 6 | \$ 3,417 | \$ 3,417 | 25 | \$ 10,612 | \$ 10,612 |

The pre-modification and post-modification recorded investment represents amounts as of the date of loan modification. Since the modifications on these loans have been only interest rate concessions and term extensions, not principal reductions, the pre-modification and post-modification recorded investment amounts are the same.

The following tables provide information on troubled debt restructured loans for which there was a payment default during the three and six months ended June 30, 2012, and June 30, 2011, in thousands, that had been modified during the 12-month period prior to the default:

| | With Payment Defaults During the Following Periods | | | |
|---|--|------------------------|-------------------------------------|------------------------|
| | Three Months Ended June 30, 2012 | | Three Months Ended June 30, 2011 | |
| | Number of Loans | Recorded Investment | Number of Loans | Recorded Investment |
| Commercial | — | \$— | 2 | \$64 |
| Commercial real estate | — | — | 1 | 329 |
| Total commercial and commercial real estate | — | — | 3 | 393 |

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| | | | | |
|---|---|-----|---|-------|
| Agricultural and agricultural real estate | — | — | — | — |
| Residential real estate | — | — | — | — |
| Consumer | — | — | — | — |
| Total | — | \$— | 3 | \$393 |

| | With Payment Defaults During the Following Periods | | | |
|---|--|------------------------|-----------------------------------|------------------------|
| | Six Months Ended June 30, 2012 | | Six Months Ended June 30, 2011 | |
| | Number of Loans | Recorded Investment | Number of Loans | Recorded Investment |
| Commercial | — | \$— | \$2 | \$64 |
| Commercial real estate | 1 | 640 | 1 | 329 |
| Total commercial and commercial real estate | 1 | 640 | 3 | 393 |
| Agricultural and agricultural real estate | — | — | — | — |
| Residential real estate | — | — | 4 | 444 |
| Consumer | — | — | — | — |
| Total | 1 | \$640 | \$7 | \$837 |

Heartland's internal rating system is a series of grades reflecting management's risk assessment, based on its analysis of the borrower's financial condition. The "pass" category consists of all loans that are not in the "nonpass" category, categorized into a range of loan grades that reflect increasing, though still acceptable, risk. Movement of risk through the various grade levels in the pass category is monitored for early identification of credit deterioration. The "nonpass" category consists of special mention, substandard, doubtful and loss loans. The "special mention" rating is attached to loans where the borrower exhibits negative financial trends due to borrower specific or systemic conditions that, if left uncorrected, threaten its capacity to meet its debt obligations. The borrower is believed to have sufficient financial flexibility to react to and resolve its negative financial situation. These credits are closely monitored for improvement or deterioration. The "substandard" rating is assigned to loans that are inadequately protected by the current sound net worth and paying capacity of the borrower and may be further at risk due to deterioration in the value of collateral pledged. Well-defined weaknesses jeopardize liquidation of the debt. These loans are still considered collectible, however, a distinct possibility exists that Heartland will sustain some loss if deficiencies are not corrected. Substandard loans may exhibit some or all of the following weaknesses: deteriorating trends, lack of earnings, inadequate debt service capacity, excessive debt and/or lack of liquidity. The "doubtful" rating is assigned to loans where identified weaknesses make collection or liquidation in full, on the basis of existing facts, conditions and values, highly questionable and improbable. These borrowers are usually in default, lack liquidity and capital, as well as, resources necessary to remain an operating entity. Specific pending events, such as capital injections, liquidations or perfection of liens on additional collateral, may strengthen the credit, thus deferring classification of the loan as loss until exact status can be determined. The "loss" rating is assigned to loans considered uncollectible. As of June 30, 2012, Heartland had no loans classified as doubtful or loss. Loans are placed on "nonaccrual" when management does not expect to collect payments of principal and interest in full or when principal or interest has been in default for a period of 90 days or more, unless the loan is both well secured and in the process of collection.

The following table presents loans and leases not covered by loss share agreements by credit quality indicator at June 30, 2012, and December 31, 2011, in thousands:

| | Pass | Nonpass | Total |
|--|-------------|-----------|-------------|
| June 30, 2012 | | | |
| Commercial | \$620,320 | \$46,931 | \$667,251 |
| Commercial real estate | 1,056,864 | 179,881 | 1,236,745 |
| Total commercial and commercial real estate | 1,677,184 | 226,812 | 1,903,996 |
| Agricultural and agricultural real estate | 243,092 | 36,193 | 279,285 |
| Residential real estate | 201,274 | 18,810 | 220,084 |
| Consumer | 220,512 | 10,082 | 230,594 |
| Lease financing | 290 | — | 290 |
| Total gross loans and leases receivable held to maturity | \$2,342,352 | \$291,897 | \$2,634,249 |
| December 31, 2011 | | | |
| Commercial | \$596,759 | \$48,907 | \$645,666 |
| Commercial real estate | 988,906 | 174,878 | 1,163,784 |
| Total commercial and commercial real estate | 1,585,665 | 223,785 | 1,809,450 |
| Agricultural and agricultural real estate | 223,247 | 39,728 | 262,975 |
| Residential real estate | 177,128 | 17,308 | 194,436 |
| Consumer | 211,073 | 9,026 | 220,099 |
| Lease financing | 450 | — | 450 |
| Total gross loans and leases receivable held to maturity | \$2,197,563 | \$289,847 | \$2,487,410 |

The nonpass category in the table above is comprised of approximately 51% special mention and 49% substandard as of June 30, 2012. The percent of nonpass loans on nonaccrual status as of June 30, 2012, was 15%. As of December 31, 2011, the nonpass category in the table above was comprised of approximately 43% special mention and 57% substandard. The percent of nonpass loans on nonaccrual status as of December 31, 2011, was 20%. Changes in credit risk are monitored on a continuous basis and changes in risk ratings are made when identified. All impaired loans are reviewed at least annually.

The following table sets forth information regarding Heartland's accruing and nonaccrual loans and leases not covered by loss share agreements at June 30, 2012, and December 31, 2011, in thousands:

| | Accruing Loans and Leases | | | | Current | Nonaccrual | Total Loans and Leases |
|--|---------------------------|---------------------|--------------------------|----------------|-------------|------------|------------------------|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | | | |
| June 30, 2012 | | | | | | | |
| Commercial | \$3,929 | \$396 | \$— | \$4,325 | \$661,135 | \$1,791 | \$667,251 |
| Commercial real estate | 3,026 | 744 | — | 3,770 | 1,200,561 | 32,414 | 1,236,745 |
| Total commercial and commercial real estate | 6,955 | 1,140 | — | 8,095 | 1,861,696 | 34,205 | 1,903,996 |
| Agricultural and agricultural real estate | 912 | 136 | — | 1,048 | 277,838 | 399 | 279,285 |
| Residential real estate | 635 | 22 | — | 657 | 213,448 | 5,979 | 220,084 |
| Consumer Lease financing | 2,047 | 628 | — | 2,675 | 223,657 | 4,262 | 230,594 |
| | — | — | — | — | 290 | — | 290 |
| Total gross loans and leases receivable held to maturity | \$10,549 | \$1,926 | \$— | \$12,475 | \$2,576,929 | \$44,845 | \$2,634,249 |
| December 31, 2011 | | | | | | | |
| Commercial | \$220 | \$479 | \$— | \$699 | \$643,273 | \$1,694 | \$645,666 |
| Commercial real estate | 668 | — | — | 668 | 1,117,274 | 45,842 | 1,163,784 |
| Total commercial and commercial real estate | 888 | 479 | — | 1,367 | 1,760,547 | 47,536 | 1,809,450 |
| Agricultural and agricultural real estate | 32 | — | — | 32 | 262,409 | 534 | 262,975 |
| Residential real estate | 940 | 93 | — | 1,033 | 188,865 | 4,538 | 194,436 |
| Consumer Lease financing | 2,176 | 555 | — | 2,731 | 212,541 | 4,827 | 220,099 |
| | — | — | — | — | 450 | — | 450 |
| Total gross loans and leases receivable held to maturity | \$4,036 | \$1,127 | \$— | \$5,163 | \$2,424,812 | \$57,435 | \$2,487,410 |

The majority of Heartland's impaired loans are those that are nonaccrual, are past due 90 days or more and still accruing or have had their terms restructured in a troubled debt restructuring. The following tables present, for impaired loans not covered by loss share agreements and by category of loan, the unpaid balance that was contractually due at June 30, 2012, and December 31, 2011, the outstanding loan balance recorded on the consolidated balance sheets at June 30, 2012, and December 31, 2011, any related allowance recorded for those loans as of June 30, 2012, and December 31, 2011, the average outstanding loan balance recorded on the consolidated balance sheets during the three and six months ended June 30, 2012, and year ended December 31, 2011, and the interest income recognized on the impaired loans during the three and six months ended June 30, 2012, and year ended December 31, 2011, in thousands:

| | Unpaid Contractual Balance | Loan Balance | Related Allowance Recorded | Quarter-to-Date Avg. Loan Balance | Quarter-to-Date Interest Income Recognized | Year-to-Date Avg. Loan Balance | Year-to-Date Interest Income Recognized |
|---|----------------------------|--------------|----------------------------|-----------------------------------|--|--------------------------------|---|
| June 30, 2012 | | | | | | | |
| Impaired loans with a related allowance: | | | | | | | |
| Commercial | \$2,224 | \$2,174 | \$1,241 | 6,467 | \$ 14 | \$ 7,338 | \$32 |
| Commercial real estate | 20,371 | 18,038 | 3,513 | 16,554 | 94 | 15,006 | 186 |
| Total commercial and commercial real estate | 22,595 | 20,212 | 4,754 | 23,021 | 108 | 22,344 | 218 |
| Agricultural and agricultural real estate | 100 | 100 | 10 | 2,506 | 24 | 80 | 5 |
| Residential real estate | 2,627 | 2,627 | 720 | 116 | 1 | 2,291 | 47 |
| Consumer | 4,245 | 3,986 | 2,152 | 3,891 | 7 | 3,396 | 16 |
| Total loans held to maturity | \$29,567 | \$26,925 | \$7,636 | 29,534 | \$ 140 | \$ 28,111 | \$286 |
| Impaired loans without a related allowance: | | | | | | | |
| Commercial | \$6,397 | \$6,046 | \$— | 2,393 | \$ 61 | \$ 1,765 | \$62 |
| Commercial real estate | 46,433 | 36,071 | — | 40,387 | 185 | 45,229 | 396 |
| Total commercial and commercial real estate | 52,830 | 42,117 | — | 42,780 | 246 | 46,994 | 458 |
| Agricultural and agricultural real estate | 13,366 | 13,347 | — | 4,037 | 13 | 13,865 | 291 |
| Residential real estate | 4,136 | 3,967 | — | 13,587 | 135 | 4,034 | 20 |
| Consumer | 1,779 | 1,488 | — | 1,755 | (4 |) 1,892 | 2 |
| Total loans held to maturity | \$72,111 | \$60,919 | \$— | 62,159 | \$ 390 | \$ 66,785 | \$771 |
| Total impaired loans held to maturity: | | | | | | | |
| Commercial | \$8,621 | \$8,220 | \$1,241 | 8,860 | \$ 75 | \$ 9,103 | \$94 |
| Commercial real estate | 66,804 | 54,109 | 3,513 | 56,941 | 279 | 60,235 | 582 |
| Total commercial and commercial real estate | 75,425 | 62,329 | 4,754 | 65,801 | 354 | 69,338 | 676 |
| Agricultural and agricultural real estate | 13,466 | 13,447 | 10 | 6,543 | 37 | 13,945 | 296 |
| Residential real estate | 6,763 | 6,594 | 720 | 13,703 | 136 | 6,325 | 67 |
| Consumer | 6,024 | 5,474 | 2,152 | 5,646 | 3 | 5,288 | 18 |
| | \$101,678 | \$87,844 | \$7,636 | 91,693 | \$ 530 | \$ 94,896 | \$1,057 |

Total impaired loans
held to maturity

| | Unpaid Contractual Balance | Loan Balance | Related Allowance Recorded | Year-to-Date Avg. Loan Balance | Year-to-Date Interest Income Recognized |
|---|----------------------------------|-----------------|----------------------------------|--------------------------------------|--|
| December 31, 2011 | | | | | |
| Impaired loans with a related allowance: | | | | | |
| Commercial | \$8,433 | \$8,397 | \$1,990 | \$9,395 | \$434 |
| Commercial real estate | 13,558 | 13,558 | 1,929 | 32,471 | 412 |
| Total commercial and commercial real estate | 21,991 | 21,955 | 3,919 | 41,866 | 846 |
| Agricultural and agricultural real estate | — | — | — | 2,722 | — |
| Residential real estate | 1,776 | 1,775 | 464 | 1,854 | 57 |
| Consumer | 2,764 | 2,764 | 1,097 | 2,688 | 32 |
| Total loans held to maturity | \$26,531 | \$26,494 | \$5,480 | \$49,130 | \$935 |
| Impaired loans without a related allowance: | | | | | |
| Commercial | \$1,737 | \$896 | \$— | \$2,221 | \$2 |
| Commercial real estate | 79,876 | 52,909 | — | 54,657 | 804 |
| Total commercial and commercial real estate | 81,613 | 53,805 | — | 56,878 | 806 |
| Agricultural and agricultural real estate | 14,428 | 14,385 | — | 14,302 | 557 |
| Residential real estate | 4,324 | 4,130 | — | 4,293 | 46 |
| Consumer | 2,226 | 1,627 | — | 1,470 | 5 |
| Total loans held to maturity | \$102,591 | \$73,947 | \$— | \$76,943 | \$1,414 |
| Total impaired loans held to maturity: | | | | | |
| Commercial | \$10,170 | \$9,293 | \$1,990 | \$11,616 | \$436 |
| Commercial real estate | 93,434 | 66,467 | 1,929 | 87,128 | 1,216 |
| Total commercial and commercial real estate | 103,604 | 75,760 | 3,919 | 98,744 | 1,652 |
| Agricultural and agricultural real estate | 14,428 | 14,385 | — | 17,024 | 557 |
| Residential real estate | 6,100 | 5,905 | 464 | 6,147 | 103 |
| Consumer | 4,990 | 4,391 | 1,097 | 4,158 | 37 |
| Total impaired loans held to maturity | \$129,122 | \$100,441 | \$5,480 | \$126,073 | \$2,349 |

On July 2, 2009, Heartland acquired all deposits of The Elizabeth State Bank in Elizabeth, Illinois through its subsidiary Galena State Bank & Trust Co. based in Galena, Illinois, in a whole bank loss sharing transaction facilitated by the FDIC. As of July 2, 2009, The Elizabeth State Bank had loans of \$42.7 million. The estimated fair value of the loans acquired was \$37.8 million.

The acquired loans and other real estate owned are covered by two loss share agreements between the FDIC and Galena State Bank & Trust Co., which affords Galena State Bank & Trust Co. significant loss protection. Under the loss share agreements, the FDIC covers 80% of the covered loan and other real estate owned losses (referred to as covered assets) up to \$10 million and 95% of losses in excess of that amount. The term for loss sharing on

non-residential real estate losses is five years with respect to losses and eight years with respect to recoveries, while the term for loss sharing on residential real estate loans is ten years with respect to losses and recoveries. The reimbursable losses from the FDIC are based on the book value of the relevant loan as determined by the FDIC at the date of the transaction. New loans made after the acquisition are not covered by the loss share agreements.

The Elizabeth State Bank acquisition was accounted for under the acquisition method of accounting in accordance with ASC 805, "Business Combinations." Purchased loans acquired in a business combination, which include loans purchased in The Elizabeth State Bank acquisition, are recorded at estimated fair value on their purchase date, but the purchaser can not carry over the related allowance for loan and lease losses. Purchased loans are accounted for under ASC 310-30, "Loans and Debt Securities with Deteriorated Credit Quality," when the loans have evidence of credit deterioration since origination and it is probable at the date of the acquisition that Heartland will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration at the purchase date included statistics such as past due and nonaccrual status.

Generally, acquired loans that meet Heartland's definition for nonaccrual status fall within the scope of ASC 310-30. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference which is included in the carrying value of the loans. Subsequent decreases to the expected cash flows will generally result in a provision for loan and lease losses. Subsequent increases in cash flows result in a reversal of the provision for loan and lease losses to the extent of prior charges, or a reclassification of the difference from nonaccretable to accretable with a positive impact on future interest income. Further, any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

The carrying amount of the loans covered by these loss share agreements at June 30, 2012, and December 31, 2011, consisted of purchased impaired and nonimpaired loans as summarized in the following table:

(Dollars in thousands)

| | June 30, 2012 | | | December 31, 2011 | | |
|---|--------------------------|------------------------------|---------------------|--------------------------|------------------------------|---------------------|
| | Impaired Purchased Loans | Non Impaired Purchased Loans | Total Covered Loans | Impaired Purchased Loans | Non Impaired Purchased Loans | Total Covered Loans |
| Commercial and commercial real estate | \$1,663 | \$2,834 | \$4,497 | \$2,553 | \$3,827 | \$6,380 |
| Agricultural and agricultural real estate | — | 858 | 858 | — | 1,659 | 1,659 |
| Residential real estate | — | 3,309 | 3,309 | — | 4,158 | 4,158 |
| Consumer loans | 307 | 596 | 903 | 503 | 647 | 1,150 |
| Total Covered Loans | \$1,970 | \$7,597 | \$9,567 | \$3,056 | \$10,291 | \$13,347 |

On the acquisition date, the preliminary estimate of the contractually required payments receivable for all loans with evidence of credit deterioration since origination acquired in the acquisition was \$13.8 million and the estimated fair value of the loans was \$9.0 million. At June 30, 2012, and December 31, 2011, a majority of these loans were valued based upon the liquidation value of the underlying collateral, because the expected cash flows are primarily based on the liquidation of underlying collateral and the timing and amount of the cash flows could not be reasonably estimated. There was no allowance for loan and lease losses related to these ASC 310-30 loans at June 30, 2012, and December 31, 2011.

On the acquisition date, the preliminary estimate of the contractually required payments receivable for all nonimpaired loans acquired in the acquisition was \$28.9 million and the estimated fair value of the loans was \$28.7 million.

NOTE 4: ALLOWANCE FOR LOAN AND LEASE LOSSES

Changes in the allowance for loan and lease losses for the three months and six months ended June 30, 2012 and June 30, 2011, were as follows, in thousands:

| | Commercial | Commercial Real Estate | Agricultural | Residential Real Estate | Consumer | Leases | Unallocated | Total |
|------------------------------|------------|---------------------------|--------------|----------------------------|----------|--------|-------------|-----------|
| Balance at March 31, 2012 | \$ 11,019 | \$ 15,400 | \$ 1,847 | \$ 3,540 | \$ 7,555 | \$ 1 | \$— | \$ 39,362 |
| Charge-offs | (205) | (808) | — | (213) | (1,028) | — | — | (2,254) |
| Recoveries | 216 | 849 | 3 | 33 | 230 | — | — | 1,331 |
| Provision | (743) | 1,616 | 152 | 539 | 1,436 | — | — | 3,000 |
| Balance at June 30, 2012 | \$ 10,287 | \$ 17,057 | \$ 2,002 | \$ 3,899 | \$ 8,193 | \$ 1 | \$— | \$ 41,439 |

| | Commercial | Commercial Real Estate | Agricultural | Residential Real Estate | Consumer | Leases | Unallocated | Total |
|------------------------------------|------------|---------------------------|--------------|----------------------------|----------|--------|-------------|-----------|
| Balance at December 31, 2011 | \$ 10,547 | \$ 14,621 | \$ 1,763 | \$ 3,001 | \$ 6,874 | \$ 2 | \$— | \$ 36,808 |
| Charge-offs | (707) | (1,094) | — | (276) | (1,785) | — | — | (3,862) |
| Recoveries | 249 | 2,279 | 81 | 66 | 464 | — | — | 3,139 |
| Provision | 198 | 1,251 | 158 | 1,108 | 2,640 | (1) | — | 5,354 |
| Balance at June 30, 2012 | \$ 10,287 | \$ 17,057 | \$ 2,002 | \$ 3,899 | \$ 8,193 | \$ 1 | \$— | \$ 41,439 |

| | Commercial | Commercial Real Estate | Agricultural | Residential Real Estate | Consumer | Leases | Unallocated | Total |
|------------------------------|------------|---------------------------|--------------|----------------------------|----------|--------|-------------|-----------|
| Balance at March 31, 2011 | \$ 10,644 | \$ 21,787 | \$ 1,982 | \$ 2,336 | \$ 6,502 | \$ 20 | \$— | \$ 43,271 |
| Charge-offs | (617) | (5,480) | (95) | (616) | (1,375) | — | — | (8,183) |
| Recoveries | 324 | 1,155 | — | 23 | 167 | — | — | 1,669 |
| Provision | (254) | 1,900 | 95 | 765 | 1,352 | (13) | — | 3,845 |
| Balance at June 30, 2011 | \$ 10,097 | \$ 19,362 | \$ 1,982 | \$ 2,508 | \$ 6,646 | \$ 7 | \$— | \$ 40,602 |

| | Commercial | Commercial Real Estate | Agricultural | Residential Real Estate | Consumer | Leases | Unallocated | Total |
|------------------------------------|------------|---------------------------|--------------|----------------------------|----------|--------|-------------|-----------|
| Balance at December 31, 2010 | 10,525 | 20,316 | 2,147 | 2,381 | 6,315 | 9 | 1,000 | 42,693 |
| Charge-offs | (2,004) | (12,584) | (167) | (1,229) | (2,222) | — | — | (18,206) |
| Recoveries | 393 | 1,529 | — | 25 | 314 | — | — | 2,261 |
| Provision | 1,183 | 10,101 | 2 | 1,331 | 2,239 | (2) | (1,000) | 13,854 |
| Balance at June 30, 2011 | \$ 10,097 | \$ 19,362 | \$ 1,982 | \$ 2,508 | \$ 6,646 | \$ 7 | \$— | \$ 40,602 |

NOTE 5: GOODWILL, CORE DEPOSIT PREMIUM AND OTHER INTANGIBLE ASSETS

Heartland had goodwill of \$25.9 million at June 30, 2012 and December 31, 2011. The gross carrying amount of intangible assets and the associated accumulated amortization at June 30, 2012, and December 31, 2011, are presented in the table below, in thousands:

| | June 30, 2012 | | Net Carrying Amount | December 31, 2011 | | Net Carrying Amount |
|----------------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
| | Gross Carrying Amount | Accumulated Amortization | | Gross Carrying Amount | Accumulated Amortization | |
| Amortizing intangible assets: | | | | | | |
| Core deposit intangibles | \$9,957 | \$9,034 | \$923 | \$9,957 | \$8,815 | \$1,142 |
| Mortgage servicing rights | 19,114 | 6,250 | 12,864 | 16,779 | 5,503 | 11,276 |
| Customer relationship intangible | 1,177 | 669 | 508 | 1,177 | 635 | 542 |
| Total | \$30,248 | \$15,953 | \$14,295 | \$27,913 | \$14,953 | \$12,960 |

The following table shows the estimated future amortization expense for amortizable intangible assets, in thousands:

| | Core Deposit Intangibles | Mortgage Servicing Rights | Customer Relationship Intangible | Total |
|-------------------------------------|--------------------------|---------------------------|----------------------------------|---------|
| Six months ending December 31, 2012 | \$223 | \$2,740 | \$21 | \$2,984 |
| Year ending December 31, | | | | |
| 2013 | 423 | 3,374 | 45 | 3,842 |
| 2014 | 184 | 2,700 | 43 | 2,927 |
| 2015 | 15 | 2,025 | 42 | 2,082 |
| 2016 | 14 | 1,350 | 41 | 1,405 |
| 2017 | 12 | 675 | 40 | 727 |
| Thereafter | 52 | — | 276 | 328 |

Projections of amortization expense for mortgage servicing rights are based on existing asset balances and the existing interest rate environment as of June 30, 2012. Heartland's actual experience may be significantly different depending upon changes in mortgage interest rates and market conditions. Mortgage loans serviced for others were \$1.78 billion and \$1.54 billion as of June 30, 2012 and December 31, 2011, respectively. The fair value of Heartland's mortgage servicing rights was estimated at \$12.9 million and \$11.5 million at June 30, 2012, and December 31, 2011, respectively. Heartland's mortgage servicing rights are separated into 15- and 30-year tranches. At June 30, 2012, the 30-year tranche had a fair value of \$10.3 million in comparison with the book value of \$10.3 million. At December 31, 2011, the 30-year tranche had a fair value of \$9.1 million in comparison with the book value of \$8.9 million. At June 30, 2012, the 15-year tranche had a fair value of \$2.6 million in comparison with the book value of \$2.8 million. At December 31, 2011, the 15-year tranche had a fair value of \$2.4 million in comparison with the book value of \$2.4 million. Accordingly, valuation allowances of \$200 thousand and \$19 thousand, were required as of June 30, 2012, and December 31, 2011, respectively.

The following table summarizes, in thousands, the changes in capitalized mortgage servicing rights:

| | 2012 | 2011 |
|----------------------|----------|----------|
| Balance at January 1 | \$11,276 | \$11,210 |
| Originations | 4,600 | 1,599 |
| Amortization | (2,831) | (1,672) |
| Valuation adjustment | (181) | — |
| Balance at June 30 | \$12,864 | \$11,137 |

NOTE 6: BORROWINGS

On January 31, 2012, Heartland issued an additional \$10.0 million of its senior notes to two of the accredited investors that had purchased senior notes in 2011. Additionally, Heartland extended the maturities on a portion of the existing senior notes such that \$17.5 million remained at the original maturity date of December 1, 2015; \$7.0 million will mature on each of February 1, 2017, and February 1, 2018; and \$6.0 million will mature on February 1, 2019. Total senior notes outstanding were \$37.5 million as of June 30, 2012, and \$27.5 million as of December 31, 2011.

On March 7, 2012, Heartland exercised its call option on \$5.0 million of its trust preferred capital securities that were at a fixed rate of 10.60%. The prepayment obligation of \$238 thousand and the remaining unamortized issuance costs of \$64 thousand were expensed upon redemption.

NOTE 7: DERIVATIVE FINANCIAL INSTRUMENTS

Heartland uses derivative financial instruments as part of its interest rate risk management strategy, including interest rate swaps, caps, floors and collars and certain interest rate lock commitments and forward sales of securities related to mortgage banking activities. Heartland's objectives are to add stability to its net interest margin and to manage its exposure to movements in interest rates. The contract or notional amount of a derivative is used to determine, along with the other terms of the derivative, the amounts to be exchanged between the counterparties. Heartland is exposed to credit risk in the event of nonperformance by counterparties to financial instruments. Heartland minimizes this risk by entering into derivative contracts with large, stable financial institutions. Heartland has not experienced any losses from nonperformance by these counterparties. Heartland monitors counterparty risk in accordance with the provisions of ASC 815. In addition, interest rate-related derivative instruments generally contain language outlining collateral pledging requirements for each counterparty. Collateral must be posted when the market value exceeds certain threshold limits which are determined by credit ratings of each counterparty. Heartland was required to pledge \$7.7 million and \$6.3 million of cash as collateral at June 30, 2012, and December 31, 2011, respectively.

Heartland's derivative and hedging instruments are recorded at fair value on the consolidated balance sheets. See Note 8, "Fair Value," for additional fair value information and disclosures.

Cash Flow Hedges

Heartland has variable rate funding which creates exposure to variability in interest payments due to changes in interest rates. To manage the interest rate risk related to the variability of interest payments, Heartland has entered into various interest rate swap agreements. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are received or made on Heartland's variable-rate liabilities. For the six months ended June 30, 2012, the change in net unrealized losses on cash flow hedges reflects changes in the fair value of the swaps and reclassification from accumulated other comprehensive income to interest expense totaling \$985 thousand. For the next twelve months, Heartland estimates that cash payments and reclassification from accumulated other comprehensive income to interest expense will total \$2.0 million.

Heartland executed an interest rate swap transaction on April 5, 2011, with an effective date of April 20, 2011, and an expiration date of April 20, 2016, to effectively convert \$15.0 million of its newly issued variable rate amortizing debt to fixed rate debt. For accounting purposes, this swap transaction is designated as a cash flow hedge of the changes in cash flows attributable to changes in one-month LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on an amount of Heartland's debt principal equal to the then-outstanding swap notional amount. At inception, Heartland asserted that the underlying principal balance would remain outstanding throughout the hedge transaction making it probable that sufficient LIBOR-based interest payments would exist through the

maturity date of the swap.

During the first quarter of 2009, Heartland entered into three forward-starting interest rate swap transactions to effectively convert \$65.0 million of its variable interest rate subordinated debentures (issued in connection with the trust preferred securities of Heartland Financial Statutory Trust IV, V and VII) to fixed interest rate debt. For accounting purposes, these three swap transactions are designated as cash flow hedges of the changes in cash flows attributable to changes in LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on \$65.0 million of Heartland's subordinated debentures (issued in connection with the trust preferred securities of Heartland Financial Statutory Trust IV, V and VII) that reset quarterly on a specified reset date. At inception, Heartland asserted that the underlying principal balance would remain outstanding throughout the hedge transaction making it probable that sufficient LIBOR-based interest payments would exist through the maturity date of the swaps.

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The table below identifies the balance sheet category and fair values of Heartland's derivative instruments designated as cash flow hedges at June 30, 2012, and December 31, 2011, in thousands:

| | Notional Amount | Fair Value | Balance Sheet Category | Receive Rate | Weighted Average Pay Rate | Maturity |
|--------------------|-----------------|------------|------------------------|--------------|---------------------------|-------------|
| June 30, 2012 | | | | | | |
| Interest rate swap | \$ 13,620 | \$(769) |) Other Liabilities | 2.993 | % 5.140 | % 4/20/2016 |
| Interest rate swap | 25,000 | (900) |) Other Liabilities | 0.468 | % 2.580 | % 3/17/2014 |
| Interest rate swap | 20,000 | (2,214) |) Other Liabilities | 0.467 | % 3.220 | % 3/1/2017 |
| Interest rate swap | 20,000 | (2,990) |) Other Liabilities | 0.469 | % 3.355 | % 1/7/2020 |
| December 31, 2011 | | | | | | |
| Interest rate swap | \$ 14,221 | \$(725) |) Other Liabilities | 3.035 | % 5.140 | % 4/20/2016 |
| Interest rate swap | 25,000 | (1,032) |) Other Liabilities | 0.559 | % 2.580 | % 3/17/2014 |
| Interest rate swap | 20,000 | (2,064) |) Other Liabilities | 0.527 | % 3.220 | % 3/1/2017 |
| Interest rate swap | 20,000 | (2,584) |) Other Liabilities | 0.384 | % 3.355 | % 1/7/2020 |

The table below identifies the gains and losses recognized on Heartland's derivative instruments designated as cash flow hedges for the six months ended June 30, 2012, and June 30, 2011, in thousands:

| | Effective Portion | | Ineffective Portion | | |
|--------------------|----------------------|------------------------------------|----------------------|------------------------------------|-------------------------------------|
| | Recognized in OCI | Reclassified from AOCI into Income | Recognized in OCI | Reclassified from AOCI into Income | Recognized in Income on Derivatives |
| | Amount of Gain(Loss) | Category | Amount of Gain(Loss) | Category | Amount of Gain(Loss) |
| June 30, 2012 | | | | | |
| Interest rate swap | \$(44) |) Interest Expense | \$(151) |) Other Income | \$— |
| Interest rate swap | 132 |) Interest Expense | (262) |) Other Income | — |
| Interest rate swap | (150) |) Interest Expense | (276) |) Other Income | — |
| Interest rate swap | (406) |) Interest Expense | (296) |) Other Income | — |
| June 30, 2011 | | | | | |
| Interest rate swap | \$(98) |) Interest Expense | \$(287) |) Other Income | \$— |
| Interest rate swap | (272) |) Interest Expense | (295) |) Other Income | — |
| Interest rate swap | (295) |) Interest Expense | (309) |) Other Income | — |

Economic Hedges

Heartland has certain derivative contracts which are accounted for as economic hedges. These contracts do not qualify for hedge accounting. These contracts are carried on the balance sheet at fair value with changes in fair value recorded as a component of other noninterest expense on the consolidated statements of income.

To reduce the potentially negative impact an upward movement in interest rates would have on its net interest income, Heartland entered into two cap transactions. For accounting purposes, these two cap transactions were designated as cash flow hedges of the changes in cash flows attributable to changes in LIBOR, the benchmark interest rate being hedged, above the cap strike rate associated with the hedged interest payments made on \$40 million of Heartland's subordinated debentures that reset quarterly on a specified reset date.

The first transaction, executed on January 15, 2008, was a fifty-five month interest rate cap on a notional amount of \$20.0 million. The cap had an effective date of January 15, 2008 and a maturity date of September 1, 2012. Should 3-month LIBOR exceed 5.12% on a reset date, the counterparty will pay Heartland the amount of interest that exceeds the amount owed on the debt at the cap LIBOR rate of 5.12%. The floating rate subordinated debentures contain an

interest rate deferral feature that is mirrored in the cap transaction. Heartland executed an interest rate swap transaction on February 4, 2009, and converted this cap transaction into an economic hedge and hedge accounting for the cap transaction was ceased.

The second transaction, executed on March 27, 2008, was a twenty-eight month interest rate cap transaction on a notional amount of \$20.0 million. The cap had an effective date of January 7, 2009, and a maturity date of April 7, 2011. When 3-month LIBOR exceeded 5.50% on a reset date, the counterparty paid Heartland the amount of interest that exceeds the amount owed on the debt at the cap LIBOR rate of 5.50%. The floating rate subordinated debentures contain an interest rate deferral feature that was mirrored in the cap transaction.

Mortgage Derivatives

Heartland also has entered into interest rate lock commitments to originate residential mortgage loans held for sale and forward commitments to sell residential mortgage loans and mortgage backed securities that are considered derivative instruments. The fair value of these commitments is recorded on the consolidated balance sheets with the changes in fair value recorded in the consolidated statements of income as a component of gains on sale of loans held for sale. These derivative contracts are designated as free standing derivative contracts and are not designated against specific assets and liabilities on the balance sheet or forecasted transactions and therefore do not qualify for hedge accounting treatment.

The table below identifies the balance sheet category and fair values of Heartland's derivative instruments not designated as hedging instruments at June 30, 2012, and December 31, 2011, in thousands:

| | Notional Amount | Fair Value | Balance Sheet Category |
|---|--------------------|------------|---------------------------|
| June 30, 2012 | | | |
| Interest rate lock commitments (mortgage) | \$316,351 | \$11,011 | Other Assets |
| Interest rate cap | 20,000 | — | Other Assets |
| Forward commitments | 53,326 | 214 | Other Assets |
| Forward commitments | 316,571 | (3,217) |) Other Liabilities |
| December 31, 2011 | | | |
| Interest rate lock commitments (mortgage) | \$113,438 | \$3,697 | Other Assets |
| Interest rate cap | 20,000 | — | Other Assets |
| Forward commitments | 91,750 | (869) |) Other Assets |

The table below identifies the income statement category of the gains and losses recognized in income on Heartland's derivative instruments not designated as hedging instruments for the six months ended June 30, 2012, and June 30, 2011, in thousands :

| | Income Statement Category | Year-to-Date Gain(Loss) Recognized |
|---|--------------------------------------|--|
| June 30, 2012 | | |
| Interest rate lock commitments (mortgage) | Gains on Sale of Loans Held for Sale | \$11,011 |
| Interest rate cap | Other Income | — |
| Forward commitments | Gains on Sale of Loans Held for Sale | (3,003) |
| June 30, 2011 | | |
| Interest rate cap | Other Income | — |
| Interest rate cap | Other Income | (4) |

NOTE 8: FAIR VALUE

Heartland utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale, trading securities and derivatives are recorded in the consolidated balance sheets at fair value on a recurring basis. Additionally, from time to time, Heartland may be

required to record at fair value other assets on a nonrecurring basis such as loans held for sale, loans held to maturity and certain other assets including, but not limited to, mortgage servicing rights and other real estate owned. These nonrecurring fair value adjustments typically involve application of lower of cost or fair value accounting or write-downs of individual assets.

Fair Value Hierarchy

Under ASC 820, assets and liabilities are grouped at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 — Valuation is based upon quoted prices for identical instruments in active markets.

Level 2 — Valuation is based upon quoted prices for similar instruments in active markets, or similar instruments in markets that are not active, and model-based valuation techniques for all significant assumptions are observable in the market.

Level 3 — Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value on a recurring or non-recurring basis.

Assets

Securities Available for Sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury and other U.S. government and agency securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include agency mortgage-backed securities and private collateralized mortgage obligations, municipal bonds and corporate debt securities. The Level 3 securities consist primarily of Z tranche mortgage-backed securities. On a quarterly basis, a secondary independent pricing service is used for a sample of securities to validate the pricing from our primary pricing service.

Trading Assets

Trading assets are recorded at fair value and consist of securities held for trading purposes. The valuation method for trading securities is the same as the methodology used for securities classified as available for sale.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, Heartland classifies loans held for sale subjected to nonrecurring fair value adjustments as Level 2.

Loans Held to Maturity

Heartland does not record loans held to maturity at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC 310. Loan impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except where more practical, at the observable market price of the loan or the fair value

of the collateral if the loan is collateral dependent. At June 30, 2012, all impaired loans were measured based on the fair value of the collateral. In accordance with ASC 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. Heartland classifies impaired loans as nonrecurring Level 3.

Derivative Financial Instruments

Currently, Heartland uses interest rate swaps, caps, floors, collars and certain interest rate lock commitments and forward sales of securities related to mortgage banking activities to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate options are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates fell below (rise above) the strike rate of the floors (caps). The variable interest rates used in the

calculation of projected receipts on the floor (cap) are based on an expectation of future interest rates derived from observable market interest rate curves and volatilities. To comply with the provisions of ASC 820, Heartland incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, Heartland has considered the impact of netting any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Although Heartland has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of June 30, 2012, and December 31, 2011, Heartland has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, Heartland has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

Other Real Estate Owned

Other real estate owned ("OREO") represents property acquired through foreclosures and settlements of loans. Property acquired is carried at the lower of the principal amount of the loan outstanding at the time of acquisition, plus any acquisition costs, or the estimated fair value of the property, less disposal costs. Heartland considers third party appraisals, as well as independent fair value assessments from realtors or persons involved in selling OREO, in determining the fair value of particular properties. Accordingly, the valuation of OREO is subject to significant external and internal judgment. Heartland also periodically reviews OREO to determine if the fair value of the property, less disposal costs, has declined below its recorded book value and records any adjustments accordingly. OREO is classified as nonrecurring Level 3.

The table below presents Heartland's assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2012, and December 31, 2011, in thousands, aggregated by the level in the fair value hierarchy within which those measurements fall:

| | Total Fair Value | Level 1 | Level 2 | Level 3 |
|---------------------------------|------------------|-----------|-------------|---------|
| June 30, 2012 | | | | |
| Trading securities | \$379 | \$379 | \$— | \$— |
| Securities available for sale | 1,274,552 | 48,657 | 1,222,761 | 3,134 |
| Derivative assets | 11,225 | — | 11,225 | — |
| Total assets at fair value | \$1,286,156 | \$49,036 | \$1,233,986 | \$3,134 |
| Derivative liabilities | \$10,090 | \$— | \$10,090 | \$— |
| Total liabilities at fair value | \$10,090 | \$— | \$10,090 | \$— |
| December 31, 2011 | | | | |
| Trading securities | \$333 | \$333 | \$— | \$— |
| Securities available for sale | 1,267,999 | 107,147 | 1,157,609 | 3,243 |
| Derivative assets | 2,828 | — | 2,828 | — |
| Total assets at fair value | \$1,271,160 | \$107,480 | \$1,160,437 | \$3,243 |
| Derivative liabilities | \$6,405 | \$— | \$6,405 | \$— |
| Total liabilities at fair value | \$6,405 | \$— | \$6,405 | \$— |

There were no transfers between Levels 1, 2 or 3 during the three- and six-month periods ended June 30, 2012, or the year ended December 31, 2011.

The tables below present Heartland's assets that are measured at fair value on a nonrecurring basis, in thousands:

Fair Value Measurements at June 30, 2012

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Losses |
|---|----------|--|---|--|---------|
| Assets: | | | | | |
| Collateral dependent impaired loans: | | | | | |
| Commercial | \$6,979 | \$— | \$— | \$6,979 | \$707 |
| Commercial real estate | 50,596 | — | — | 50,596 | 1,094 |
| Agricultural and agricultural real estate | 13,437 | — | — | 13,437 | — |
| Residential real estate | 5,874 | — | — | 5,874 | 276 |
| Consumer | 3,322 | — | — | 3,322 | 1,785 |
| Total collateral dependent impaired loans | \$80,208 | \$— | \$— | \$80,208 | \$3,862 |
| Other real estate owned | \$37,941 | \$— | \$— | \$37,941 | \$2,683 |

Fair Value Measurements at December 31, 2011

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Losses |
|-------------------------------------|--------|--|---|--|----------|
| Assets: | | | | | |
| Collateral dependent impaired loans | 94,961 | — | — | 94,961 | \$32,640 |
| Other real estate owned | 44,387 | — | — | 44,387 | \$7,079 |

| | Quantitative Information About Level 3 Fair Value Measurements | | | |
|---|--|--------------------------|-----------------------|--------------------------|
| | Fair Value at 6/30/12 | Valuation Technique | Unobservable Input | Range (Weighted Average) |
| Z-Tranche Securities | \$3,134 | Discounted cash flows | Pretax discount rate | 15.00% |
| | | | Actual defaults | 13.94-20.94% (15.52%) |
| | | | Actual deferrals | 6.30-23.71% (11.32%) |
| Collateral dependent impaired loans: | | | | |
| Commercial real estate | 50,596 | Modified appraised value | Third party appraisal | NM* |
| | | | Appraisal discount | NM* |
| Commercial | 6,979 | Modified appraised value | Third party appraisal | NM* |
| | | | Appraisal discount | NM* |
| Agricultural and agricultural real estate | 13,437 | Modified appraised value | Third party appraisal | NM* |
| | | | Appraisal discount | NM* |
| Residential real estate | 5,874 | Modified appraised value | Third party appraisal | NM* |
| | | | Appraisal discount | NM* |
| Consumer | 3,322 | Modified appraised value | Third party appraisal | NM* |
| | | | Appraisal discount | NM* |
| Other real estate owned | 37,941 | Modified appraised value | Disposal costs | NM* |

* Not Meaningful. Third party appraisals are obtained as to the value of the underlying asset, but disclosure of this information would not provide meaningful information, as the range will vary widely from loan to loan. Types of discounts considered included age of the appraisal, local market conditions, current condition of the property, and estimated sales costs. These discounts will also vary from loan to loan, thus providing range would not be meaningful.

The changes in Level 3 assets that are measured at fair value on a recurring basis are summarized in the following table, in thousands:

| | For the Six Months Ended June 30, 2012 Fair Value | For the Year Ended December 31, 2011 Fair Value |
|--|---|---|
| Balance at January 1, | \$3,243 | \$4,676 |
| Total gains: | | |
| Included in earnings | — | (1,424) |
| Included in other comprehensive income | (95) | 12 |
| Purchases, issuances, sales and settlements: | | |
| Sales | — | (11) |
| Settlements | (14) | (10) |
| Balance at period end, | \$3,134 | \$3,243 |

The table below is a summary of the estimated fair value of Heartland's financial instruments as defined by ASC 825 as of June 30, 2012, and December 31, 2011, in thousands. The carrying amounts in the following table are recorded in the balance sheet under the indicated captions. In accordance with ASC 825, the assets and liabilities that are not financial instruments are not included in the disclosure, such as the value of the mortgage servicing rights, premises, furniture and equipment, goodwill and other intangibles and other liabilities.

Heartland does not believe that the estimated information presented herein is representative of the earnings power or value of Heartland. The following analysis, which is inherently limited in depicting fair value, also does not consider any value associated with either existing customer relationships or the ability of Heartland to create value through loan origination, deposit gathering or fee generating activities. Many of the estimates presented herein are based upon the use of highly subjective information and assumptions and, accordingly, the results may not be precise. Management believes that fair value estimates may not be comparable between financial institutions due to the wide range of permitted valuation techniques and numerous estimates which must be made. Furthermore, because the disclosed fair value amounts were estimated as of the balance sheet date, the amounts actually realized or paid upon maturity or settlement of the various financial instruments could be significantly different.

| (in thousands) | Carrying Amount | Estimated Fair Value | Fair Value Measurement at | | | December 31, 2011 | |
|---|-----------------|----------------------|---------------------------|--|---|---|-----------------|
| | | | June 30, 2012 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Carrying Amount |
| Financial assets: | | | | | | | |
| Cash and cash equivalents | \$82,831 | \$82,831 | \$82,831 | \$— | \$— | \$129,834 | \$129,834 |
| Securities: | | | | | | | |
| Trading | 379 | 379 | 379 | — | — | 333 | 333 |
| Available for sale | 1,274,552 | 1,274,552 | 48,657 | 1,222,761 | 3,134 | 1,267,999 | 1,267,999 |
| Held to maturity | 56,157 | 56,120 | — | 56,120 | — | 58,260 | 57,486 |
| Total securities | 1,331,088 | 1,331,051 | 49,036 | 1,278,881 | 3,134 | 1,326,592 | 1,325,818 |
| Loans held for sale | 73,284 | 73,331 | — | 73,331 | — | 53,528 | 53,999 |
| Loans, net: | | | | | | | |
| Commercial | 657,942 | 655,969 | — | 648,990 | 6,979 | | |
| Commercial real estate | 1,223,207 | 1,227,403 | — | 1,176,807 | 50,596 | | |
| Agricultural and agricultural real estate | 278,141 | 280,534 | — | 267,097 | 13,437 | | |
| Residential real estate | 219,494 | 211,572 | — | 205,698 | 5,874 | | |
| Consumer | 223,304 | 225,210 | — | 221,888 | 3,322 | | |
| Total Loans, net | 2,602,088 | 2,600,688 | — | 2,520,480 | 80,208 | 2,494,631 | 2,488,881 |
| Mortgage derivatives | \$11,225 | \$11,225 | \$— | \$11,225 | \$— | \$2,828 | \$2,828 |
| Financial liabilities | | | | | | | |
| Deposits | | | | | | | |
| Demand deposits | 799,548 | 799,548 | — | 799,548 | — | 737,323 | 737,323 |
| Savings deposits | 1,734,155 | 1,734,155 | — | 1,734,155 | — | 1,678,154 | 1,678,154 |
| Time deposits | 801,204 | 801,204 | — | 801,204 | — | 794,636 | 794,636 |
| Short term borrowings | 249,485 | 249,485 | — | 249,485 | — | 270,081 | 270,081 |
| Other borrowings | 377,543 | 366,206 | — | 366,206 | — | 372,820 | 352,847 |

| | | | | | | | |
|-------------|--------|--------|---|--------|---|-------|-------|
| Derivatives | 10,090 | 10,090 | — | 10,090 | — | 6,405 | 6,405 |
|-------------|--------|--------|---|--------|---|-------|-------|

Cash and Cash Equivalents — The carrying amount is a reasonable estimate of fair value due to the short-term nature of these instruments.

Securities — For securities either held to maturity, available for sale or trading, fair value equals quoted market price if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. For Level 3 securities, Heartland utilizes independent pricing provided by third party vendors or brokers.

Loans and Leases — The fair value of loans is estimated using an entrance price concept, except for impaired loans which are measured using the fair value of the underlying collateral. The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, except for the impaired loans which are measured using the fair value of the underlying collateral. The fair value of loans held for sale is estimated using quoted market prices.

Derivatives — The fair value of all derivatives is estimated based on the amount that Heartland would pay or would be paid to terminate the contract or agreement, using current rates and, when appropriate, the current creditworthiness of the counter-party.

Deposits — The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. If the fair value of the fixed maturity certificates of deposit is calculated at less than the carrying amount, the carrying value of these deposits is reported as the fair value.

Short-term and Other Borrowings — Rates currently available to Heartland for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

Commitments to Extend Credit, Unused Lines of Credit and Standby Letters of Credit — Based upon management's analysis of the off balance sheet financial instruments, there are no significant unrealized gains or losses associated with these financial instruments based upon review of the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties.

NOTE 9: SUBSEQUENT EVENTS

Heartland evaluated subsequent events through the filing date of this Quarterly Report on Form 10-Q filed with the SEC.

On July 13, 2012, Heartland completed the purchase of three retail banking offices from Liberty Bank, FSB in its Dubuque, Iowa market. The purchase was completed through Heartland's Dubuque Bank and Trust Company subsidiary. It included deposits of approximately \$54 million and loans of \$10 million.

Effective July 31, 2012, Heartland executed a Merger Agreement with First Shares, Inc. ("FSI"), the bank holding company for the First National Bank of Platteville in Platteville, Wisconsin. Under the terms of the agreement, the outstanding shares of FSI will be converted into a combination of cash and shares of Heartland common stock, with the aggregate purchase price, estimated at \$11.0 million, to be based upon the financial position of FSI prior to closing. The stock consideration is expected to be approximately 60 percent of the purchase price. Simultaneous with the closing of the transaction, First National Bank will be merged into Heartland's Wisconsin Bank & Trust subsidiary. The First National Bank of Platteville had total assets of approximately \$130 million and deposits of approximately \$114 million at June 30, 2012. The merger, which is subject to regulatory approval and approval of the shareholders of FSI, is expected to be completed in the fourth quarter of 2012.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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. Although Heartland has made these statements based on management's experience and best estimate of future events, there may be events or factors that management has not anticipated, and the accuracy and achievement of such forward-looking statements and estimates are subject to a number of risks, including those identified in our Annual Report on Form 10-K for the year ended December 31, 2011, and under Part II, Item 1A of this Quarterly Report on Form 10-Q. 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.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, income and expenses. These estimates are based upon historical experience and on various other assumptions that management believes are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The estimates and judgments that management believes have the most effect on Heartland's reported financial position and results of operations are described as critical accounting policies in Heartland's Annual Report on Form 10-K for the year ended December 31, 2011. There have been no significant changes in the critical accounting policies or the assumptions and judgments utilized in applying these policies since the year ended December 31, 2011.

OVERVIEW

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 and fees, loan servicing income, trust income, brokerage and insurance commissions, securities gains and gains on sale of loans, also affects Heartland's results of operations. Heartland's principal operating expenses, aside from interest expense, consist of salaries and employee benefits, occupancy and equipment costs, professional fees, FDIC insurance premiums and the provision for loan and lease losses. During the most recent years, Heartland's operating expenses have also been significantly impacted by net losses on repossessed assets.

Net income was \$14.0 million for the quarter ended June 30, 2012, an increase of \$3.8 million or 37 percent from the \$10.2 million recorded for the second quarter of 2011. Net income available to common stockholders was \$12.9 million, or \$0.77 per diluted common share, for the quarter ended June 30, 2012, compared to \$8.9 million, or \$0.54 per diluted common share, for the second quarter of 2011. Return on average common equity was 18.28 percent and return on average assets was 1.20 percent for the second quarter of 2012, compared to 13.69 percent and 0.89 percent, respectively, for the same quarter in 2011.

Earnings for the second quarter of 2012, in comparison to the second quarter of 2011, were most significantly affected by the continued expansion of mortgage operations in both new and existing markets, and the noninterest income generated from those operations. Solid loan growth also contributed to the maintenance of a net interest margin above 4.00 percent for the 12th consecutive quarter.

Net income recorded for the first six months of 2012 was \$26.8 million, compared to \$14.4 million recorded during the first six months of 2011. Net income available to common stockholders was \$24.8 million, or \$1.48 per diluted common share, for the six months ended June 30, 2012, compared to \$11.8 million, or \$0.71 per diluted common share, earned during the first six months of 2011. Return on average common equity was 17.78 percent and return on average assets was 1.16 percent for the first six months of 2012, compared to 9.28 percent and 0.59 percent, respectively, for the same period in 2011.

Earnings for the first six months of 2012 compared to the first six months of 2011 were positively affected by reduced provision for loan and lease losses, combined with increases in net interest income, gains on sale of loans and securities gains.

The effect of these improvements was partially offset by increases in salaries and employee benefits, professional fees and other noninterest expenses.

Total assets were \$4.43 billion at June 30, 2012, an increase of \$122.6 million since December 31, 2011, with \$114.8 million of this growth occurring in the second quarter. Securities represented 30 percent of total assets at June 30, 2012, compared to 31 percent at year-end 2011.

Total loans and leases held to maturity were \$2.63 billion at June 30, 2012, compared to \$2.48 billion at year-end 2011, an increase of \$148.3 million or 12 percent annualized, with \$97.2 million or 66 percent of this growth occurring during the second quarter. Growth in the commercial and commercial real estate loan portfolio made up \$94.5 million or 64 percent of this increase, with \$61.4 million occurring in the second quarter.

Total deposits were \$3.33 billion at June 30, 2012, compared to \$3.21 billion at year-end 2011, an increase of \$124.8 million or 8 percent annualized, with \$59.1 million or 47 percent of the growth occurring during the second quarter. The composition of Heartland's deposits continues to improve as no cost demand deposits as a percentage of total deposits was 24 percent at June 30, 2012, compared to 23 percent at year-end 2011. Demand deposits increased \$62.2 million or 17 percent annualized since year-end 2011, with \$28.1 million or 45 percent of this growth occurring during the second quarter.

RESULTS OF OPERATIONS

Net Interest Income

Net interest margin, expressed as a percentage of average earning assets, was 4.05 percent during the second quarter of 2012 compared to 4.23 percent for the second quarter of 2011. For the six-month periods ended June 30, net interest margin was 4.14 percent during 2012 and 4.21 percent during 2011. The ability to maintain a net interest margin above 4.00 percent has been a direct result of Heartland's pricing discipline. Also, positively affecting net interest margin was improvement in the level of nonperforming loans not covered under loss share agreements, which had balances of \$44.8 million or 1.71 percent of total loans and leases at June 30, 2012, and \$68.1 million or 2.90 percent of total loans and leases at June 30, 2011.

On a tax-equivalent basis, interest income in the second quarter of 2012 was \$48.8 million compared to \$49.9 million in the second quarter of 2011, a decrease of \$1.1 million or 2 percent. For the first six months of 2012, interest income on a tax-equivalent basis was \$98.7 million compared to \$99.2 million during the same period in 2011, a decrease of \$511 thousand or 1 percent. Even though average earning assets increased \$270.3 million or 8 percent during the second quarter of 2012 compared to the second quarter of 2011 and \$235.5 million or 7 percent during the first six months of 2012 compared to the same period in 2011, this growth did not cover the decline in interest income due to a decrease in the rates earned on these assets. The average interest rate earned on these assets was 5.07 percent during the second quarter of 2012 compared to 5.57 percent during the second quarter of 2011. For the first six months of the year, the average interest rate earned on these assets was 5.19 percent during 2012 compared to 5.57 percent during 2011. The declines in interest income were a result of the interest rates earned on the securities portfolio, which decreased 90 basis points during the quarter ended June 30, 2012, compared to the same quarter in 2011 and 63 basis points during the six months ended June 30, 2012, compared to the same six months in 2011.

Interest expense for the second quarter of 2012 was \$9.9 million, a decrease of \$2.1 million or 18 percent from \$12.0 million in the second quarter of 2011. On a six-month comparative basis, interest expense decreased \$4.3 million or 18 percent. Even though average interest bearing liabilities increased \$135.1 million or 4 percent for the quarter ended June 30, 2012, as compared to the same quarter in 2011, and \$102.9 million or 3 percent for the six-month period ended on June 30, 2012, as compared to the same six-month period in 2011, the total interest paid decreased as the

average interest rate paid on Heartland's deposits and borrowings declined 34 basis points during the quarterly period under comparison and 33 basis points during the six-month period under comparison. Contributing to this improvement in interest expense was a change in the mix of deposits as average savings balances, the lowest cost interest bearing deposits, as a percentage of total average interest bearing deposits was 69 percent during both the second quarter and first six months of 2012 compared to 64 percent for both the second quarter and first six months of 2011. Additionally, the average interest rate paid on savings deposits was 0.40 percent during both the second quarter and first six months of 2012 compared to 0.62 percent during the second quarter and 0.64 percent during the first six months of 2011. Management continues to look for opportunities to reduce Heartland's funding costs. Certificates of deposit maturing within the next six months total \$181.0 million at an average interest rate of 1.19 percent. Renewal rates have generally been ranging between 35 and 50 basis points.

Net interest income on a tax-equivalent basis totaled \$39.0 million during the second quarter of 2012, an increase of \$980 thousand or 3 percent from the \$38.0 million recorded during the second quarter of 2011. For the first six months of 2012, net interest income on a tax-equivalent basis was \$78.8 million, an increase of \$3.8 million or 5 percent from the \$75.0 million

recorded during the first six months of 2011.

Heartland attempts to manage its balance sheet to minimize the effect that a change in interest rates has on its net interest margin. Heartland plans to continue to work toward improving both its earning assets and funding mix through targeted organic growth strategies, which management believes will result in additional net interest income. Heartland believes its net interest income simulations reflect a well-balanced and manageable interest rate posture. Management supports a pricing discipline in which the focus is less on price and more on the unique value provided to business and retail clients. Approximately 40 percent of Heartland's commercial and agricultural loan portfolios consist of floating rate loans that reprice immediately upon a change in the national prime interest rate. Since a large portion of these floating rate loans have interest rate floors that are currently in effect, an upward movement in the national prime interest rate would not have an immediate positive effect on Heartland's interest income. Item 3 of this Form 10-Q contains additional information about the results of Heartland's most recent net interest income simulations. Note 7 to the quarterly financial statements contains a detailed discussion of the derivative instruments Heartland has utilized to manage its interest rate risk.

The table below 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 periods 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. Nonaccrual loans and loans held for sale are included in each respective loan category.

ANALYSIS OF AVERAGE BALANCES, TAX EQUIVALENT YIELDS AND RATES⁽¹⁾

For the quarters ended June 30, 2012 and 2011

(Dollars in thousands)

| | 2012 | | | 2011 | | | |
|--|-------------|----------|-------|---------------|----------|------|---|
| | Average | Interest | Rate | Average | Interest | Rate | |
| | Balance | | | Balance | | | |
| EARNING ASSETS | | | | | | | |
| Securities: | | | | | | | |
| Taxable | \$954,684 | \$5,026 | 2.12 | % \$1,081,753 | \$9,305 | 3.45 | % |
| Nontaxable ⁽¹⁾ | 272,561 | 4,029 | 5.95 | 167,630 | 2,763 | 6.61 | |
| Total securities | 1,227,245 | 9,055 | 2.97 | 1,249,383 | 12,068 | 3.87 | |
| Interest bearing deposits | 6,587 | 1 | 0.06 | 4,402 | — | — | |
| Federal funds sold | 1,433 | 2 | 0.56 | 1,104 | 1 | 0.36 | |
| Loans and leases: | | | | | | | |
| Commercial and commercial real estate ⁽¹⁾ | 1,881,836 | 25,199 | 5.39 | 1,728,649 | 25,222 | 5.85 | |
| Residential mortgage | 290,702 | 3,322 | 4.60 | 186,034 | 2,483 | 5.35 | |
| Agricultural and agricultural real estate ⁽¹⁾ | 276,557 | 3,929 | 5.71 | 256,962 | 4,059 | 6.34 | |
| Consumer | 226,295 | 5,793 | 10.30 | 215,723 | 5,004 | 9.30 | |
| Direct financing leases, net | 304 | 4 | 5.29 | 720 | 10 | 5.57 | |
| Fees on loans | — | 1,510 | — | — | 1,116 | — | |
| Less: allowance for loan and lease losses | (40,599) | — | — | (42,882) | — | — | |
| Net loans and leases | 2,635,095 | 39,757 | 6.07 | 2,345,206 | 37,894 | 6.48 | |
| Total earning assets | 3,870,360 | \$48,815 | 5.07 | % 3,600,095 | \$49,963 | 5.57 | % |
| NONEARNING ASSETS | 480,556 | | | 414,195 | | | |
| TOTAL ASSETS | \$4,350,916 | | | \$4,014,290 | | | |
| INTEREST BEARING LIABILITIES | | | | | | | |
| Savings | \$1,726,357 | \$1,718 | 0.40 | % \$1,553,450 | \$2,406 | 0.62 | % |
| Time, \$100,000 and over | 255,701 | 1,195 | 1.88 | 266,036 | 1,546 | 2.33 | |
| Other time deposits | 520,140 | 2,691 | 2.08 | 606,384 | 3,723 | 2.46 | |
| Short-term borrowings | 260,523 | 224 | 0.35 | 201,246 | 225 | 0.45 | |
| Other borrowings | 377,342 | 4,025 | 4.29 | 377,812 | 4,081 | 4.33 | |
| Total interest bearing liabilities | 3,140,063 | 9,853 | 1.26 | % 3,004,928 | 11,981 | 1.60 | % |
| NONINTEREST BEARING LIABILITIES | | | | | | | |
| Noninterest bearing deposits | 789,095 | | | 633,490 | | | |
| Accrued interest and other liabilities | 52,798 | | | 34,075 | | | |
| Total noninterest bearing liabilities | 841,893 | | | 667,565 | | | |
| STOCKHOLDERS' EQUITY | 368,960 | | | 341,797 | | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$4,350,916 | | | \$4,014,290 | | | |
| Net interest income ⁽¹⁾ | | \$38,962 | | | \$37,982 | | |

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| | | | | | | |
|--|-------|------|---|-------|------|---|
| Net interest spread ⁽¹⁾ | | 3.81 | % | | 3.97 | % |
| Net interest income to total earning assets ⁽¹⁾ | | 4.05 | % | | 4.23 | % |
| Interest bearing liabilities to earning assets | 81.13 | % | | 83.47 | % | |

(1) Tax equivalent basis is calculated using an effective tax rate of 35%.

ANALYSIS OF AVERAGE BALANCES, TAX EQUIVALENT YIELDS AND RATES⁽¹⁾

For the six months ended June 30, 2012 and 2011

(Dollars in thousands)

| | 2012 Average Balance | Interest | Rate | | 2011 Average Balance | Interest | Rate | |
|--|----------------------------|----------|-------|---|----------------------------|----------|------|---|
| EARNING ASSETS | | | | | | | | |
| Securities: | | | | | | | | |
| Taxable | \$987,956 | \$12,598 | 2.56 | % | \$1,071,347 | \$18,526 | 3.49 | % |
| Nontaxable ⁽¹⁾ | 245,922 | 7,523 | 6.15 | | 164,536 | 5,462 | 6.69 | |
| Total securities | 1,233,878 | 20,121 | 3.28 | | 1,235,883 | 23,988 | 3.91 | |
| Interest bearing deposits | 5,205 | 1 | 0.04 | | 4,392 | 1 | 0.05 | |
| Federal funds sold | 790 | 2 | 0.51 | | 718 | 1 | 0.28 | |
| Loans and leases: | | | | | | | | |
| Commercial and commercial real estate ⁽¹⁾ | 1,854,595 | 50,189 | 5.44 | | 1,737,703 | 50,179 | 5.82 | |
| Residential mortgage | 277,649 | 6,438 | 4.66 | | 185,667 | 4,893 | 5.31 | |
| Agricultural and agricultural real estate ⁽¹⁾ | 271,660 | 7,862 | 5.82 | | 254,980 | 7,899 | 6.25 | |
| Consumer | 222,316 | 11,170 | 10.10 | | 214,695 | 9,854 | 9.26 | |
| Direct financing leases, net | 342 | 9 | 5.29 | | 827 | 23 | 5.61 | |
| Fees on loans | — | 2,905 | — | | — | 2,370 | — | |
| Less: allowance for loan and lease losses | (38,901) | — | — | | (42,876) | — | — | |
| Net loans and leases | 2,587,661 | 78,573 | 6.11 | | 2,350,996 | 75,218 | 6.45 | |
| Total earning assets | 3,827,534 | \$98,697 | 5.19 | % | 3,591,989 | \$99,208 | 5.57 | % |
| NONEARNING ASSETS | 461,807 | | | | 420,088 | | | |
| TOTAL ASSETS | \$4,289,341 | | | | \$4,012,077 | | | |
| INTEREST BEARING LIABILITIES | | | | | | | | |
| Savings | \$1,703,004 | \$3,381 | 0.40 | % | \$1,553,372 | \$4,953 | 0.64 | % |
| Time, \$100,000 and over | 251,548 | 2,423 | 1.94 | | 268,242 | 3,156 | 2.37 | |
| Other time deposits | 526,647 | 5,575 | 2.13 | | 610,033 | 7,592 | 2.51 | |
| Short-term borrowings | 253,807 | 437 | 0.35 | | 205,639 | 484 | 0.47 | |
| Other borrowings | 375,696 | 8,086 | 4.33 | | 370,493 | 8,017 | 4.36 | |
| Total interest bearing liabilities | 3,110,702 | 19,902 | 1.29 | % | 3,007,779 | 24,202 | 1.62 | % |
| NONINTEREST BEARING LIABILITIES | | | | | | | | |
| Noninterest bearing deposits | 764,984 | | | | 632,410 | | | |
| Accrued interest and other liabilities | 49,353 | | | | 34,481 | | | |
| Total noninterest bearing liabilities | 814,337 | | | | 666,891 | | | |
| STOCKHOLDERS' EQUITY | 364,302 | | | | 337,407 | | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$4,289,341 | | | | \$4,012,077 | | | |
| Net interest income ⁽¹⁾ | | \$78,795 | | | | \$75,006 | | |
| Net interest spread ⁽¹⁾ | | | 3.90 | % | | | 3.95 | % |
| Net interest income to total earning assets ⁽¹⁾ | | | 4.14 | % | | | 4.21 | % |
| Interest bearing liabilities to earning assets | 81.27 | % | | | 83.74 | % | | |

(1) Tax equivalent basis is calculated using an effective tax rate of 35%.

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 management's opinion, an adequate allowance for loan and lease losses. The provision for loan losses was \$3.0 million for the second quarter of 2012 compared to \$3.8 million for the second quarter of 2011, an \$845 thousand or 22 percent decrease, primarily as a result of reduced charge-offs and reductions in the level of nonperforming and substandard loans. For the first six

months of 2012, provision for loan losses was \$5.4 million compared to \$13.9 million for the first six months of 2011, an \$8.5 million or 61 percent reduction.

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 in Heartland's Annual Report on Form 10-K for the year ended December 31, 2011, and this Quarterly Report on Form 10-Q. Heartland believes the allowance for loan and lease losses as of June 30, 2012, was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions should become more unfavorable, certain 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.

Noninterest Income

The tables below show Heartland's noninterest income for the quarters and the six-month periods indicated.

| (Dollars in thousands) | Three Months Ended | | | |
|---|--------------------|-----------------|-----------------|-------------|
| | June 30, 2012 | June 30, 2011 | Change | % Change |
| NONINTEREST INCOME: | | | | |
| Service charges and fees | \$3,712 | \$3,599 | \$113 | 3 % |
| Loan servicing income | 3,056 | 1,298 | 1,758 | 135 |
| Trust fees | 2,660 | 2,656 | 4 | — |
| Brokerage and insurance commissions | 939 | 856 | 83 | 10 |
| Securities gains, net | 4,951 | 4,756 | 195 | 4 |
| Gain on trading account securities, net | 49 | 81 | (32) | (40) |
| Impairment loss on securities | — | — | — | — |
| Gains on sale of loans | 12,689 | 1,308 | 11,381 | 870 |
| Valuation adjustment on mortgage servicing rights | (194) | — | (194) | — |
| Income on bank owned life insurance | 267 | 331 | (64) | (19) |
| Other noninterest income | 149 | (216) | 365 | (169) |
| TOTAL NONINTEREST INCOME | \$28,278 | \$14,669 | \$13,609 | 93 % |

| (Dollars in thousands) | Six Months Ended | | | |
|---|------------------|-----------------|-----------------|-------------|
| | June 30, 2012 | June 30, 2011 | Change | % Change |
| NONINTEREST INCOME: | | | | |
| Service charges and fees | \$7,296 | \$6,960 | \$336 | 5 % |
| Loan servicing income | 4,816 | 2,847 | 1,969 | 69 |
| Trust fees | 5,273 | 5,135 | 138 | 3 |
| Brokerage and insurance commissions | 1,849 | 1,704 | 145 | 9 |
| Securities gains, net | 8,894 | 6,845 | 2,049 | 30 |
| Gain on trading account securities, net | 46 | 297 | (251) | (85) |
| Impairment loss on securities | (981) | — | (981) | — |
| Gains on sale of loans | 21,191 | 2,710 | 18,481 | 682 |
| Valuation adjustment on mortgage servicing rights | (181) | — | (181) | — |
| Income on bank owned life insurance | 749 | 734 | 15 | 2 |
| Other noninterest income | 2,714 | 45 | 2,669 | 5,931 |
| TOTAL NONINTEREST INCOME | \$51,666 | \$27,277 | \$24,389 | 89 % |

Noninterest income was \$28.3 million during the second quarter of 2012 compared to \$14.7 million during the second quarter of 2011, an increase of \$13.6 million or 93 percent. For the six-month period ended June 30, noninterest income was \$51.7 million in 2012 compared to \$27.3 million in 2011, an increase of \$24.4 million or 89 percent. The categories contributing most significantly to the improvement in noninterest income during both periods were loan servicing income and gains on sale of

loans. Offsetting, in part, the increased securities gains was an impairment loss on securities recorded during the first quarter of 2012.

Service charges and fees increased \$113 thousand or 3 percent during the quarters under comparison and \$336 thousand or 5 percent during the six-month periods under comparison. Service charges on checking and savings accounts recorded during the second quarter of 2012 were \$988 thousand compared to \$805 thousand during the second quarter of 2011, an increase of \$183 thousand or 23 percent. For the six months ended June 30, service charges on checking and savings accounts totaled \$1.9 million during 2012 compared to \$1.6 million during 2011, an increase of \$276 thousand or 17 percent. Overdraft fees were \$1.3 million during the second quarter of 2012 compared to \$1.4 million during the second quarter of 2011, a decrease of \$120 thousand or 9 percent. For the six months ended June 30, overdraft fees totaled \$2.5 million during 2012 compared to \$2.6 million during 2011, a decrease of \$90 thousand or 3 percent. Interchange revenue from activity on bank debit cards, along with surcharges on ATM activity, resulted in service charges and fees of \$1.3 million during both the second quarter of 2012 and the second quarter of 2011. These same fees were \$2.6 million during the first six months of 2012 compared to \$2.4 million during the first six months of 2011, an increase of \$141 thousand or 6 percent.

Loan servicing income increased \$1.8 million or 135 percent for the second quarter of 2012 as compared to the second quarter of 2011 and \$2.0 million or 69 percent for the first half of 2012 compared to the first half of 2011. Two components of loan servicing income, mortgage servicing rights and amortization of mortgage servicing rights, are dependent upon the level of loans Heartland originates and sells into the secondary market, which in turn is highly influenced by market interest rates for home mortgage loans and by the size of our residential mortgage origination operations. Mortgage servicing rights income was \$2.6 million during the second quarter of 2012 compared to \$616 thousand during the second quarter of 2011 and \$4.6 million during the first six months of 2012 compared to \$1.6 million during the first six months of 2011. Amortization of mortgage servicing rights was \$1.1 million during the second quarter of 2012 compared to \$808 thousand during the second quarter of 2011 and \$2.8 million during the first six months of 2012 compared to \$1.7 million during the first six months of 2011. Loan servicing income also includes the fees collected for the servicing of mortgage loans for others, which is dependent upon the aggregate outstanding balance of these loans, rather than quarterly production and sale of mortgage loans. Fees collected for the servicing of mortgage loans for others were \$1.0 million during the second quarter of 2012 compared to \$892 thousand during the second quarter of 2011. The portfolio of mortgage loans serviced for others by Heartland totaled \$1.78 billion at June 30, 2012, compared to \$1.45 billion at June 30, 2011.

The following table summarizes Heartland's residential mortgage loan activity during the most recent five quarters:

| | As Of and For the Quarter Ended | | | | |
|---|---------------------------------|-------------|-------------|-------------|-------------|
| (Dollars in thousands) | 06/30/2012 | 03/31/2012 | 12/31/2011 | 09/30/2011 | 06/30/2011 |
| Mortgage Servicing Fees | \$1,037 | \$967 | \$932 | \$908 | \$892 |
| Mortgage Servicing Rights Income | 2,614 | 1,986 | 1,380 | 743 | 616 |
| Mortgage Servicing Rights Amortization | (1,112) | (1,718) | (862) | (1,103) | (808) |
| Total Residential Mortgage Loan Servicing Income | \$2,539 | \$1,235 | \$1,450 | \$548 | \$700 |
| Valuation Adjustment on Mortgage Servicing Rights | \$(194) | \$13 | \$(19) | \$— | \$— |
| Gains On Sale of Loans | \$12,689 | \$8,502 | \$5,473 | \$3,183 | \$1,308 |
| Residential Mortgage Loans Originated | \$374,743 | \$293,724 | \$253,468 | \$143,317 | \$111,575 |
| Residential Mortgage Loans Sold | \$360,743 | \$243,836 | \$208,494 | \$97,591 | \$65,812 |
| Residential Mortgage Loan Servicing Portfolio | \$1,776,912 | \$1,626,129 | \$1,541,417 | \$1,467,127 | \$1,446,527 |

Securities gains totaled \$5.0 million during the second quarter of 2012 compared to \$4.8 million during the second quarter of 2011. For the six-month comparative period, securities gains totaled \$8.9 million during 2012 compared to

\$6.8 million during 2011. Volatility in the bond market provided opportunities to swap securities from one sector of the portfolio to another without significantly changing the duration of the portfolio. Offsetting, in part, the securities gains was an impairment loss on securities totaling \$981 thousand recorded during the first quarter of 2012. The charge related to a decline in the credit quality of these securities. Management does not anticipate further declines on these or any other securities within the portfolio due to credit quality, but will continue to monitor the portfolio for any further declines. Based on its analysis, management believes it is prudent to continue to hold these securities as their economic value exceeds their market value.

Trading securities contributed a net gain of \$49 thousand during the second quarter of 2012 compared to a net gain of \$81 thousand during the second quarter of 2011. For the six-month period ended June 30, trading securities experienced a net gain of \$46 thousand during 2012 compared to a net gain of \$297 thousand during 2011. These changes were driven by overall

market conditions.

Gains on sale of loans totaled \$12.7 million during the second quarter of 2012 compared to \$1.3 million during the second quarter of 2011. For the six-month period ended June 30, gains on sale of loans totaled \$21.2 million during 2012 compared to \$2.7 million during 2011. The volume of loans sold totaled \$360.7 million during the second quarter of 2012, more than five times the \$65.8 million sold during the second quarter of 2011. For the six months ended June 30, the volume of loans sold totaled \$604.6 million during 2012 compared to \$146.8 million during 2011. Most of the increase in volume was due to improved interest rates on home mortgages and to the expansion of Heartland's mortgage banking operations through its Heartland Mortgage and National Residential Mortgage operations. Pricing received on the sale of fixed rate residential mortgage loans into the secondary market improved through a bulk delivery method that was implemented during the second quarter of 2011, instead of an individual delivery method that had been used previously. At the same time, secondary market pricing began to be matched with origination pricing through the use of a software tool that assists in hedging the locked rate pipeline position. Heartland believes long term success in the mortgage banking business will depend on its ability to shift toward purchase originations, which will drive revenue when the refinance boom comes to an end. For the second quarter of 2012, refinancing activity represented 58 percent of the total mortgage originations.

Other noninterest income totaled \$2.7 million during the first six months of 2012 compared to \$45 thousand during the first six months of 2011. Included in other noninterest income during the first quarter of 2012 was \$2.0 million in equity earnings which resulted from the sale of two low-income housing projects within partnerships in which Dubuque Bank and Trust Company was a member.

Noninterest Expenses

The tables below show Heartland's noninterest expense for the quarters and six-month periods indicated.

| (Dollars in thousands) | Three Months Ended | | Change | % Change | |
|-----------------------------------|--------------------|-----------------|----------------|-----------|----------|
| | June 30, 2012 | June 30, 2011 | | | |
| NONINTEREST EXPENSES: | | | | | |
| Salaries and employee benefits | \$25,384 | \$17,480 | \$7,904 | 45 | % |
| Occupancy | 2,534 | 2,213 | 321 | 15 | |
| Furniture and equipment | 1,517 | 1,360 | 157 | 12 | |
| Professional fees | 3,961 | 3,053 | 908 | 30 | |
| FDIC insurance assessments | 807 | 786 | 21 | 3 | |
| Advertising | 1,304 | 1,113 | 191 | 17 | |
| Intangible assets amortization | 122 | 144 | (22) | (15) |) |
| Net loss on repossessed assets | 1,307 | 2,511 | (1,204) | (48) |) |
| Other noninterest expenses | 4,523 | 3,683 | 840 | 23 | |
| TOTAL NONINTEREST EXPENSES | \$41,459 | \$32,343 | \$9,116 | 28 | % |

| (Dollars in thousands) | Six Months Ended | | Change | % Change | |
|--------------------------------|------------------|---------------|----------|----------|---|
| | June 30, 2012 | June 30, 2011 | | | |
| NONINTEREST EXPENSES: | | | | | |
| Salaries and employee benefits | \$49,380 | \$35,666 | \$13,714 | 38 | % |
| Occupancy | 5,016 | 4,599 | 417 | 9 | |
| Furniture and equipment | 2,963 | 2,769 | 194 | 7 | |
| Professional fees | 6,721 | 6,072 | 649 | 11 | |
| FDIC insurance assessments | 1,671 | 2,131 | (460) | (22) |) |
| Advertising | 2,375 | 1,963 | 412 | 21 | |
| Intangible assets amortization | 253 | 290 | (37) | (13) |) |

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| | | | | | |
|--------------------------------|----------|----------|----------|----|---|
| Net loss on repossessed assets | 4,211 | 4,143 | 68 | 2 | |
| Other noninterest expenses | 9,009 | 7,597 | 1,412 | 19 | |
| TOTAL NONINTEREST EXPENSES | \$81,599 | \$65,230 | \$16,369 | 25 | % |

For the second quarter of 2012, noninterest expense totaled \$41.5 million, an increase of \$9.1 million or 28 percent from the same quarter of 2011. For the six-month period ended June 30, noninterest expense totaled \$81.6 million in 2012 compared to \$65.2 million in 2011, a \$16.4 million or 25 percent increase.

The largest component of noninterest expense, salaries and employee benefits, increased \$7.9 million or 45 percent during the second quarter of 2012 compared to the second quarter of 2011 and \$13.7 million or 38 percent during the first six months of 2012 compared to the first six months of 2011. A large portion of these increases resulted from the expansion of residential loan origination and the addition of personnel in the Heartland Mortgage and National Residential Mortgage unit. Full-time equivalent employees totaled 1,321 on June 30, 2012, compared to 1,078 on June 30, 2011.

Professional fees increased \$908 thousand or 30 percent during the second quarter of 2012 compared to the second quarter of 2011 and \$649 thousand or 11 percent during the first six months of 2012 compared to the same six months in 2011. These increases were primarily associated with the workout and disposition of nonperforming assets and the services provided to Heartland by third-party consultants.

FDIC insurance assessments decreased \$460 thousand or 22 percent during the first six months of 2012 compared to the first six months of 2011, primarily associated with a change in the FDIC assessment rates that became effective April 1, 2011. These new rates are based upon total assets minus tangible equity of the insured bank instead of total deposits.

Net losses on repossessed assets totaled \$1.3 million during the second quarter of 2012 compared to \$2.5 million during the second quarter of 2011. For the six-month period ended on June 30, net losses on repossessed assets totaled \$4.2 million during 2012 compared to \$4.1 million during 2011. A majority of these losses resulted from valuation adjustments due to reductions in real estate values.

Other noninterest expenses increased \$840 thousand or 23 percent during the second quarter of 2012 compared to the second quarter of 2011 and \$1.4 million or 19 percent during the first six months of 2012 compared to the first six months of 2011.

A portion of these increases was attributable to the ramp up of our mortgage origination operations. Included in noninterest expenses are provisions to a reserve for the potential buyback of residential mortgage loans which amounted to \$363 thousand during the second quarter of 2012 and \$663 thousand during the first six months of 2012. Also included in the first quarter 2012 other noninterest expenses was a \$302 thousand charge for an early payment obligation (\$238 thousand) and remaining unamortized issuance costs (\$64 thousand) due to the early redemption of \$5.0 million of trust preferred securities. The first quarter of 2011 noninterest expenses included a \$403 thousand writedown on land in Phoenix, Arizona, which had originally been purchased for branch expansion but has now been listed for sale.

Income Taxes

Heartland's effective tax rate was 33.19 percent for the first six months of 2012 compared to 29.65 percent for the first six months of 2011. Federal low-income housing tax credits included in Heartland's effective tax rate totaled \$399 thousand during the first six months of both 2012 and 2011. Heartland's effective tax rate is also affected by the level of tax-exempt interest income which, as a percentage of pre-tax income, was 15.86 percent during the first six months of 2012 compared to 24.26 percent during the first six months of 2011. The tax-equivalent adjustment for this tax-exempt interest income was \$3.4 million during the first six months of 2012 compared to \$2.7 million during the first six months of 2011.

FINANCIAL CONDITION

Total assets were \$4.43 billion at June 30, 2012, an increase of \$122.6 million since December 31, 2011, with \$114.8 million of this growth occurring in the second quarter.

Lending Activities

Total loans and leases held to maturity were \$2.63 billion at June 30, 2012, compared to \$2.48 billion at year-end 2011, an increase of \$148.3 million or 12 percent annualized, with \$97.2 million or 66 percent of this growth occurring during the second quarter. Commercial and commercial real estate loans, which totaled \$1.90 billion at June 30, 2012, increased \$94.5 million or 10 percent annualized since year-end 2011, with \$61.4 million or 65 percent of this growth occurring in the second quarter. Residential mortgage loans, which totaled \$220.1 million at June 30, 2012, increased \$25.6 million or 26 percent annualized since year-end 2011, with \$17.2 million of this growth occurring in the second quarter. Agricultural and agricultural real estate loans, which totaled \$279.3 million at June 30, 2012, increased \$16.3 million or 12 percent annualized since year-end 2011, with \$8.6 million of this growth occurring in the second quarter. Consumer loans, which totaled \$230.6 million at June 30, 2012, increased \$10.5 million or 10 percent annualized since year-end 2011, with \$8.2 million of the growth occurring

during the second quarter.

Heartland is focused on providing affordable credit to small commercial and agricultural clients, and participation in the Small Business Lending Fund ("SBLF") provides an additional incentive to employ these funds to support expansion of programs for small businesses at all of Heartland's subsidiary banks. The initial 5.00 percent dividend rate payable on the preferred stock issued to the U.S. Treasury under the SBLF is subject to reduction during the second to tenth quarter after issuance (through December 31, 2013) based upon increases in qualified small business lending ("QSBL") over a baseline amount, and may be reduced to as low as 1.00 percent if QSBL increases by ten percent or more over that period. Heartland's baseline amount was determined to be \$923.0 million, which would require growth in QSBL of \$92.3 million to have the dividend rate paid to the U.S. Treasury reduced to 1.00 percent. Any reduction in the dividend rate paid to the U.S. Treasury does not begin until QSBL has grown by more than 2.5 percent over the baseline. Through June 30, 2012, Heartland's QSBL had grown by \$86.2 million or 9.3 percent, qualifying Heartland for a 2.00 percent dividend rate on the \$81.7 million preferred stock issued to the U.S. Treasury, for the fourth quarter of 2012.

The table below presents the composition of the loan portfolio as of June 30, 2012, and December 31, 2011:

LOAN PORTFOLIO

(Dollars in thousands)

| | June 30, 2012 | | December 31, 2011 | | |
|--|---------------|---------|-------------------|---------|---|
| | Amount | Percent | Amount | Percent | |
| Loans and leases receivable held to maturity: | | | | | |
| Commercial | \$667,251 | 25.33 | % \$645,666 | 25.95 | % |
| Commercial real estate | 1,236,745 | 46.95 | 1,163,784 | 46.79 | |
| Agricultural and agricultural real estate | 279,285 | 10.60 | 262,975 | 10.57 | |
| Residential mortgage | 220,084 | 8.36 | 194,436 | 7.82 | |
| Consumer | 230,594 | 8.75 | 220,099 | 8.85 | |
| Lease financing, net | 290 | 0.01 | 450 | 0.02 | |
| Gross loans and leases receivable held to maturity | 2,634,249 | 100.00 | % 2,487,410 | 100.00 | % |
| Unearned discount | (1,382) | | (2,463) | | |
| Deferred loan fees | (3,270) | | (3,663) | | |
| Total net loans and leases receivable held to maturity | 2,629,597 | | 2,481,284 | | |
| Loans covered under loss share agreements: | | | | | |
| Commercial and commercial real estate | \$4,497 | 47.00 | % \$6,380 | 47.80 | % |
| Agricultural and agricultural real estate | 858 | 8.97 | 1,659 | 12.43 | |
| Residential mortgage | 3,309 | 34.59 | 4,158 | 31.15 | |
| Consumer | 903 | 9.44 | 1,150 | 8.62 | |
| Total loans covered under loss share agreements | 9,567 | 100.00 | % 13,347 | 100.00 | % |
| Allowance for loan and lease losses | (41,439) | | (36,808) | | |
| Loans and leases receivable, net | \$2,597,725 | | \$2,457,823 | | |

Loans and leases secured by real estate, either fully or partially, totaled \$1.83 billion or 72 percent of total loans and leases at June 30, 2012. Of the non-farm, nonresidential loans, 59 percent are owner occupied. The largest categories within Heartland's real estate secured loans at June 30, 2012, and December 31, 2011, are listed below:

LOANS SECURED BY REAL ESTATE

(Dollars in thousands)

| | June 30, 2012 | December 31, 2011 |
|---|---------------|-------------------|
| Residential real estate, excluding residential construction and residential lot loans | \$481,423 | \$426,736 |
| Industrial, manufacturing, business and commercial | 199,487 | 199,487 |
| Agriculture | 187,862 | 200,204 |
| Retail | 172,489 | 161,795 |
| Office | 145,650 | 136,826 |
| Land development and lots | 115,079 | 129,783 |
| Hotel, resort and hospitality | 109,057 | 111,550 |
| Food and beverage | 75,700 | 73,196 |
| Multi-family | 81,902 | 66,063 |
| Warehousing | 67,145 | 62,973 |
| Residential construction | 38,151 | 37,685 |
| Health services | 34,558 | 23,803 |
| All other | 119,633 | 111,999 |
| Total loans secured by real estate | \$1,828,136 | \$1,742,100 |

The process utilized by Heartland to determine the adequacy of the allowance for loan and lease losses is considered a critical accounting practice for Heartland. The allowance for loan and lease losses represents management's estimate of identified and unidentified probable losses in the existing loan portfolio. For additional details on the specific factors considered, refer to the critical accounting policies section of our Annual Report on Form 10-K for the year ended December 31, 2011.

The allowance for loan and lease losses at June 30, 2012, was 1.58 percent of loans and leases and 92.40 percent of nonperforming loans compared to 1.48 percent of loans and leases and 64.09 percent of nonperforming loans at December 31, 2011, and 1.73 percent of loans and leases and 59.61 percent of nonperforming loans at June 30, 2011.

Nonperforming loans, exclusive of those covered under loss sharing agreements, were \$44.8 million or 1.71 percent of total loans and leases at June 30, 2012, compared to \$57.4 million or 2.31 percent of total loans and leases at December 31, 2011, and \$68.1 million or 2.90 percent of total loans and leases at June 30, 2011. Approximately 42 percent, or \$18.7 million, of Heartland's nonperforming loans have individual loan balances exceeding \$1.0 million. These nonperforming loans, to an aggregate of 9 borrowers, are primarily concentrated in Heartland's banks serving the Western states, with \$6.8 million originated by Arizona Bank & Trust, \$3.4 million originated by Rocky Mountain Bank, \$4.2 million originated by Wisconsin Bank & Trust (formerly known as Wisconsin Community Bank), \$2.5 million originated by New Mexico Bank & Trust and \$1.8 million originated by Galena State Bank and Trust Company. The portion of Heartland's nonperforming loans covered by government guarantees was \$2.0 million at June 30, 2012. As identified using the North American Industry Classification System (NAICS), \$8.4 million of nonperforming loans with individual balances exceeding \$1.0 million was for lot and land development and the remaining \$10.3 million was distributed among seven other industry categories.

Other real estate owned was \$37.9 million at June 30, 2012, compared to \$38.9 million at March 31, 2012, and \$44.4 million at December 31, 2011. Liquidation strategies have been identified for all the assets held in other real estate owned. Management continues to market these properties through an orderly liquidation process instead of a quick liquidation process in order to avoid discounts greater than the projected carrying costs. During 2012, \$5.9 million of

other real estate owned was sold during the second quarter and \$18.3 million during the first six months.

Net charge-offs on loans during the second quarter of 2012 were \$923 thousand compared to \$6.5 million during the second quarter of 2011.

Delinquencies in each of the loan portfolios continue to be well-managed and no significant adverse trends were identified during the second quarter of 2012. Loans delinquent 30 to 89 days were 0.46 percent of total loans at June 30, 2012, compared to 0.55 percent at March 31, 2012, 0.23 percent at December 31, 2011, 0.54 percent at September 30, 2011, and 0.60 percent at

June 30, 2011.

It is too early to estimate the impact this year's drought will have on Heartland's agricultural loan portfolio, which totaled \$279.3 million at June 30, 2012. While well diversified within this portfolio, a drought-damaged crop will impact most agricultural segments. Grain operations will see reduced income from lower yields, livestock producers will see increased costs for feed, and dairy operations will not only see increased costs for feed but also may suffer reduced income due to the heat stress on their dairy herds. Most of our grain producers carry crop insurance that will protect them from a catastrophic loss, but will not be sufficient to protect their expected profit. Most of our larger livestock operations also forward contract feed costs to protect from rising costs. Recent rains in the Midwest have been beneficial, but not sufficient to ward off the damage that has already occurred.

The table below presents the changes in the allowance for loan and lease losses during the periods indicated:

ANALYSIS OF ALLOWANCE FOR LOAN AND LEASE LOSSES

(Dollars in thousands)

| | Six Months Ended June 30, | |
|--|---------------------------|----------|
| | 2012 | 2011 |
| Balance at beginning of period | \$36,808 | \$42,693 |
| Provision for loan and lease losses | 5,354 | 13,854 |
| Recoveries on loans and leases previously charged off | 3,139 | 2,261 |
| Charge-offs on loans and leases not covered by loss share agreements | (3,827) | (17,861) |
| Charge-offs on loans and leases covered by loss share agreements | (35) | (345) |
| Balance at end of period | \$41,439 | \$40,602 |
| Annualized ratio of net charge offs to average loans and leases | 0.11 | % 2.69 |

The table below presents the amounts of nonperforming loans and leases and other nonperforming assets on the dates indicated:

NONPERFORMING ASSETS

(Dollars in thousands)

| | June 30, 2012 | 2011 | December 31, 2011 | 2010 | |
|--|------------------|-----------|----------------------|-----------|---|
| Not covered under loss share agreements: | | | | | |
| Nonaccrual loans and leases | \$44,845 | \$68,110 | \$57,435 | \$90,512 | |
| Loan and leases contractually past due 90 days or more | — | — | — | 85 | |
| Total nonperforming loans and leases | 44,845 | 68,110 | 57,435 | 90,597 | |
| Other real estate | 37,709 | 38,642 | 43,506 | 31,731 | |
| Other repossessed assets | 465 | 188 | 648 | 302 | |
| Total nonperforming assets not covered under loss share agreements | \$83,019 | \$106,940 | \$101,589 | \$122,630 | |
| Covered under loss share agreements: | | | | | |
| Nonaccrual loans and leases | \$2,862 | \$4,480 | \$3,345 | \$4,901 | |
| Loan and leases contractually past due 90 days or more | — | — | — | — | |
| Total nonperforming loans and leases | 2,862 | 4,480 | 3,345 | 4,901 | |
| Other real estate | 232 | 433 | 881 | 271 | |
| Other repossessed assets | — | — | — | — | |
| Total nonperforming assets covered under loss share agreements | \$3,094 | \$4,913 | \$4,226 | 5,172 | |
| Performing troubled debt restructured loans (1) | \$24,715 | \$31,246 | \$25,704 | \$23,719 | |
| Nonperforming loans and leases not covered under loss share agreements to total loans and leases | 1.71 | % 2.90 | % 2.31 | % 3.86 | % |
| Nonperforming assets not covered under loss share agreements to total loans and leases plus repossessed property | 3.11 | % 4.47 | % 4.02 | % 5.16 | % |
| Nonperforming assets not covered under loss share agreements to total assets | 1.87 | % 2.67 | % 2.36 | % 3.07 | % |

(1) Represents accruing troubled debt restructured loans performing according to their restructured terms.

The schedules below summarize the changes in Heartland's nonperforming assets, including those covered by loss share agreements, during the second quarter of 2012 and the first six months of 2012:

| (Dollars in thousands) | Nonperforming Loans | Other Real Estate Owned | Other Repossessed Assets | Total Nonperforming Assets |
|---|------------------------|----------------------------|--------------------------------|----------------------------------|
| March 31, 2012 | \$53,129 | \$38,934 | \$710 | \$92,773 |
| Loan foreclosures | (5,853) |) 5,840 | 13 | — |
| Net loan recoveries | (923) |) — | — | (923) |
| New nonperforming loans | 5,600 |) — | — | 5,600 |
| Reduction of nonperforming loans ⁽¹⁾ | (4,246) |) — | — | (4,246) |
| OREO/Repossessed sales proceeds | — |) (6,175) | (279) | (6,454) |
| OREO/Repossessed assets writedowns, net | — |) (658) | (104) | (762) |
| Net activity at Citizens Finance Co. | — | — | 125 | 125 |

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| | | | | |
|---------------|----------|----------|-------|----------|
| June 30, 2012 | \$47,707 | \$37,941 | \$465 | \$86,113 |
|---------------|----------|----------|-------|----------|

(1) Includes principal reductions and transfers to performing status.

| (Dollars in thousands) | Nonperforming Loans | Other Real Estate Owned | Other Reposessed Assets | Total Nonperforming Assets |
|---|------------------------|----------------------------|-------------------------------|----------------------------------|
| December 31, 2011 | \$60,780 | \$44,387 | \$648 | \$105,815 |
| Loan foreclosures | (14,639) |) 14,562 | 77 | — |
| Net loan recoveries | (723) |) — | — | (723) |
| New nonperforming loans | 8,955 | — | — | 8,955 |
| Reduction of nonperforming loans ⁽¹⁾ | (6,666) |) — | — | (6,666) |
| OREO/Reposessed sales proceeds | — | (18,241) |) (344) | (18,585) |
| OREO/Reposessed assets writedowns, net | — | (2,767) |) (112) | (2,879) |
| Net activity at Citizens Finance Co. | — | — | 196 | 196 |
| June 30, 2012 | \$47,707 | \$37,941 | \$465 | \$86,113 |

(1) Includes principal reductions and transfers to performing status.

Securities

The composition of Heartland's securities portfolio is managed to maximize the return on the portfolio while considering the impact it has on Heartland's asset/liability position and liquidity needs. Securities represented 30 percent of total assets at June 30, 2012, compared to 31 percent at December 31, 2011. Total available for sale securities as of June 30, 2012, were \$1.27 billion, an increase of \$6.6 million or less than 1 percent since December 31, 2011.

The composition of the securities portfolio changed slightly as a larger portion of the securities sales were in the lower-yielding U.S. government corporations and agency securities. The percentage of mortgage-backed securities to total securities was 62 percent at June 30, 2012, compared to 63 percent at year-end 2011. Approximately 84 percent of Heartland's mortgage-backed securities were issuances of government-sponsored enterprises at June 30, 2012. Heartland's securities portfolio had an expected duration of 3.88 years as of June 30, 2012.

The table below presents the composition of the securities portfolio, including trading, available for sale and held to maturity, by major category, as of June 30, 2012, and December 31, 2011:

SECURITIES PORTFOLIO COMPOSITION

(Dollars in thousands)

| | June 30, 2012 | | December 31, 2011 | | |
|---|---------------|---------|-------------------|---------|---|
| | Amount | Percent | Amount | Percent | % |
| U.S. government corporations and agencies | \$48,657 | 3.66 | % \$107,147 | 8.08 | % |
| Mortgage-backed securities | 824,792 | 61.96 | 834,185 | 62.88 | |
| Obligation of states and political subdivisions | 411,400 | 30.91 | 335,799 | 25.31 | |
| Other securities | 46,239 | 3.47 | 49,461 | 3.73 | |
| Total securities | \$1,331,088 | 100.00 | % \$1,326,592 | 100.00 | % |

Deposits And Borrowed Funds

Total deposits were \$3.33 billion at June 30, 2012, compared to \$3.21 billion at year-end 2011, an increase of \$124.8 million or 8 percent annualized, with \$59.1 million or 47 percent of the growth occurring during the second quarter. The composition of Heartland's deposits continues to improve as no cost demand deposits as a percentage of total deposits were 24 percent at June 30, 2012, compared to 23 percent at year-end 2011. Demand deposits increased \$62.2 million or 17 percent annualized since year-end 2011, with \$28.1 million or 45 percent of this growth occurring

during the second quarter. Savings deposits increased \$56.0 million or 7 percent annualized since December 31, 2011, with \$2.8 million or 5 percent of this growth occurring during the second quarter. Certificates of deposit, exclusive of brokered deposits, decreased \$3.8 million or 1 percent annualized since year-end 2011, although, during the second quarter of 2012, certificates of deposit increased \$18.2 million, due primarily to additional deposits from a few public entities in the Dubuque, Iowa market. As a percentage of total deposits, certificates of deposit remained below 25 percent at June 30, 2012.

Short-term borrowings generally include federal funds purchased, securities sold under agreements to repurchase, short-term

FHLB advances and discount window borrowings from the Federal Reserve Bank. These funding alternatives are utilized in varying degrees depending on their pricing and availability. As of June 30, 2012, the amount of short-term borrowings was \$249.5 million compared to \$270.1 million at year-end 2011, a decrease of \$20.6 million or 8 percent, primarily due to activity in retail repurchase agreements. All of the bank subsidiaries provide retail repurchase agreements to their customers as a cash management tool, sweeping excess funds from demand deposit accounts into these agreements. This source of funding does not increase the bank's reserve requirements. Although the aggregate balance of these retail repurchase agreements is subject to variation, the account relationships represented by these balances are principally local. The balances of retail repurchase agreements were \$209.6 million at June 30, 2012, compared to \$253.5 million at December 31, 2011, a decrease of \$43.9 million or 17 percent.

Also included in short-term borrowings are the revolving credit lines Heartland has with two unaffiliated banks, primarily to provide working capital to Heartland. These credit lines may also be used to fund the operations of Heartland Community Development Inc., a wholly-owned subsidiary of Heartland formed to hold and manage certain nonperforming loans and assets and to allow the liquidation of those assets at a time that is more economically advantageous. Under these unsecured revolving credit lines, Heartland may borrow up to \$10.0 million at any one time. There was no balance outstanding on these revolving credit lines at both June 30, 2012, and December 31, 2011.

As of June 30, 2012, the amount of other borrowings was \$377.5 million, an increase of \$4.7 million or 1 percent since year-end 2011. Other borrowings include all debt arrangements Heartland and its subsidiaries have entered into with original maturities that extend beyond one year. Heartland continues to have a \$15.0 million amortizing term loan with an unaffiliated bank. In January 2012, Heartland issued an additional \$10.0 million of senior notes to two of the accredited investors that had purchased senior notes in 2011. Additionally, maturities on a portion of the existing senior notes were extended such that \$17.5 million remained at the original maturity date of December 1, 2015, \$7.0 million will mature on each of February 1, 2017, and February 1, 2018, and \$6.0 million will mature on February 1, 2019. The senior notes are unsecured and bear interest at 5.00 percent per annum payable quarterly. A portion of the additional senior notes was used to redeem \$5.0 million of trust preferred securities.

Other borrowings also include structured wholesale repurchase agreements, which totaled \$85.0 million at both June 30, 2012, and December 31, 2011. The balances outstanding on trust preferred capital securities issued by Heartland are also included in other borrowings. On March 7, 2012, Heartland exercised its call option on \$5.0 million of its trust preferred capital securities that were at a fixed rate of 10.60 percent. The prepayment obligation of \$238 thousand and the remaining unamortized issuance costs of \$64 thousand were expensed upon redemption. A schedule of Heartland's trust preferred offerings outstanding as of June 30, 2012, is as follows:

(Dollars in thousands)

| Amount Issued | Issuance Date | Interest Rate | Interest Rate as of June 30, 2012 ⁽¹⁾ | Maturity Date | Callable Date |
|---------------|---------------|------------------|--|---------------|---------------|
| 20,000 | 10/10/2003 | 8.25% | 8.25% | 10/10/2033 | 9/30/2012 |
| 25,000 | 3/17/2004 | 2.75% over Libor | 3.22% ⁽²⁾ | 3/17/2034 | 9/17/2012 |
| 20,000 | 1/31/2006 | 1.33% over Libor | 1.80% ⁽³⁾ | 4/7/2036 | 7/7/2012 |
| 20,000 | 6/21/2007 | 6.75% | 6.75% | 9/15/2037 | 9/15/2012 |
| 20,000 | 6/26/2007 | 1.48% over Libor | 1.95% ⁽⁴⁾ | 9/1/2037 | 9/1/2012 |
| \$105,000 | | | | | |

(1) Effective weighted average interest rate as of June 30, 2012, was 5.91% due to interest rate swap transactions on the variable rate securities as discussed in Note 7 to Heartland's consolidated financial statements.

(2) Effective interest rate as of June 30, 2012, was 5.33% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements.

(3) Effective interest rate as of June 30, 2012, was 4.69% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements.

(4) Effective interest rate as of June 30, 2012, was 4.70% due to an interest rate swap transaction as discussed in Note 7 to Heartland's consolidated financial statements.

Also in other borrowings are the borrowings by the bank subsidiaries from the Federal Home Loan Bank ("FHLB") of which they are a member. All of Heartland's bank subsidiaries own FHLB stock in either the Chicago, Dallas, Des Moines, Seattle, San Francisco or Topeka FHLB, enabling them to borrow funds from their respective FHLB for short- or long-term purposes

under a variety of programs. FHLB borrowings totaled \$142.1 million at June 30, 2012, and \$132.3 million at December 31, 2011. Total FHLB borrowings at June 30, 2012, had an average rate of 3.02 percent and an average maturity of 2.63 years. When considering the earliest possible call date on these advances, the average maturity is shortened to 2.49 years.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Heartland banks evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Heartland banks upon extension of credit, is based upon management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties. Standby letters of credit and financial guarantees written are conditional commitments issued by the Heartland banks to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. At June 30, 2012, and December 31, 2011, commitments to extend credit aggregated \$810.5 million and \$765.8 million, and standby letters of credit aggregated \$38.2 million and \$49.1 million, respectively.

Contractual obligations and other commitments were presented in Heartland's Annual Report on Form 10-K for the year ended December 31, 2011. Except for the funding obligations under the merger agreement referenced below, there have been no material changes in Heartland's contractual obligations and other commitments since that report was filed.

On August 2, 2012, Heartland announced that it had entered into a definitive merger agreement with First Shares, Inc. ("FSI"), the parent company of First National Bank of Platteville in Platteville, Wisconsin. Under the terms of the agreement, the outstanding shares of FSI will be converted into a combination of cash and shares of Heartland common stock, with the aggregate purchase price, estimated at \$11.0 million, to be based upon the financial position of FSI prior to closing. The stock consideration is expected to be approximately 60 percent of the purchase price. Simultaneous with the closing of the transaction, First National Bank will be merged into Heartland's Wisconsin Bank & Trust subsidiary. Heartland expects to close on this transaction during the fourth quarter of 2012.

CAPITAL RESOURCES

Bank regulatory agencies have adopted capital standards by which all bank holding companies will be evaluated. Under the risk-based method of measurement, the resulting ratio is dependent upon not only the level of capital and assets, but also the composition of assets and capital and the amount of off-balance sheet commitments. Heartland and its bank subsidiaries have been, and will continue to be, managed so they meet the well-capitalized requirements under the regulatory framework for prompt corrective action. To be categorized as well capitalized under the regulatory framework, bank holding companies and banks must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios of 10 percent, 6 percent and 4 percent, respectively. The most recent notification from the FDIC categorized Heartland and each of its bank subsidiaries as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed each institution's category.

Heartland's capital ratios were as follows for the dates indicated:

CAPITAL RATIOS

(Dollars in thousands)

| | June 30, 2012 | | December 31, 2011 | | |
|---|---------------|-------|-------------------|-------|---|
| | Amount | Ratio | Amount | Ratio | |
| Risk-Based Capital Ratios ⁽¹⁾ | | | | | |
| Tier 1 capital | \$444,754 | 13.95 | % \$427,145 | 14.08 | % |
| Tier 1 capital minimum requirement | 127,516 | 4.00 | % 121,357 | 4.00 | % |
| Excess | \$317,238 | 9.95 | % \$305,788 | 10.08 | % |
| Total capital | \$514,880 | 16.15 | % \$481,513 | 15.87 | % |
| Total capital minimum requirement | 255,032 | 8.00 | % 242,715 | 8.00 | % |
| Excess | \$259,848 | 8.15 | % \$238,798 | 7.87 | % |
| Total risk-adjusted assets | \$3,187,904 | | \$3,033,935 | | |
| Leverage Capital Ratios ⁽²⁾ | | | | | |
| Tier 1 capital | \$444,754 | 10.28 | % \$427,145 | 10.24 | % |
| Tier 1 capital minimum requirement ⁽³⁾ | 172,981 | 4.00 | % 166,865 | 4.00 | % |
| Excess | \$271,773 | 6.28 | % \$260,280 | 6.24 | % |
| Average adjusted assets (less goodwill and other intangible assets) | \$4,324,526 | | \$4,171,625 | | |

Based on the risk-based capital guidelines of the Federal Reserve, a bank holding company is required to

(1) maintain a Tier 1 capital to risk-adjusted assets ratio of 4.00% and total capital to risk-adjusted assets ratio of 8.00%.

(2) The leverage ratio is defined as the ratio of Tier 1 capital to average adjusted assets.

Management of Heartland has established a minimum target leverage ratio of 4.00%. Based on Federal Reserve

(3) guidelines, a bank holding company generally is required to maintain a leverage ratio of 3.00% plus additional capital of at least 100 basis points.

LIQUIDITY

Liquidity refers to Heartland's ability to maintain a cash flow that is adequate to meet maturing obligations and existing commitments, to withstand fluctuations in deposit levels, to fund operations and to provide for customers' credit needs. The liquidity of Heartland principally depends on cash flows from operating activities, investment in and maturity of assets, changes in balances of deposits and borrowings and its ability to borrow funds in the money or capital markets.

Operating activities provided cash of \$18.3 million during the first six months of 2012 compared to \$37.1 million during the first six months of 2011. The biggest contributor to this change was activity in loans originated for sale which used cash of \$19.8 million during the first six months of 2012 compared to \$8.1 million during the first six months of 2011.

Investing activities used cash of \$168.4 million during the first six months of 2012 compared to providing cash of \$57.5 million during the first six months of 2011. A net increase in loans and leases used cash of \$159.9 million during the first six months of 2012 compared to \$22.8 million during the first six months of 2011. Additionally, purchases of securities used cash of \$517.8 million during the first six months of 2012 compared to \$408.3 million during the first six months of 2011 while the proceeds from securities sales, paydowns and maturities was \$503.0 million during the first six months of 2012 compared to \$487.0 million during the first six months of 2011.

Financing activities provided cash of \$103.1 million during the first six months of 2012 compared to using cash of \$8.8 million during the first six months of 2011. A net increase in deposit accounts provided cash of \$124.8 million during the first six months of 2012 compared to \$46.6 million during the same six months of 2011. Activity in short-term borrowings used cash of \$20.6 million during the first six months of 2012 compared to \$67.8 million during the first six months of 2011. Cash proceeds from other borrowings were \$10.7 million during the first six months of 2012 compared to \$18.1 million during the first six months of 2011. Repayment of other borrowings used cash of \$6.0 million during the first six months of 2012 compared to \$1 million during the first six months of 2011.

Management of investing and financing activities, and market conditions, determine the level and the stability of net interest cash flows. Management attempts to mitigate the impact of changes in market interest rates to the extent possible, so that

balance sheet growth is the principal determinant of growth in net interest cash flows.

In the event of short-term liquidity needs, the bank subsidiaries may purchase federal funds from each other or from correspondent banks and may also borrow from the Federal Reserve Bank. Additionally, the subsidiary banks' FHLB memberships give them the ability to borrow funds for short- and long-term purposes under a variety of programs.

At June 30, 2012, Heartland's revolving credit agreements with two unaffiliated banks provided a maximum borrowing capacity of \$10.0 million, of which nothing had been borrowed. These credit agreements contain specific covenants, with which Heartland was in compliance on June 30, 2012.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in market prices and rates. Heartland's market risk is comprised primarily of interest rate risk resulting from its core banking activities of lending and deposit gathering. Interest rate risk measures the impact on earnings from changes in interest rates and the effect on current fair market values of Heartland's assets, liabilities and off-balance sheet contracts. The objective is to measure this risk and manage the balance sheet to avoid unacceptable potential for economic loss.

Management continually develops and applies strategies to mitigate market risk. Exposure to market risk is reviewed on a regular basis by the asset/liability committees of the banks and, on a consolidated basis, by Heartland's executive management and board of directors. Darling Consulting Group, Inc. has been engaged to provide asset/liability management position assessment and strategy formulation services to Heartland and its bank subsidiaries. At least quarterly, a detailed review of the balance sheet risk profile is performed for Heartland and each of its bank subsidiaries. Included in these reviews are interest rate sensitivity analyses, which simulate changes in net interest income in response to various interest rate scenarios. These analyses consider current portfolio rates, existing maturities, repricing opportunities and market interest rates, in addition to prepayments and growth under different interest rate assumptions. Selected strategies are modeled prior to implementation to determine their effect on Heartland's interest rate risk profile and net interest income. Management does not believe that Heartland's primary market risk exposures have changed significantly in the first six months of 2012.

The core interest rate risk analysis utilized by Heartland examines the balance sheet under increasing and decreasing interest scenarios that are neither too modest nor too extreme. All rate changes are ramped over a 12-month horizon based upon a parallel shift in the yield curve and then maintained at those levels over the remainder of the simulation horizon. Using this approach, management is able to see the effect that both a gradual change of rates (year 1) and a rate shock (year 2 and beyond) could have on Heartland's net interest income. Starting balances in the model reflect actual balances on the "as of" date, adjusted for material and significant transactions. Pro-forma balances remain static. This enables interest rate risk embedded within the existing balance sheet structure to be isolated from the interest rate risk often caused by growth in assets and liabilities. Due to the low interest rate environment, the simulations under a decreasing interest rate scenario were prepared using a 100 basis point shift in rates. The most recent reviews at June 30, 2012, and June 30, 2011, provided the following results:

| | 2012 | | 2011 | | | |
|-----------------------|--|--------------------------|------|--|--------------------------|----|
| | Net Interest Margin (in thousands) | % Change From Base | | Net Interest Margin (in thousands) | % Change From Base | |
| Year 1 | | | | | | |
| Down 100 Basis Points | \$ 145,282 | (0.27 |)% | \$ 140,692 | 0.46 |)% |
| Base | \$ 145,669 | | | \$ 140,046 | | |
| Up 200 Basis Points | \$ 143,769 | (1.30 |)% | \$ 136,281 | (2.69 |)% |
| Year 2 | | | | | | |
| Down 100 Basis Points | \$ 141,730 | (2.70 |)% | \$ 132,057 | (5.70 |)% |
| Base | \$ 145,504 | (0.11 |)% | \$ 135,590 | (3.18 |)% |
| Up 200 Basis Points | \$ 149,863 | 2.88 | % | \$ 137,230 | (2.01 |)% |

Heartland uses derivative financial instruments to manage the impact of changes in interest rates on its future interest income or interest expense. Heartland is exposed to credit-related losses in the event of nonperformance by the counterparties to these derivative instruments, but believes it has minimized the risk of these losses by entering into the contracts with large, stable financial institutions. The estimated fair market values of these derivative instruments are presented in Note 7 to the consolidated financial statements.

Heartland enters into financial instruments with off balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates and may require collateral from the borrower. Standby letters of credit are conditional commitments issued by Heartland to guarantee the performance of a customer to a third party up to a stated amount and with specified terms and conditions. These commitments to extend credit and standby letters of credit are not recorded on the balance sheet until the instrument is exercised.

Heartland holds a securities trading portfolio that would also be subject to elements of market risk. These securities are carried on the balance sheet at fair value. These securities had a carrying value of \$379 thousand at June 30, 2012, and \$333 thousand at December 31, 2011, and in both cases were less than 1 percent of total assets.

ITEM 4. CONTROLS AND PROCEDURES

Under the direction of our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of June 30, 2012. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure.

There were no significant changes to Heartland's disclosure controls or internal controls over financial reporting during the first six months of 2012 that have materially affected or are reasonably likely to materially affect Heartland's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which Heartland or its subsidiaries are a party other than ordinary routine litigation incidental to their respective businesses. 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 1A. RISK FACTORS

Except as set forth below, there have been no material changes in the risk factors applicable to Heartland from those disclosed in Part I, Item 1A. "Risk Factors" in Heartland's 2011 Annual Report on Form 10-K. Please refer to that section of Heartland's Form 10-K for disclosures regarding the risks and uncertainties related to Heartland's business.

Our ability to obtain reimbursement from the FDIC under loss share agreements depends on our compliance with the terms of those loss share agreements.

Under loss share agreements we have with the FDIC relating to assets of The Elizabeth State Bank that we purchased, we are obligated to certify to the FDIC on a quarterly basis our compliance with the terms of the loss share agreements as a prerequisite to obtaining reimbursement from the FDIC for realized losses on the covered assets. These agreements have specific, detailed and cumbersome compliance, servicing, notification and reporting requirements. Our failure to comply with the terms of the agreements or to properly service the loans and other real estate owned under the requirements of the agreements may cause a specific asset or group of assets to lose eligibility for loss share payments from the FDIC.

Additionally, management may decide to forgo loss share coverage on certain assets to allow greater flexibility over the management of those assets. As of June 30, 2012, Heartland had \$9.6 million of loans and \$232 thousand of other real estate owned, or a total of \$9.8 million (0.2 percent of total assets), covered by loss share agreements with the FDIC.

Our participation in the SBLF does subject us to certain reporting obligations and imposes restrictions on the payment of dividends on our common stock and the repurchase of shares of our common stock.

Under the SBLF, we have quarterly reporting obligations to the U. S. Treasury that will be used to determine the dividend rate to be paid on the Series C Preferred Stock issued to the U.S. Treasury. If we fail to grow our small business lending by December 31, 2013, the interest rate on the \$81.7 million of SBLF funds we received will increase to 9.00 percent, which includes a special lending incentive fee of 2.00 percent due to our previous participation in the CPP, and if we do not repay the SBLF funds by March 16, 2016, will increase to 9.00 percent.

The terms of the securities purchase agreement between us and the Treasury in connection with the SBLF transaction also prohibit us from paying dividends on our common stock, or repurchasing shares, to the extent that, after payment of such dividends or repurchases, our Tier 1 Capital would generally fall below 90 percent of our \$281.2 million of Tier 1 Capital on September 15, 2011, our SBLF closing date. Additionally, if we fail to pay an SBLF dividend in a given quarter, we may not pay dividends on or repurchase any common stock for the next three quarters, except in very limited circumstances. If any of the Series C Preferred Stock issued to the U.S. Treasury has not been redeemed by September 15, 2021, the tenth anniversary of issuance, we may not pay any further dividends on our common stock until the Series C Preferred Stock is redeemed in full.

ITEM 2. UNREGISTERED SALES OF ISSUER SECURITIES AND USE OF PROCEEDS

The following table provides information about purchases by Heartland and its affiliated purchasers during the quarter ended June 30, 2012, of its common stock:

| 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 | (d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs ⁽¹⁾ |
|-------------------|--|--|--|---|
| 04/01/12-04/30/12 | 0 | \$— | 0 | \$6,942,555 |
| 05/01/12-05/31/12 | 31,254 | \$19.34 | 31,254 | \$6,565,925 |
| 06/01/12-06/30/12 | 0 | — | 0 | \$8,549,232 |
| Total: | 31,254 | \$19.34 | 31,254 | N/A |

Effective January 24, 2008, Heartland's board of directors authorized management to acquire and hold up to 500,000 shares of common stock as treasury shares at any one time. During participation in the Treasury's Capital (1)Purchase Program, which was terminated on September 15, 2011, Heartland was prohibited from any repurchase, redemption, or acquisition of its common stock, except for certain repurchases to the extent of increases in shares outstanding because of issuances under existing benefit plans.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

In April 2012, Rocky Mountain Bank was released from the informal agreements it had entered into with the FDIC in the fall of 2009.

On July 13, 2012, Heartland completed the purchase of three retail banking offices from Liberty Bank, FSB in its Dubuque, Iowa market. The purchase was completed through Heartland's Dubuque Bank and Trust Company subsidiary. It included deposits of approximately \$54 million and loans of \$10 million.

On August 2, 2012, Heartland announced that it had entered into a definitive merger agreement with First Shares, Inc. ("FSI"), the parent company of First National Bank of Platteville in Platteville, Wisconsin. Under the terms of the agreement, the outstanding shares of FSI will be converted into a combination of cash and shares of Heartland common stock, with the aggregate purchase price, estimated at \$11.0 million, to be based upon the financial position of FSI prior to closing. The stock consideration is expected to be approximately 60 percent of the purchase price. Simultaneous with the closing of the transaction, First National Bank will be merged into Heartland's Wisconsin Bank & Trust subsidiary. The First National Bank of Platteville had total assets of approximately \$130 million and deposits of approximately \$114 million at June 30, 2012. Heartland expects to close on this transaction during the fourth quarter of 2012. In connection with the transaction, Heartland will file a registration statement with the SEC that will

include a proxy statement/prospectus to be used by FSI at the special meeting it will call to approve the merger.

ITEM 6. EXHIBITS

Exhibits

- 4.1 Amended and Restated Rights Agreement, dated January 17, 2012, between Heartland Financial USA, Inc. and Dubuque Bank and Trust Company, as Rights Agent (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement of Form 8-A filed on May 17, 2012).
- 10.1⁽¹⁾ Form of Agreement for Heartland Financial USA, Inc. 2005 Long-Term Incentive Plan Restricted Stock Unit Agreement for awards granted in January 2012 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on May 10, 2012).
- 10.2⁽¹⁾ Form of Agreement for Heartland Financial USA, Inc. 2005 Long-Term Incentive Plan Performance-Based Restricted Stock Unit Agreement for awards granted in January 2012 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed on May 10, 2012).
- 10.3⁽¹⁾ Heartland Financial USA, Inc. 2012 Long-Term Incentive Plan (incorporated by reference to Exhibit 4.4 to the Registrant's Registration Statement on Form S-8 filed on May 17, 2012).
- 10.4⁽¹⁾ Form of Agreement for Heartland Financial USA, Inc. 2012 Long-Term Incentive Plan Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 4.5 to the Registrant's Registration Statement on Form S-8 filed on May 17, 2012).
- 10.5⁽¹⁾ Form of Director Restricted Stock Unit Award Agreement under the Heartland Financial USA, Inc. 2012 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on May 21, 2012).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Financial statement formatted in Extensible Business Reporting Language: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Cash Flows, (v) the Consolidated Statements of Changes in Equity, and (vi) the Notes to Consolidated Financial Statements.

(1) Management contracts or compensatory plans or arrangements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned there unto duly authorized.

HEARTLAND FINANCIAL USA, INC.
(Registrant)

Principal Executive Officer

/s/ Lynn B. Fuller
By: Lynn B. Fuller
President and Chief Executive Officer

Principal Financial and Accounting Officer

/s/ John K. Schmidt
John K. Schmidt
Executive Vice President and Chief Financial
Officer

Dated: August 9, 2012