

HEARTLAND FINANCIAL USA INC
Form 10-Q
November 09, 2007

**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 September 30, 2007

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

For transition period _____ to _____

Commission File Number: 0-24724

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

Delaware
(State or other jurisdiction of incorporation or organization)

42-1405748
(I.R.S. employer identification number)

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

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

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer
filer

Accelerated
Non-accelerated filer

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** **No**

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Indicate the number of shares outstanding of each of the classes of Registrant's common stock as of the latest practicable date: As of November 8, 2007, the Registrant had outstanding 16,447,779 shares of common stock, \$1.00 par value per share.

HEARTLAND FINANCIAL USA, INC.
Form 10-Q Quarterly Report

Part I

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

	September 30, 2007		December 31, 2006
	(Unaudited)		
ASSETS			
Cash and due from banks	\$ 31,178	\$	47,753
Federal funds sold and other short-term investments	413		1,390
Cash and cash equivalents	31,591		49,143
Securities:			
Trading, at fair value	2,039		1,568
Available for sale, at fair value (cost of \$640,265 at September 30, 2007, and \$612,440 for December 31, 2006)	643,655		613,950
Held to maturity, at cost (fair value of \$2,679 at September 30, 2007, and \$1,513 at December 31, 2006)	2,643		1,522
Loans held for sale	16,267		50,381
Gross loans and leases:			
Held to maturity	2,274,119		2,147,845
Allowance for loan and lease losses	(31,438)		(29,981)
Loans and leases, net	2,242,681		2,117,864
Premises, furniture and equipment, net	119,461		108,567
Other real estate, net	2,129		1,575
Goodwill	40,207		39,817
Other intangible assets, net	8,378		9,010
Cash surrender value on life insurance	54,936		33,371
Other assets	38,468		31,474
TOTAL ASSETS	\$ 3,202,455	\$	3,058,242
LIABILITIES AND STOCKHOLDERS' EQUITY			
LIABILITIES:			
Deposits:			
Demand	\$ 367,617	\$	371,465
Savings	850,845		822,915
Time	1,202,814		1,117,277
Total deposits	2,421,276		2,311,657
Short-term borrowings	256,822		275,694
Other borrowings	268,716		224,523
Accrued expenses and other liabilities	33,366		36,657
TOTAL LIABILITIES	2,980,180		2,848,531
STOCKHOLDERS' EQUITY:			
Preferred stock (par value \$1 per share; authorized, 184,000 shares; none issued or outstanding)	-		-

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Series A Junior Participating preferred stock (par value \$1 per share; authorized, 16,000 shares; none issued or outstanding)	-	-
Common stock (par value \$1 per share; authorized, 20,000,000 shares; issued 16,611,671 shares at September 30, 2007, and 16,572,080 shares at December 31, 2006)	16,612	16,572
Capital surplus	37,345	37,963
Retained earnings	168,778	154,308
Accumulated other comprehensive income	2,198	868
Treasury stock at cost (119,426 shares at September 30, 2007, and no shares at December 31, 2006)	(2,658)	-
TOTAL STOCKHOLDERS' EQUITY	222,275	209,711
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 3,202,455	\$ 3,058,242

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		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
INTEREST INCOME:				
Interest and fees on loans and leases	\$ 47,406	\$ 43,664	\$ 140,712	\$ 121,850
Interest on securities:				
Taxable	5,446	4,591	16,010	12,465
Nontaxable	1,513	1,441	4,414	4,338
Interest on federal funds sold and other short-term investments	310	64	310	164
Interest on interest bearing deposits in other financial institutions	2	4	20	16
TOTAL INTEREST INCOME	54,677	49,764	161,466	138,833
INTEREST EXPENSE:				
Interest on deposits	20,477	16,862	58,325	44,457
Interest on short-term borrowings	2,764	2,702	10,545	6,876
Interest on other borrowings	4,199	3,348	10,762	9,543
TOTAL INTEREST EXPENSE	27,440	22,912	79,632	60,876
NET INTEREST INCOME	27,237	26,852	81,834	77,957
Provision for loan and lease losses	575	1,381	6,769	4,040
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	26,662	25,471	75,065	73,917
NONINTEREST INCOME:				
Service charges and fees, net	2,861	3,085	8,287	8,354
Loan servicing income	1,068	1,150	3,103	3,188
Trust fees	2,089	1,774	6,265	5,332
Brokerage and insurance commissions	820	450	2,158	1,339
Securities gains, net	31	67	303	428
Gain (loss) on trading account securities, net	(7)	53	80	61
Impairment loss on equity securities	-	(76)	-	(76)
Gains on sale of loans	604	551	2,051	1,678
Income on bank owned life insurance	595	250	1,212	769
Other noninterest income	(145)	197	161	418
TOTAL NONINTEREST INCOME	7,916	7,501	23,620	21,491
NONINTEREST EXPENSES:				
Salaries and employee benefits	14,301	13,039	42,680	38,457
Occupancy	2,004	1,828	5,941	5,373
Furniture and equipment	1,669	1,593	5,124	4,987
Outside services	2,374	2,273	7,011	6,954
Advertising	886	998	2,694	2,863
Intangible assets amortization	241	249	652	693
Other noninterest expenses	3,272	3,180	9,970	11,604
TOTAL NONINTEREST EXPENSES	24,747	23,160	74,072	70,931
INCOME BEFORE INCOME TAXES	9,831	9,812	24,613	24,477
Income taxes	2,906	3,207	7,403	7,665
	6,925	6,605	17,210	16,812

INCOME FROM CONTINUING
OPERATIONS

Discontinued operations:

Income from discontinued operations before income taxes	-	423	2,756	1,191
Income taxes	-	154	1,085	434
INCOME FROM DISCONTINUED OPERATIONS	-	269	1,671	757
NET INCOME	\$ 6,925	\$ 6,874	\$ 18,881	\$ 17,569
EARNINGS PER COMMON SHARE – BASIC	\$.42	\$.42	\$ 1.15	\$ 1.06
EARNINGS PER COMMON SHARE – DILUTED	\$.42	\$.41	\$ 1.14	\$ 1.05
EARNINGS PER COMMON SHARE FROM CONTINUING OPERATIONS – BASIC	\$.42	\$.40	\$ 1.04	\$ 1.02
EARNINGS PER COMMON SHARE FROM CONTINUING OPERATIONS– DILUTED	\$.42	\$.39	\$ 1.04	\$ 1.00
CASH DIVIDENDS DECLARED PER COMMON SHARE	\$.18	\$.18	\$.27	\$.27

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME (Unaudited)
(Dollars in thousands, except per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance at January 1, 2006	\$ 16,547	\$ 40,256	\$135,112	\$ (1,011)	\$ (3,092)	\$187,812
Net income			17,569			17,569
Unrealized gain on securities available for sale arising during the period				2,147		2,147
Reclassification adjustment for net security gains realized in net income				(352)		(352)
Unrealized gain on derivatives arising during the period, net of realized losses of \$97				136		136
Income taxes				(726)		(726)
Comprehensive income						18,774
Cash dividends declared:						
Common, \$0.27 per share			(4,430)			(4,430)
Purchase of 142,368 shares of common stock					(3,357)	(3,357)
Issuance of 282,219 shares of common stock	10	(3,207)			5,751	2,554
Commitments to issue common stock		630				630
Balance at September 30, 2006	\$ 16,557	\$ 37,679	\$148,251	\$ 194	\$ (698)	\$201,983
Balance at January 1, 2007	\$ 16,572	\$ 37,963	\$154,308	\$ 868	\$ -	\$209,711
Net income			18,881			18,881
Unrealized gain on securities available for sale arising during the period				2,183		2,183

Reclassification adjustment for net security gains realized in net income				(303)		(303)
Unrealized gain on derivatives arising during the period, net of realized losses of \$73				235		235
Income taxes				(785)		(785)
Comprehensive income						20,211
Cash dividends declared:						
Common, \$0.27 per share			(4,411)			(4,411)
Purchase of 303,786 shares of common stock					(7,832)	(7,832)
Issuance of 184,360 shares of common stock	40	(1,801)			5,174	3,413
Commitments to issue common stock		1,183				1,183
Balance at September 30, 2007	\$ 16,612	\$ 37,345	\$168,778	\$ 2,198	\$ (2,658)	\$222,275

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 18,881	\$ 17,569
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,635	5,914
Provision for loan and lease losses	6,769	4,040
Net amortization of premium on securities	143	785
Securities gains, net	(303)	(428)
Increase in trading account securities	(471)	(961)
Loss on impairment of equity securities	-	76
Stock-based compensation	1,183	630
Loans originated for sale	(233,626)	(207,328)
Proceeds on sales of loans	241,460	207,190
Net gain on sales of loans	(2,051)	(1,678)
Increase in accrued interest receivable	(422)	(5,037)
Increase (decrease) in accrued interest payable	(745)	1,528
Other, net	(16,702)	(8,561)
Net cash provided by operating activities – continuing operations	20,751	13,739
Net cash provided by operating activities – discontinued operations	10	9,856
NET CASH PROVIDED BY OPERATING ACTIVITIES	20,761	23,595
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the sale of securities available for sale	36,897	9,158
Proceeds from the maturity of and principal paydowns on securities available for sale	118,820	59,892
Proceeds from the maturity of and principal paydowns on securities held to maturity	24	-
Purchase of securities available for sale	(183,024)	(123,709)
Purchase of securities held to maturity	(1,157)	-
Net increase in loans and leases	(121,548)	(120,867)
Purchase of bank-owned life insurance policies	(20,500)	-
Capital expenditures	(16,925)	(18,366)
Net cash and cash equivalents received in acquisition of subsidiaries, net of cash paid	-	(15,015)
Proceeds on sale of OREO and other repossessed assets	359	1,869
Net cash used by investing activities – continuing operations	(187,054)	(207,038)
Net cash provided (used) by investing activities – discontinued operations	22,631	(12,810)

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NET CASH USED BY INVESTING ACTIVITIES	(164,423)	(219,848)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits and savings accounts	38,824	42,885
Net increase in time deposit accounts	101,509	88,476
Net increase (decrease) in short-term borrowings	(17,061)	17,014
Proceeds from other borrowings	62,114	71,661
Repayments of other borrowings	(17,921)	(47,315)
Purchase of treasury stock	(7,832)	(3,357)
Proceeds from issuance of common stock	2,568	936
Excess tax benefits on exercised stock options	845	388
Dividends paid	(4,411)	(4,430)
Net cash provided by financing activities – continuing operations	158,635	166,258
Net cash used by financing activities – discontinued operations	(32,525)	(5,543)
NET CASH PROVIDED BY FINANCING ACTIVITIES	126,710	160,715
Net decrease in cash and cash equivalents	(17,552)	(35,538)
Cash and cash equivalents at beginning of year	49,143	81,021
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 31,591	\$ 45,483
Supplemental disclosures:		
Cash paid for income/franchise taxes	\$ 16,668	\$ 8,131
Cash paid for interest	\$ 80,377	\$ 59,908
Acquisitions:		
Net assets acquired	\$ 650	\$ 13,061
Cash paid for acquisition	\$ -	\$ 18,081
Cash acquired	\$ -	\$ 3,066
Net cash paid for acquisition	\$ 50	\$ (15,015)
Common stock issued for acquisition	\$ -	\$ -

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, 2006, included in Heartland Financial USA, Inc.'s ("Heartland") Form 10-K filed with the Securities and Exchange Commission on March 16, 2007. 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 periods ended September 30, 2007, are not necessarily indicative of the results expected for the year ending December 31, 2007.

Earnings Per Share

Basic earnings per share is determined using net income and weighted average common shares outstanding. Diluted earnings per share is computed by dividing net income 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 nine-month periods ended September 30, 2007 and 2006, are shown in the tables below:

(Dollars and numbers in thousands, except per share data)	Three Months Ended	
	Sept. 30, 2007	Sept. 30, 2006
Income from continuing operations	\$ 6,925	\$ 6,605
Income from discontinued operations	-	269
Net income	\$ 6,925	\$ 6,874
Weighted average common shares outstanding for basic earnings per share	16,447	16,522
Assumed incremental common shares issued upon exercise of stock options	97	254
Weighted average common shares for diluted earnings per share	16,544	16,776
Earnings per common share – basic	\$ 0.42	\$ 0.42
Earnings per common share – diluted	\$ 0.42	\$ 0.41
Earnings per common share from continuing operations – basic	\$ 0.42	\$ 0.40
Earnings per common share from continuing operations – diluted	\$ 0.42	\$ 0.39
Earnings per common share from discontinued operations – basic	\$ -	\$ 0.02
Earnings per common share from discontinued operations – diluted	\$ -	\$ 0.02

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(Dollars and numbers in thousands, except per share data)	Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006
Income from continuing operations	\$ 17,210	\$ 16,812
Income from discontinued operations	1,671	757
Net income	\$ 18,881	\$ 17,569
Weighted average common shares outstanding for basic earnings per share	16,487	16,498
Assumed incremental common shares issued upon exercise of stock options	133	232
Weighted average common shares for diluted earnings per share	16,620	16,730
Earnings per common share – basic	\$ 1.15	\$ 1.06
Earnings per common share – diluted	\$ 1.14	\$ 1.05
Earnings per common share from continuing operations – basic	\$ 1.04	\$ 1.02
Earnings per common share from continuing operations – diluted	\$ 1.04	\$ 1.00
Earnings per common share from discontinued operations – basic	\$ 0.10	\$ 0.05
Earnings per common share from discontinued operations – diluted	\$ 0.10	\$ 0.05

Stock-Based Compensation

Options are typically granted annually with an expiration date ten years after the date of grant. Vesting is 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. The standard stock option agreement provides that the options become fully exercisable and expire if not exercised within 6 months of the date of retirement, including early retirement at age 55, provided the officer has provided 10 years of service to Heartland. A summary of the status of the stock options as of September 30, 2007 and 2006, and changes during the nine months ended September 30, 2007 and 2006, follows:

	2007		2006	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at January 1	815,300	\$ 14.46	796,650	\$ 12.70
Granted	146,750	29.65	130,750	21.60
Exercised	(194,788)	9.86	(65,825)	8.09
Forfeited	(14,500)	25.24	(15,900)	16.87
Outstanding at September 30	752,762	\$ 18.40	845,675	\$ 14.36
Options exercisable at September 30	300,554	\$ 11.60	438,050	\$ 10.38
Weighted-average fair value of options granted during the nine-month periods ended September 30	\$ 7.69		\$ 5.65	

At September 30, 2007, the vested options totaled 300,554 shares with a weighted average exercise price of \$11.60 per share and a weighted average remaining contractual life of 3.44 years. The intrinsic value for the vested options as of September 30, 2007, was \$2.7 million. The intrinsic value for the total of all options exercised during the nine months ended September 30, 2007, was \$2.1 million, and the total fair value of shares vested during the nine months

ended September 30, 2007, was \$1.2 million. At September 30, 2007, shares available for issuance under the 2005 Long-Term Incentive Plan totaled 613,860.

The fair value of the 2007 stock options granted was estimated utilizing the Black Scholes valuation model. The fair value of a share of common stock on the grant date of the 2007 options was \$27.85. The fair value of a share of common stock on the grant date of the 2006 options was \$21.60. Significant assumptions include:

	2007	2006
Risk-free interest rate	4.74%	4.52%
Expected option life	6.2	7.0
	years	years
Expected volatility	24.20%	22.00%
Expected dividends	1.25%	2.00%

The option term of each award granted was based upon Heartland's historical experience of employees' exercise behavior. Expected volatility was based upon historical volatility levels and future expected volatility of Heartland's common stock. Expected dividend yield was based on a set dividend rate. Risk free interest rate reflects the yield on the 7 year zero coupon U.S. Treasury bond. Cash received from options exercised for the nine months ended September 30, 2007, was \$1.9 million, with a related tax benefit of \$845 thousand. Cash received from options exercised for the nine months ended September 30, 2006, was \$533 thousand, with a related tax benefit of \$388 thousand.

Total compensation costs recorded were \$1.2 million and \$630 thousand for the nine months ended September 30, 2007 and September 30, 2006, respectively, for stock options, restricted stock awards and shares to be issued under the 2006 Employee Stock Purchase Plan. As of September 30, 2007, there was \$3.1 million of total unrecognized compensation costs related to the 2005 Long-Term Incentive Plan for stock options and restricted stock awards which is expected to be recognized through 2011.

Effect of New Financial Accounting Standards

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), which is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. This interpretation prescribes the minimum recognition threshold a tax position must meet before being recognized in the financial statements. FIN 48 also provides guidance on the derecognition, measurement, classification, interest and penalties, accounting in interim periods and disclosure requirements for uncertain tax positions. FIN 48 is effective as of the beginning of an entity's first fiscal year that begins after December 15, 2006. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The cumulative effect adjustment would not apply to those items that would not have been recognized in earnings, such as the effect of adopting FIN 48 on tax positions related to business combinations. Heartland adopted FIN 48 on January 1, 2007. See Note 6 for a discussion of the effect of the adoption on Heartland's consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 ("FAS 157"), *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The provisions of FAS 157 apply to other accounting pronouncements that require or permit fair value measurements. FAS 157 is effective for all financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Heartland plans to adopt FAS 157 on January 1, 2008, and is evaluating the impact of the adoption of this statement on its consolidated financial statements.

In September 2006, the Emerging Issues Task Force Issue 06-4 (“EITF 06-4”), *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*, was ratified. EITF 06-4 addresses accounting for separate agreements which split life insurance policy benefits between an employer and employee and requires the employer to recognize a liability for future benefits payable to the employee under these agreements. The effects of applying EITF 06-4 must be recognized through either a change in accounting principle through an adjustment to equity or through the retrospective application to all prior periods. For calendar year companies, EITF 06-4 is effective beginning January 1, 2008. Heartland is assessing the impact of the adoption of this issue on its consolidated financial statements.

In September 2006, the Emerging Issues Task Force Issue 06-5 (“EITF 06-5”), *Accounting for Purchases of Life Insurance – Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4*, was ratified. EITF 06-5 requires that a policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract on a policy by policy basis. EITF 06-5 is effective for fiscal years beginning after December 15, 2006, and requires that recognition of the effects of adoption should be by a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or a change in accounting principle through retrospective application to all prior periods. Heartland’s adoption of EITF 06-5 on January 1, 2007, did not have an impact on its consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (“FAS 159”), *The Fair Value Option for Financial Assets and Financial Liabilities*, which allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, FAS 159 specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. FAS 159 is effective for all financial statements issued for fiscal years beginning after November 15, 2007. Heartland plans to adopt FAS 159 on January 1, 2008, and is evaluating the impact of the adoption of this statement on its consolidated financial statements.

NOTE 2: CORE DEPOSIT PREMIUM AND OTHER INTANGIBLE ASSETS

The gross carrying amount of intangible assets and the associated accumulated amortization at September 30, 2007, and December 31, 2006, are presented in the table below, in thousands:

	September 30, 2007		December 31, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Core deposit intangibles	\$ 9,757	\$ 6,037	\$ 9,757	\$ 5,095
Mortgage servicing rights	6,115	2,434	5,546	1,986
Customer relationship intangible	1,177	200	917	129
Total	\$ 17,049	\$ 8,671	\$ 16,220	\$ 7,210
Unamortized intangible assets		\$ 8,378		\$ 9,010

Projections of amortization expense for mortgage servicing rights are based on existing asset balances and the existing interest rate environment as of September 30, 2007. Heartland’s actual experience may be significantly different depending upon changes in mortgage interest rates and market conditions. There was no valuation allowance on mortgage servicing rights at September 30, 2007, and at December 31, 2006. The fair value of Heartland’s mortgage servicing rights was estimated at \$6.7 million and \$6.0 million at September 30, 2007, and December 31, 2006, respectively.

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

	Core Deposit Intangibles	Mortgage Servicing Rights	Customer Relationship Intangible	Total
Three months ending December 31, 2007	\$ 214	\$ 275	\$ 26	\$ 515
Year ending December 31,				
2008	847	973	104	1,924
2009	748	811	102	1,661
2010	466	649	101	1,216
2011	450	487	98	1,035
2012	422	324	55	801
Thereafter	573	162	491	1,226

NOTE 3: DERIVATIVE FINANCIAL INSTRUMENTS

On occasion, Heartland uses derivative financial instruments as part of its interest rate risk management, including interest rate swaps, caps, floors and collars. Heartland's objectives in using derivatives are to add stability to its net interest margin and to manage its exposure to movements in interest rates.

To reduce the potentially negative impact a downward movement in interest rates would have on its interest income, Heartland entered into the following two transactions during 2006 and 2005, respectively. On April 4, 2006, Heartland entered into a three-year interest rate collar transaction with a notional amount of \$50.0 million. The collar was effective on April 4, 2006, and matures on April 4, 2009. Heartland is the payer on prime at a cap strike rate of 8.95% and the counterparty is the payer on prime at a floor strike rate of 7.00%. As of September 30, 2007, and December 31, 2006, the fair market value of this collar transaction was recorded as an asset of \$202 thousand and \$59 thousand, respectively.

On September 19, 2005, Heartland entered into a five-year interest rate collar transaction on a notional amount of \$50.0 million. The collar has an effective date of September 21, 2005, and a maturity date of September 21, 2010. Heartland is the payer on prime at a cap strike rate of 9.00% and the counterparty is the payer on prime at a floor strike rate of 6.00%. As of September 30, 2007, the fair market value of this collar transaction was recorded as an asset of \$112 thousand. As of December 31, 2006, the fair market value of this collar transaction was recorded as a liability of \$43 thousand.

For accounting purposes, the two collar transactions above are designated as cash flow hedges of the overall changes in the cash flows above and below the collar strike rates associated with interest payments on certain of Heartland's prime-based loans that reset whenever prime changes. The hedged transactions for the two hedging relationships are designated as the first prime-based interest payments received by Heartland each calendar month during the term of the collar that, in aggregate for each period, are interest payments on principal from specified portfolios equal to the notional amount of the collar.

Prepayments in the hedged loan portfolios are treated in a manner consistent with the guidance in SFAS 133 Implementation Issue No. G25, Cash Flow Hedges: Using the First-Payments-Received Technique in Hedging the Variable Interest Payments on a Group of Non-Benchmark-Rate-Based Loans, which allows the designated forecasted transactions to be the variable, prime-rate-based interest payments on a rolling portfolio of prepayable interest-bearing loans using the first-payments-received technique, thereby allowing interest payments from loans that prepay to be replaced with interest payments from new loan originations. Based on Heartland's assessments, both at inception and

throughout the life of the hedging relationship, it is probable that sufficient prime-based interest receipts will exist through the maturity dates of the collars.

To reduce the potentially negative impact an upward movement in interest rates would have on its net interest income, Heartland entered into the following two transactions on February 1, 2007. For accounting purposes, these two cap transactions are 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 interest payments made on \$45.0 million of Heartland's subordinated debentures (issued in connection with the trust preferred securities of Heartland Financial Statutory Trust IV and V) that reset quarterly on a specified reset date. At inception, Heartland asserted that the underlying principal balance will remain outstanding throughout the hedge transaction making it probable that sufficient LIBOR-based interest payments will exist through the maturity date of the caps.

The first transaction executed was a twenty-three month interest rate cap transaction on a notional amount of \$20.0 million. The cap has an effective date of February 1, 2007, and a maturity date of January 7, 2009. Should 3-month LIBOR exceed 5.5% 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 5.5%. The floating-rate subordinated debentures contain an interest deferral feature that is mirrored in the cap transaction. As of September 30, 2007, the fair market value of this cap transaction was recorded as an asset of \$5 thousand.

The second transaction executed on February 1, 2007, was a twenty-five month interest rate cap transaction on a notional amount of \$25.0 million to reduce the potentially negative impact an upward movement in interest rates would have on its net interest income. The cap has an effective date of February 1, 2007, and a maturity date of March 17, 2009. Should 3-month LIBOR exceed 5.5% 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 5.5%. The floating-rate subordinated debentures contain an interest rate deferral feature that is mirrored in the cap transaction. As of September 30, 2007, the fair market value of this cap transaction was recorded as an asset of \$22 thousand.

For both the collar and cap transactions described above, the effective portion of changes in the fair values of the derivatives is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings (interest income on loans or interest expense on borrowings) when the hedged transactions affect earnings. Ineffectiveness resulting from the hedging relationship, if any, is recorded as a gain or loss in earnings as part of noninterest income. Heartland uses the "Hypothetical Derivative Method" described in SFAS 133 Implementation Issue No. G20, Cash Flow Hedges: Assessing and Measuring the Effectiveness of a Purchased Option Used in a Cash Flow Hedge, for its quarterly prospective and retrospective assessments of hedge effectiveness, as well as for measurements of hedge ineffectiveness. No component of the change in the fair value of the hedging instrument is excluded from the assessment of hedge effectiveness. No significant ineffectiveness was realized on the derivatives qualifying for cash flow hedge accounting for the three and nine months ended September 30, 2007 and 2006.

A portion of the September 19, 2005, collar transaction did not meet the retrospective hedge effectiveness test at June 30, 2007. The failure was on a portion of the \$50.0 million notional amount. That portion, \$14.3 million, was designated as a cash flow hedge of the overall changes in the cash flows above and below the collar strike rates associated with interest payments on certain of Rocky Mountain Bank's prime-based loans. The failure of this hedge relationship was caused by the sale of the Broadus branch (see Note 5), which reduced the designated loan pool from \$14.3 million to \$7.5 million. This hedge failure resulted in the recognition of a loss of \$51 thousand during the quarter ended June 30, 2007, which consists of the mark to market loss on the collar transaction of \$36 thousand and a reclass of unrealized losses out of other comprehensive income to earnings of \$15 thousand. On August 17, 2007, the \$14.3 million portion of the September 19, 2005, collar transaction was redesignated and met the requirements for hedge accounting treatment. Since the fair value of the collar transaction was zero on the redesignation date, a mark to market gain of \$36 thousand was recorded as other noninterest income during the period from June 30, 2007, to August 17, 2007. As was the case at origination, the redesignation remains as a cash flow hedge of the overall changes in the cash flows above and below the collar strike rates associated with interest payments on certain of Rocky

Mountain Bank's prime-based loans. On September 30, 2007, this portion of the collar transaction demonstrated retrospective hedge effectiveness.

For the nine months ended September 30, 2007, the change in net unrealized gains of \$235 thousand for derivatives designated as cash flow hedges is separately disclosed in the statement of changes in stockholders' equity, before income taxes of \$87 thousand. For the nine months ended September 30, 2006, the change in net unrealized gains of \$136 thousand for derivatives designated as cash flow hedges is separately disclosed in the statement of changes in shareholders' equity, before income taxes of \$51 thousand.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest income or expense as interest payments are received or made on Heartland's variable-rate assets and liabilities. For the nine months ended September 30, 2007, the change in net unrealized losses on cash flow hedges reflects a reclassification of \$45 thousand of net unrealized losses from accumulated other comprehensive income to interest income or interest expense. For the next twelve months, Heartland estimates that an additional \$9 thousand will be reclassified from accumulated other comprehensive income to interest income.

On July 8, 2005, Heartland entered into a two-year interest rate floor transaction on prime at a strike level of 5.50% on a notional amount of \$100.0 million. This floor transaction matured on July 8, 2007, and was not replaced upon maturity. Changes in the fair market value of this hedge transaction were recorded through Heartland's income statement under the other noninterest income category as it was not designated in a formal hedging relationship. The floor contract had no fair market value as of December 31, 2006.

By using derivatives, Heartland is exposed to credit risk if counterparties to derivative instruments do not perform as expected. Heartland minimizes this risk by entering into derivative contracts with large, stable financial institutions and Heartland has not experienced any losses from counterparty nonperformance on derivative instruments. Furthermore, Heartland also periodically monitors counterparty credit risk in accordance with the provisions of SFAS 133.

NOTE 4: ACQUISITIONS

On March 9, 2007, Heartland completed its acquisition of a book of business from Independent Financial Marketing Group, Inc. ("IFMG"), a subsidiary of Sun Life. The brokers and support staff at the Denver office of IFMG served 8,800 investment clients. Immediately upon the acquisition, the staff relocated to Summit Bank & Trust's Broomfield, Colorado office. The purchase price of \$650 thousand will be paid in installments. The initial payment of \$50 thousand was paid at closing. The remaining payments are scheduled for payment as follows: \$100 thousand on December 31, 2007, and \$125 thousand on December 31, 2008, 2009, 2010 and 2011. The resultant acquired customer relationship intangible of \$260 thousand is being amortized over a period of 5 years. The remaining excess purchase price of \$390 thousand was recorded as goodwill.

NOTE 5: DISCONTINUED OPERATIONS

On June 22, 2007, Rocky Mountain Bank, Heartland's Montana bank subsidiary, completed the sale of its branch banking office in Broadus, Montana. Included in the sale were \$20.9 million of loans and \$30.2 million of deposits. Heartland recorded a pre-tax gain of \$2.4 million as a result of the sale. The branch sale represents a strategic decision on the part of Heartland and Rocky Mountain Bank to identify branch offices of relatively smaller size and greater distance from its primary banking markets for possible divestiture. Neither Rocky Mountain Bank nor Heartland anticipates the divestiture of other Montana banking offices. The results of operations of the branch, including the gain on sale, have been reflected on the income statement as discontinued operations for both the current and prior periods reported. Also included with the results of operations of the Broadus branch on the income statement as discontinued operations for the prior periods are the results of the operations of ULTEA, Inc., Heartland's fleet leasing subsidiary, which was sold on December 22, 2006.

NOTE 6: INCOME TAXES

Heartland adopted the provisions of FIN 48 on January 1, 2007. The evaluation was performed for those tax years which remain open to audit. Heartland files a consolidated tax return for federal purposes and a separate or consolidated tax return for state purposes dependent upon the state tax regulations. The tax years ended December 31, 2006, 2005, 2004 and 2003, remain subject to examination by the Internal Revenue Service. For state purposes, the tax years ended December 31, 2006, 2005, 2004, 2003 and 2002 remain open for examination. As a result of the implementation of FIN 48, Heartland did not recognize any increase or decrease for unrecognized tax benefits. The amount of unrecognized tax benefits on January 1, 2007, and September 30, 2007, was \$1.3 million and accrued interest and penalties of \$250 thousand for a total of \$1.5 million. If recognized, the entire amount of the unrecognized tax benefits would affect the effective tax rate. At September 30, 2007, Heartland does not anticipate any significant increase or decrease in unrecognized tax benefits during the next twelve months. Wisconsin Community Bank, one of Heartland's bank subsidiaries, has undergone a franchise tax review for the years ended December 31, 2002 and 2003, and is currently in the process of appealing the field audit report. In dispute is \$1.1 million of deducted expenditures, or \$126 thousand in taxes, interest and penalties, which have been fully accrued for.

NOTE 7: OTHER BORROWINGS

On March 19, 2007, Heartland Financial Statutory Trust II, a trust subsidiary of Heartland, redeemed all of its \$8.0 million variable rate trust preferred securities and its variable rate common securities at a redemption price equal to the \$8.00 liquidation amount of each security plus all accrued and unpaid interest per security. The redeemed trust preferred securities were originally issued in 2002. Remaining unamortized issuance costs associated with these securities of \$202 thousand were expensed under the noninterest expenses category upon redemption.

On June 21, 2007, Heartland completed an offering of \$20.0 million of fixed/variable rate cumulative trust preferred securities representing undivided beneficial interests in Heartland Financial Statutory Trust VI. The proceeds from the offering were used by the trust to purchase junior subordinated debentures from Heartland. Interest is payable quarterly on March 15, June 15, September 15 and December 15 of each year. The debentures will mature and the trust preferred securities must be redeemed on September 15, 2037. Heartland has the option to shorten the maturity date to a date not earlier than June 15, 2012. If the debentures are redeemed between June 15, 2012, and June 15, 2017, Heartland may be required to pay a "make-whole" premium. On or after June 15, 2017, the debentures are redeemable at par. No underwriting commissions or placement fees were paid in connection with this issuance. For regulatory purposes, all \$20.0 million qualified as Tier 2 capital.

On June 26, 2007, Heartland completed an offering of \$20.0 million of variable rate cumulative trust preferred securities representing undivided beneficial interests in Heartland Financial Statutory Trust VII. The proceeds from the offering were used by the trust to purchase junior subordinated debentures from Heartland. Interest is payable quarterly on March 1, June 1, September 1 and December 1 of each year. The debentures will mature and the trust preferred securities must be redeemed on September 1, 2037. On or after September 1, 2012, the debentures are redeemable at par. No underwriting commissions or placement fees were paid in connection with this issuance. For regulatory purposes, all \$20.0 million qualified as Tier 2 capital. The proceeds on both of these new trust preferred securities issuances has been used as a permanent source of funding for general corporate purposes, including replacement for the redemption of \$8.0 million of higher priced trust preferred securities in March 2007 and the redemption of another \$5.0 million of trust preferred securities on October 1, 2007, future acquisitions and as a source of funding for the operations of Citizens Finance Co., Heartland's finance company subsidiary.

Heartland currently has seven wholly-owned trust subsidiaries that were formed to issue trust preferred securities. The proceeds from the offerings were used to purchase junior subordinated debentures from Heartland. The proceeds are being used for general corporate purposes. Heartland has the option to shorten the maturity date to a date not earlier than the callable dates listed in the schedule below. Heartland may not shorten the maturity date without prior

approval of the Board of Governors of the Federal Reserve System, if required. Prior redemption is permitted under certain circumstances, such as changes in tax or regulatory capital rules. In connection with these offerings, the balance of deferred issuance costs included in other assets was \$306 thousand as of September 30, 2007. These deferred costs are amortized on a straight-line basis over the life of the debentures. The majority of the interest payments are due quarterly.

A schedule of Heartland's trust preferred offerings outstanding as of September 30, 2007, is as follows:

(Dollars in thousands)

Name	Amount Issued	Interest Rate	Interest Rate as of 9/30/07	Maturity Date	Callable Date
Rocky Mountain Statutory Trust I Heartland Financial	\$ 5,155	10.60%	10.60%	09/07/2030	09/07/2010
Capital Trust II Heartland Financial	5,155	3.65% over Libor	9.01%	06/30/2032	09/30/2007
Statutory Trust III Heartland Financial	20,619	8.25%	8.25%	10/10/2033	10/10/2008
Statutory Trust IV Heartland Financial	25,774	2.75% over Libor	8.44%	03/17/2034	03/17/2009
Statutory Trust V Heartland Financial	20,619	1.33% over Libor	6.69%	04/07/2036	04/07/2011
Statutory Trust VI Heartland Financial	20,619	6.75%	6.75%	09/15/2037	06/15/2012
Statutory Trust VII	20,619	1.48% over Libor	7.06%	09/01/2037	09/01/2012
	\$ 118,560				

For regulatory purposes, \$73.3 million of the capital securities qualified as Tier 1 capital for regulatory purposes as of September 30, 2007.

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. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and Heartland undertakes no obligation to update any statement in light of new information or future events.

Heartland's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. The factors which could have a material adverse effect on the operations and future prospects of Heartland and its subsidiaries are detailed in the "Risk Factors" section included under Item 1A. of Part I of Heartland's 2006 Form 10-K filed with the Securities and Exchange Commission on March 16, 2007. In addition to the risk factors described in that section, there are other factors that may impact any public company, including Heartland, which could have a material adverse

effect on the operations and future prospects of Heartland and its subsidiaries. These additional factors include, but are not limited to, the following:

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

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

GENERAL

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, trust income, brokerage and insurance commissions and gains on sale of loans, also affects Heartland's results of operations. Heartland's principal operating expenses, aside from interest expense, consist of compensation and employee benefits, occupancy and equipment costs and provision for loan and lease losses.

Net income of \$6.9 million, or \$0.42 per diluted share, for the quarter ended September 30, 2007, was consistent with net income of \$6.9 million, or \$0.41 per diluted share, earned during the third quarter of 2006. Return on average equity was 12.72% and return on average assets was 0.86% for the third quarter of 2007, compared to 13.93% and 0.91%, respectively, for the same quarter in 2006.

The sale of Rocky Mountain Bank's branch banking office in Broadus, Montana, was completed on June 22, 2007. Included in the sale were \$20.9 million of loans and \$30.2 million of deposits. The results of operations of the branch have been reflected on the income statement as discontinued operations for the prior periods reported. Also included on the income statement as discontinued operations for the prior periods are the results of operations of ULTEA, Inc., Heartland's fleet leasing subsidiary, which was sold to ALD Automotive on December 22, 2006.

Income from continuing operations was \$6.9 million, or \$0.42 per diluted share, during the third quarter of 2007 compared to \$6.6 million, or \$0.39 per diluted share, during the third quarter of 2006. This increase in earnings from continuing operations was primarily a result of a lower provision for loan losses, which was \$575 thousand during the third quarter of 2007 compared to \$1.4 million during the third quarter of 2006. Noninterest income increased by \$415 thousand or 6% during the third quarter of 2007 compared to the same quarter in 2006. The categories experiencing the largest increases were trust fees, brokerage and insurance commissions and income on bank owned life insurance. For the third quarter of 2007, noninterest expense increased \$1.6 million or 7% in comparison with the same period in 2006. The largest component of noninterest expense, salaries and employee benefits, increased \$1.3 million or 10% during the third quarter of 2007 in comparison to the third quarter of 2006. This growth in salaries and employee benefits expense was primarily due to additional staffing at Heartland's operations center to provide support services to the growing number of bank subsidiaries and the formation and expansion of Summit Bank & Trust.

Net income recorded for the first nine months of 2007 was \$18.9 million, or \$1.14 per diluted share, an increase of \$1.3 million or 7% over net income of \$17.6 million, or \$1.05 per diluted share, recorded during the first nine months of 2006. Return on average equity was 11.89% and return on average assets was 0.80% for the first nine months of 2007, compared to 12.23% and 0.81%, respectively, for the same period in 2006. During the first quarter of 2006, a pre-tax judgment of \$2.4 million against Heartland and Wisconsin Community Bank was recorded as noninterest expense, while a \$286 thousand award under a counterclaim was recorded as a loan loss recovery. The net after-tax effect to net income for this one-time event was \$1.3 million. Exclusive of this expense, Heartland's net income for the first nine months of 2006 was \$18.9 million, or \$1.13 per diluted share. Because of the non-recurring nature of this expense, management believes that this pro-forma presentation can help investors better understand Heartland's financial performance for the first nine months of 2006.

During the nine-month period ended September 30, 2007, income from discontinued operations included a \$2.4 million pre-tax gain recorded as a result of the sale of the Broadus branch. For the nine months ended September 30, 2007, income from continuing operations was \$17.2 million, or \$1.04 per diluted share, compared to \$16.8 million, or \$1.00 per diluted share, during the same period in 2006. This increase in earnings resulted from an improvement in net interest income and noninterest income that outweighed additional provision for loan losses and noninterest expenses recorded during the nine-month comparative periods. For the first nine months of 2007, noninterest income increased \$2.1 million or 10% over the same period in 2006, primarily from trust fees, brokerage and insurance commissions, gains on sale of loans and income on bank owned life insurance. For the nine-month period ended September 30, 2007, noninterest expense increased \$3.1 million or 4% when compared to the same nine-month period in 2006. Exclusive of the \$2.4 million judgment recorded during the first quarter of 2006, noninterest expense increased \$5.5 million or 8% in comparison to the first nine months of 2006. Again, the largest contributor to this increase was salaries and employee benefits which grew by \$4.2 million or 11% during this nine-month comparative period, primarily due to the expansion efforts. Total full-time equivalent employees increased to 975 at September 30, 2007, from 953 at September 30, 2006.

At September 30, 2007, total assets had increased \$144.2 million or 6% annualized since year-end 2006, primarily because of loan growth. Total loans and leases were \$2.27 billion at September 30, 2007, an increase of \$126.3 million or 8% annualized since year-end 2006. The sale of the Broadus branch of Rocky Mountain Bank included loans of \$20.9 million. The growth in loans was balanced between Heartland's Midwestern and Western markets. The commercial and commercial real estate loan category grew by \$127.5 million or 11% annualized. In order to provide the investing community with a perspective on how the growth in both loans and deposits during the first nine months of the year equates to performance on an annualized basis, the growth rates on these two categories as an annualized percentage. These annualized numbers were calculated by multiplying the growth percentage for the first nine months of the year by 1.33.

Total deposits at September 30, 2007, were \$2.42 billion, an increase of \$109.6 million or 6% annualized since year-end 2006. The sale of the Broadus branch of Rocky Mountain Bank included deposits of \$30.2 million. Growth in deposits was greater in Heartland's Western markets. Demand deposits experienced a decline while savings and time deposit balances experienced an increase. Savings deposits increased largely as a result of the promotion of a new money market product, as well as additional temporary deposits by a municipality. Over half of the growth in time deposits occurred at the Midwestern banks where depositors tend to be more desirous of the term deposit product.

CRITICAL ACCOUNTING POLICIES

The process utilized by Heartland to estimate the adequacy of the allowance for loan and lease losses is considered a critical accounting policy for Heartland. The allowance for loan and lease losses represents management's estimate of identified and unidentified probable losses in the existing loan portfolio. Thus, the accuracy of this estimate could have a material impact on Heartland's earnings. The adequacy of the allowance for loan and lease losses is determined using factors that include the overall composition of the loan portfolio, general economic conditions, types of loans, loan collateral values, past loss experience, loan delinquencies, and potential losses from identified substandard and

doubtful credits. Nonperforming loans and large non-homogeneous loans are specifically reviewed for impairment and the allowance is allocated on a loan by loan basis as deemed necessary. Homogeneous loans and loans not specifically evaluated are grouped into pools to which a loss percentage, based on historical experience, is allocated. The adequacy of the allowance for loan and lease losses is monitored on an ongoing basis by the loan review staff, senior management and the banks' boards of directors. Specific factors considered by management in establishing the allowance included the following:

- * Heartland has continued to experience growth in more complex commercial loans as compared to relatively lower-risk residential real estate loans.
- * During the last several years, Heartland has entered new geographical markets in which it had little or no previous lending experience.
- * Heartland has experienced an increase in net charge-offs and nonperforming loans during the current year.

There can be no assurances that the allowance for loan and lease losses will be adequate to cover all loan losses, but management believes that the allowance for loan and lease losses was adequate at September 30, 2007. While management uses available information to provide for loan and lease losses, the ultimate collectibility of a substantial portion of the loan portfolio and the need for future additions to the allowance will be based on changes in economic conditions. Even though there have been various signs of emerging strength in the economy, it is not certain that this strength will be sustainable. Should the economic climate deteriorate, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs, and delinquencies could rise and require further increases in the provision for loan and lease losses. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan and lease losses carried by the Heartland subsidiaries. Such agencies may require Heartland to make additional provisions to the allowance based upon their judgment about information available to them at the time of their examinations.

NET INTEREST INCOME

Net interest margin, expressed as a percentage of average earning assets, was 3.87% during the third quarter of 2007 compared to 4.16% for the third quarter of 2006. For the first nine months of 2007, net interest margin, expressed as a percentage of average earning assets, was 3.98% compared to 4.22% for the same nine months of 2006. Contributing to the decline in net interest margin during the third quarter of 2007 was a shift in Heartland's asset mix as a larger percentage of earning assets was held in fed funds sold or investments. Also affecting the net interest margin was the impact of foregone interest on Heartland's nonperforming loans which have increased during the second and third quarters of 2007. Additionally, early in the third quarter of 2007, a \$20.5 million investment was made in bank owned life insurance upon which interest expense associated with the funding of this investment affects net interest margin while the corresponding earnings on this investment is recorded as noninterest income. Given the asset sensitive posture of Heartland's balance sheet, the 50 basis point rate cut by the Fed in August 2007 and the most recent 25 basis point rate cut by the Fed in October 2007, Heartland will be challenged to maintain its net interest margin at the current level. Management continues to support a pricing discipline in which the focus is less on price and more on the unique value provided to business and retail clients.

Net interest income on a tax-equivalent basis totaled \$28.2 million during the third quarter of 2007, an increase of \$424 thousand or 2% from the \$27.8 million recorded during the third quarter of 2006. For the nine-month period during 2007, net interest income on a tax-equivalent basis was \$84.6 million, an increase of \$4.0 million or 5% from the \$80.6 million recorded during the first nine months of 2006. Contributing to these increases was the \$246.6 million or 9% growth in average earning assets during the comparable quarterly periods and the \$289.3 million or 11% growth in average earning assets during the first nine months of 2007 compared to 2006. Also contributing to the

improvement was the decline in the percentage of nonearning assets to total average assets from 12% during the first nine months of 2006 to 9% during the first nine months of 2007, due primarily to the assets of discontinued operations which, in addition to the Broadus branch, included ULTEA, Inc. during the first nine months of 2006.

On a tax-equivalent basis, interest income in the third quarter of 2007 totaled \$55.6 million compared to \$50.7 million in the third quarter of 2006, an increase of \$4.9 million or 10%. For the first nine months of 2007, interest income on a tax-equivalent basis increased \$22.7 million or 16% over the same period in 2006. More than half of the loans in Heartland's commercial and agricultural loan portfolios are floating rate loans, thus changes in the national prime rate impact interest income more quickly than if there were more fixed rate loans. In a downward rate environment, like the present, continued increases in interest income will be partially dependent upon the amount of loan growth experienced.

Interest expense for the third quarter of 2007 was \$27.4 million compared to \$22.9 million in the third quarter of 2006, an increase of \$4.5 million or 20%. On a nine-month comparative basis, interest expense increased \$18.8 million or 31%. Approximately 77% of Heartland's certificate of deposit accounts will mature within the next twelve months at a weighted average rate of 4.87%.

Heartland manages its balance sheet to minimize the effect a change in interest rates has on its net interest margin. During the remainder of 2007, Heartland will continue to work toward improving both its earning asset and funding mix through targeted organic growth strategies, which management believes will result in additional net interest income. Heartland's net interest income simulations reflect an asset sensitive posture leading to stronger earnings performance in a rising interest rate environment. The expected benefits associated with an inherently asset sensitive balance sheet will be delayed if rates rise as a highly competitive environment is expected to place pressure on deposit costs. Eventually, in a rapidly rising interest rate environment, funding costs should stabilize while asset yields continue to improve. Alternatively, Heartland's net interest income would likely decline in a falling rate environment. Item three of this Form 10-Q contains additional information about the results of Heartland's most recent net interest income simulations.

In order to reduce the potentially negative impact a downward movement in interest rates would have on net interest income on the loan portfolio, Heartland has two derivative transactions currently open: a five-year collar transaction on a notional \$50.0 million entered into in September 2005 and a three-year collar transaction on a notional \$50.0 million entered into in April 2006. Additionally, in August 2006, Heartland entered into a leverage structured wholesale repurchase agreement transaction. This wholesale repurchase agreement in the amount of \$50.0 million bears a variable interest rate that resets quarterly to the 3-month LIBOR rate plus 29.375 basis points. Embedded within this contract is an interest floor option that results when the 3-month LIBOR rate falls to 4.40% or lower. If that situation occurs, the rate paid will be decreased by two times the difference between the 3-month LIBOR rate and 4.40%. In order to effectuate this wholesale repurchase agreement, a \$55.0 million government agency bond was acquired. On the date of the contract, the interest rate on the securities was nearly equivalent to the interest rate being paid on the repurchase agreement contract.

On February 1, 2007, Heartland entered into two interest rate cap transactions on a total notional amount of \$45.0 million to reduce the potentially negative impact an upward rate environment would have on net interest income. These two-year contracts were acquired with the counterparty as the payer on 3-month LIBOR at a cap strike rate of 5.50% and were designated as a cash flow hedge against the LIBOR based variable-rate interest payments on Heartland's subordinated debentures associated with two of its trust preferred capital securities. The cost of these derivative transactions was \$90 thousand.

The table below sets forth certain information relating to Heartland's average consolidated balance sheets and reflects the yield on average earnings 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 yield 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 RATES¹

For the quarters ended September 30, 2007 and 2006

(Dollars in thousands)

	2007			2006		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate
EARNING ASSETS						
Securities:						
Taxable	\$ 474,366	\$ 5,446	4.55%	\$ 426,368	\$ 4,591	4.27%
Nontaxable ¹	136,834	2,271	6.58	131,289	2,200	6.65
Total securities	611,200	7,717	5.01	557,657	6,791	4.83
Interest bearing deposits	764	2	1.04	286	4	5.55
Federal funds sold	24,180	310	5.09	4,594	64	5.53
Loans and leases:						
Commercial and commercial real estate ¹	1,609,044	31,757	7.83	1,457,416	28,914	7.87
Residential mortgage	239,447	4,069	6.74	229,855	3,820	6.59
Agricultural and agricultural real estate ¹	227,630	4,650	8.10	218,466	4,358	7.91
Consumer	199,823	5,351	10.62	192,245	4,876	10.06
Direct financing leases, net	11,320	171	5.99	14,109	219	6.16
Fees on loans	-	1,589	-	-	1,618	-
Less: allowance for loan and lease losses	(32,647)	-	-	(30,467)	-	-
Net loans and leases	2,254,617	47,587	8.37	2,081,624	43,805	8.35
Total earning assets	2,890,761	\$ 55,616	7.63%	2,644,161	\$ 50,664	7.60%
NONEARNING ASSETS	285,954			341,070		
TOTAL ASSETS	\$ 3,176,715			\$ 2,985,231		
INTEREST BEARING LIABILITIES						
Interest bearing deposits						
Savings	\$ 850,988	\$ 6,021	2.81%	\$ 791,790	\$ 5,177	2.59%
Time, \$100,000 and over	305,748	3,848	4.99	220,582	2,410	4.33
Other time deposits	888,706	10,608	4.74	859,106	9,275	4.28
Short-term borrowings	243,820	2,764	4.50	227,349	2,702	4.72
Other borrowings	269,198	4,199	6.19	228,727	3,348	5.81
Total interest bearing liabilities	2,558,460	27,440	4.26%	2,327,554	22,912	3.91%
NONINTEREST BEARING LIABILITIES						
Noninterest bearing deposits	369,716			358,058		
Accrued interest and other liabilities	32,501			103,882		
Total noninterest bearing liabilities	402,217			461,940		
STOCKHOLDERS' EQUITY	216,038			195,737		

TOTAL LIABILITIES

AND STOCKHOLDERS' EQUITY \$ 3,176,715

\$2,985,231

EQUITY

Net interest income ¹	\$ 28,176		\$ 27,752	
Net interest spread ¹		3.37%		3.69%
Net interest income to total earning assets ¹		3.87%		4.16%
Interest bearing liabilities to earning assets	88.50%		88.03%	

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

ANALYSIS OF AVERAGE BALANCES, TAX EQUIVALENT YIELDS AND RATES¹

For the nine months ended September 30, 2007 and 2006

(Dollars in thousands)

	2007			2006		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate
EARNING ASSETS						
Securities:						
Taxable	\$ 468,616	\$ 16,010	4.57%	\$ 404,779	\$ 12,465	4.12%
Nontaxable ¹	132,831	6,677	6.72	131,109	6,657	6.79
Total securities	601,447	22,687	5.04	535,888	19,122	4.77
Interest bearing deposits	683	20	3.92	477	16	4.48
Federal funds sold	7,490	310	5.53	4,436	164	4.94
Loans and leases:						
Commercial and commercial real estate ¹	1,590,559	94,567	7.95	1,409,859	79,967	7.58
Residential mortgage	243,299	12,399	6.81	224,677	10,920	6.50
Agricultural and agricultural real estate ¹	225,606	13,728	8.14	210,577	12,478	7.92
Consumer	196,110	15,482	10.55	185,974	13,765	9.90
Direct financing leases, net	12,553	560	5.96	13,839	628	6.07
Fees on loans	-	4,500	-	-	4,452	-
Less: allowance for loan and lease losses	(32,012)	-	-	(29,292)	-	-
Net loans and leases	2,236,115	141,236	8.44	2,015,634	122,210	8.11
Total earning assets	2,845,735	\$ 164,253	7.72%	2,556,435	\$ 141,512	7.40%
NONEARNING ASSETS	290,299			332,503		
TOTAL ASSETS	\$ 3,136,034			\$ 2,888,938		
INTEREST BEARING LIABILITIES						
Interest bearing deposits						
Savings	\$ 825,967	\$ 17,132	2.77%	\$ 774,788	\$ 13,534	2.34%
Time, \$100,000 and over	282,393	10,394	4.92	216,043	6,502	4.02
Other time deposits	878,808	30,799	4.69	812,457	24,421	4.02
Short-term borrowings	291,941	10,545	4.83	217,848	6,876	4.22
Other borrowings	234,186	10,762	6.14	227,518	9,543	5.61
Total interest bearing liabilities	2,513,295	79,632	4.24%	2,248,654	60,876	3.62%
NONINTEREST BEARING LIABILITIES						
Noninterest bearing deposits	357,679			343,554		
Accrued interest and other liabilities	52,721			104,710		
Total noninterest bearing liabilities	410,400			448,264		

STOCKHOLDERS' EQUITY	212,339		192,020	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 3,136,034		\$2,888,938	
Net interest income ¹		\$ 84,621		\$ 80,636
Net interest spread ¹			3.48%	3.78%
Net interest income to total earning assets ¹			3.98%	4.22%
Interest bearing liabilities to earning assets	88.32%		87.96%	

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's opinion, an adequate allowance for loan and lease losses. During the third quarter of 2007, the provision for loan losses was \$575 thousand, a decrease of \$806 thousand or 58% over the same period in 2006. This decrease was due, in large part, to a reduction in loan balances. The provision for loan losses for the nine-month comparative period was \$6.8 million during 2007 compared to \$4.0 million during 2006, an increase of \$2.8 million or 68%. In addition to a significant charge-off during the second quarter of 2007, the provision for loan losses increased during 2007 as a result of loan growth, an increase in nonperforming loans and the impact historical losses have on the calculation of the adequacy of Heartland's allowance for loan and lease losses.

The adequacy of the allowance for loan and lease losses is determined by management using factors that include the overall composition of the loan portfolio, general economic conditions, types of loans, loan collateral values, past loss experience, loan delinquencies, substandard credits, and doubtful credits. For additional details on the specific factors considered, refer to the critical accounting policies and allowance for loan and lease losses sections of this report. Heartland believes the allowance for loan and lease losses is at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions would become 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**(Dollars in thousands)**

	Three Months Ended		Change	% Change
	Sept. 30, 2007	Sept. 30, 2006		
NONINTEREST INCOME:				
Service charges and fees, net	\$ 2,861	\$ 3,085	\$ (224)	(7)%
Loan servicing income	1,068	1,150	(82)	(7)
Trust fees	2,089	1,774	315	18
Brokerage and insurance commissions	820	450	370	82
Securities gains, net	31	67	(36)	(54)
Gain (loss) on trading account securities, net	(7)	53	(60)	(113)
Impairment loss on equity securities	-	(76)	76	100
Gains on sale of loans	604	551	53	10
Income on bank owned life insurance	595	250	345	138
Other noninterest income	(145)	197	(342)	(174)
TOTAL NONINTEREST INCOME	\$ 7,916	\$ 7,501	\$ 415	6%

	Nine Months Ended		Change	% Change
	Sept. 30, 2007	Sept. 30, 2006		
NONINTEREST INCOME:				
Service charges and fees, net	\$ 8,287	\$ 8,354	\$ (67)	(1)%
Loan servicing income	3,103	3,188	(85)	(3)
Trust fees	6,265	5,332	933	18
Brokerage and insurance commissions	2,158	1,339	819	61
Securities gains, net	303	428	(125)	(29)
Gain on trading account securities, net	80	61	19	31

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Impairment loss on equity securities	-	(76)	76	100
Gains on sale of loans	2,051	1,678	373	22
Income on bank owned life insurance	1,212	769	443	58
Other noninterest income	161	418	(257)	(61)
TOTAL NONINTEREST INCOME	\$ 23,620	\$ 21,491	\$ 2,129	10%

Noninterest income increased by \$415 thousand or 6% during the third quarter of 2007 compared to the same quarter in 2006. The categories experiencing the largest increases were trust fees, brokerage and insurance commissions and income on bank owned life insurance. For the first nine months of 2007, noninterest income increased \$2.1 million or 10% over the same period in 2006, primarily from trust fees, brokerage and insurance commissions, gains on sale of loans and income on bank owned life insurance.

Service charges and fees decreased \$224 thousand or 7% during the quarters under comparison. On a nine-month comparative basis, service charges and fees decreased \$67 thousand or 1%. Included in service charges and fees during 2006 were the fees recorded at HTLF Capital Corp., which were \$271 thousand during the third quarter and \$497 thousand during the first nine months. In the second quarter of 2006, the officers of HTLF Capital Corp. left employment with Heartland to join an investment bank. Subsequently, management decided to close the operations of this subsidiary. Fees recorded by HTLF Capital Corp. on any transactions financed by the Heartland subsidiary banks were deferred and recognized as income over the period of the loan. HTLF Capital Corp. fees recorded in service charges and fees during 2007 were \$7 thousand for the third quarter and \$22 thousand for the nine-month period ended on September 30. Exclusive of the fees at HTLF Capital Corp., service charges and fees increased \$406 thousand or 5% for the nine-month comparative period, primarily as a result of additional overdraft fees and growth in fees collected for the processing of activity on Heartland's automated teller machines and debit cards.

Trust fees improved \$315 thousand or 18% during the third quarter of 2007 and \$933 thousand or 18% during the first nine months of 2007 when compared to the same periods in 2006. These increases were attributable to two factors. During the second quarter of 2006, the fee schedule for trust services was adjusted upward. Additionally, the market value of trust assets, upon which a large portion of trust fees are based, increased from \$1.47 billion at September 30, 2006, to \$1.70 billion at September 30, 2007.

Brokerage and insurance commissions increased \$370 thousand or 82% during the third quarter of 2007 and \$819 thousand or 61% during the first nine months of 2007 compared to the same periods of 2006. Many of Heartland's subsidiary banks have begun to more actively promote brokerage and insurance services. Upon Heartland's arrival in the Denver market, an opportunity to further enhance brokerage and insurance commissions presented itself. Summit Bank & Trust completed the acquisition of personnel and a book of business from IFMG on March 9, 2007. The experienced brokers and support staff are now serving their 8,800 investment clients from Summit Bank & Trust's Broomfield office.

Income on bank owned life insurance increased \$345 thousand or 138% during the third quarter of 2007 and \$443 thousand or 58% during the first nine months of 2007 compared to the same periods of 2006. These increases are reflective of the improved performance on a newly purchased policy which included the new premium of \$20.5 million and exchanged policies of \$30.5 million.

Other noninterest income decreased \$342 thousand or 174% during the third quarter of 2007 and \$257 thousand or 61% during the first nine months of 2007 compared to the same periods of 2006. During the third quarter of 2007, Dubuque Bank and Trust Company acquired a 99.9% ownership interest in two different limited liability companies that own certified historic structures for which historic rehabilitation tax credits apply. Amortization of the investments in these limited liability companies was recorded in the amount of \$340 thousand during the third quarter of 2007. Excluding this amortization, other noninterest income during the third quarter of 2007 remained consistent with the \$197 thousand recorded during the third quarter of 2006. On a nine-month comparative basis, noninterest income improved by \$83 thousand or 20% compared to the same period in 2006, exclusive of the amortization of

these partnership interests.

NONINTEREST EXPENSES

(Dollars in thousands)

	Three Months Ended		Change	% Change
	Sept. 30, 2007	Sept. 30, 2006		
NONINTEREST EXPENSES:				
Salaries and employee benefits	\$ 14,301	\$ 13,039	\$ 1,262	10%
Occupancy	2,004	1,828	176	10
Furniture and equipment	1,669	1,593	76	5
Outside services	2,374	2,273	101	4
Advertising	886	998	(112)	(11)
Intangible assets amortization	241	249	(8)	(3)
Other noninterest expenses	3,272	3,180	92	3
TOTAL NONINTEREST EXPENSES	\$ 24,747	\$ 23,160	\$ 1,587	7%

	Nine Months Ended		Change	% Change
	Sept. 30, 2007	Sept. 30, 2006		
NONINTEREST EXPENSES:				
Salaries and employee benefits	\$ 42,680	\$ 38,457	\$ 4,223	11%
Occupancy	5,941	5,373	568	11
Furniture and equipment	5,124	4,987	137	3
Outside services	7,011	6,954	57	1
Advertising	2,694	2,863	(169)	(6)
Intangible assets amortization	652	693	(41)	(6)
Other noninterest expenses	9,970	11,604	(1,634)	(14)
TOTAL NONINTEREST EXPENSES	\$ 74,072	\$ 70,931	\$ 3,141	4%

For the third quarter of 2007, noninterest expenses increased \$1.6 million or 7% in comparison with the same period in 2006. Salaries and employee benefits, made up \$1.3 million or 80% of this change. For the nine-month period ended September 30, 2007, noninterest expenses increased \$3.1 million or 4% when compared to the same nine-month period in 2006. Exclusive of the \$2.4 million judgment recorded during the first quarter of 2006, noninterest expenses increased \$5.5 million or 8% in comparison to the first nine months of 2006. Salaries and employee benefits expense comprised \$4.2 million or 76% of this change for the nine-month comparative period.

The largest component of noninterest expense, salaries and employee benefits, increased \$1.3 million or 10% during the third quarter of 2007 in comparison to the third quarter of 2006. This growth in salaries and employee benefits expense was primarily due to additional staffing at Heartland's operations center to provide support services to the growing number of bank subsidiaries and the formation and expansion of Summit Bank & Trust. For the nine-month comparative periods, salaries and employee benefits expense grew by \$4.2 million or 11%, primarily due to the expansion efforts. Total full-time equivalent employees increased to 975 at September 30, 2007, from 953 at September 30, 2006. Also included in salaries and employee benefits are the expenses related to stock options granted, which are usually awarded during the first quarter of each year.

Heartland has continued to focus efforts on growth opportunities. Wisconsin Community Bank celebrated the opening of its Madison, Wisconsin, office in March 2007. New Mexico Bank & Trust opened its third branch office in Santa Fe in April 2007, Summit Bank & Trust opened its second branch office in Thornton, Colorado, in May 2007 and Rocky Mountain Bank opened its second branch office in Billings, Montana, in September 2007. Additionally, Arizona Bank & Trust opened its sixth branch office in Gilbert, Arizona, in October 2007 and Summit Bank & Trust acquired its third branch office in Erie, Colorado, in October 2007. Even though expansion efforts adversely affect short-term profitability, management feels these investments offer great potential for Heartland's future profitability. Of Heartland's 58 banking offices, six have been open for less than one year, an additional six have been open for less than two years and two more have been open for less than three years. Management believes that it generally takes approximately three years for new branch offices to become profitable. Including the additional three offices under construction, Heartland has roughly 25% of its distribution network yet to make a meaningful contribution to earnings. Occupancy expense increased \$176 thousand or 10% during the third-quarter comparative periods and \$568 thousand or 11% for the nine-month comparative periods as a result of the continuing expansion efforts.

Advertising costs decreased \$112 thousand or 11% during the third quarter of 2007 compared to the third quarter of 2006. On a nine-month comparative basis, advertising costs decreased \$169 thousand or 6%, primarily as a result of the discontinuation of a demand deposit acquisition program that was implemented during the first quarter of 2006. Costs for the program totaled approximately \$750 thousand during the first nine months of 2006. Management discontinued this program during the fourth quarter of 2006.

For the nine-month comparative periods, other noninterest expenses decreased \$1.6 million or 14%. Both of the comparative nine-month periods included expenses of a nonrecurring nature. The first nine months of 2007 included \$339 thousand of remaining unamortized issuance costs expensed due to the redemption of \$13.0 million of floating rate trust preferred securities. The first nine months of 2006 included the \$2.4 million judgment mentioned previously. Exclusive of these two items, other noninterest expenses increased \$416 thousand or 5% during the first nine months of 2007 compared to the same period in 2006, primarily as a result of the expansion efforts. The following types of expenses are classified in the other noninterest expenses category: supplies, telephone, software maintenance, software amortization, seminars and other staff expense.

INCOME TAX EXPENSE

Heartland's effective tax rate was 29.56% for the third quarter of 2007 compared to 32.84% for the third quarter of 2006. On a nine-month comparative basis, Heartland's effective tax rate was 31.01% during 2007 and 31.55% during 2006. The decrease in Heartland's effective tax rate during the third quarter of 2007 resulted from \$1.1 million in projected federal rehabilitation tax credits associated with Dubuque Bank and Trust Company's newly acquired 99.9% ownership interest in two limited liability companies that own certified historic structures. During both years, low-income housing tax credits were projected to total \$225 thousand for the year. 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 17.74% during the third quarter of 2007 compared to 16.46% during the same quarter of 2006. For the nine-month periods ended September 30, 2007 and 2006, tax-exempt income as a percentage of pre-tax income was 18.91% and 19.38%, respectively. The tax-equivalent adjustment for this tax-exempt interest income was \$939 thousand during the third quarter of 2007 compared to \$900 thousand during the same quarter in 2006. For the nine-month comparative period, the tax-equivalent adjustment for tax-exempt interest income was \$2.8 million for 2007 and \$2.7 million for 2006.

FINANCIAL CONDITION

LOANS AND ALLOWANCE FOR LOAN AND LEASE LOSSES

Total loans and leases were \$2.27 billion at September 30, 2007, an increase of \$126.3 million or 8% annualized since year-end 2006. The sale of the Broadus branch of Rocky Mountain Bank included loans of \$20.9 million. The growth in loans was balanced between Heartland's Midwestern and Western markets. The Heartland subsidiary banks

experiencing notable loan growth so far this year were Dubuque Bank and Trust Company, New Mexico Bank & Trust, Rocky Mountain Bank and Summit Bank & Trust. At Dubuque Bank and Trust Company, loan growth exceeded \$48.0 million during the first nine months of 2007. During the first nine months of 2006, total loans and leases increased \$169.1 million or 12% annualized since year-end 2005. The Heartland subsidiary banks have seen loan demand slow as the year has progressed and have been focusing much more attention on nonperforming loans.

The commercial and commercial real estate loan category, which grew by \$127.5 million or 11% annualized, was the major contributor to the loan growth experienced during the first nine months of 2007. Included in this change was the reclassification of \$28.3 million of commercial real estate loans at Wisconsin Community Bank from the loans held for sale portfolio to the loans held to maturity portfolio as management intends to hold those loans in its portfolio. The sale of the Broadus branch of Rocky Mountain Bank included commercial and commercial real estate loans of \$3.1 million. The growth in commercial and commercial real estate loans was also greater in Heartland's Western banks. In the Midwest, Dubuque Bank and Trust Company experienced the largest share of the growth. All of Heartland's Western banks contributed with New Mexico Bank & Trust being the largest contributor.

The table below presents the composition of the loan portfolio as of September 30, 2007, and December 31, 2006.

LOAN PORTFOLIO
(Dollars in thousands)

	September 30, 2007		December 31, 2006	
	Amount	Percent	Amount	Percent
Commercial and commercial real estate	\$ 1,611,226	70.73%	\$ 1,483,738	68.95%
Residential mortgage	224,732	9.87	225,343	10.47
Agricultural and agricultural real estate	226,550	9.94	233,748	10.86
Consumer	204,545	8.98	194,652	9.05
Lease financing, net	10,902	0.48	14,359	0.67
Gross loans and leases	2,277,955	100.00%	2,151,840	100.00%
Unearned discount	(2,021)		(1,875)	
Deferred loan fees	(1,815)		(2,120)	
Total loans and leases	2,274,119		2,147,845	
Allowance for loan and lease losses	(31,438)		(29,981)	
Loans and leases, net	\$ 2,242,681		\$ 2,117,864	

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 this report.

The allowance for loan and lease losses at September 30, 2007, was 1.38% of loans and 104% of nonperforming loans and leases, compared to 1.40% of loans and 356% of nonperforming loans at December 31, 2006. Nonperforming loans were \$30.4 million or 1.33% of total loans and leases at September 30, 2007, compared to \$8.4 million or 0.39% of total loans and leases at December 31, 2006. The majority of the \$22.0 million increase in nonperforming loans from December 31, 2006, occurred during the second and third quarters of 2007. Over half of this increase was attributable to five nonperforming loans at Wisconsin Community Bank totaling \$12.1 million, of which \$3.5 million in outstanding balances on four of these loans is covered by government guarantees. The remaining increase was distributed among the bank subsidiaries and related to a few loan customers. Management monitors the loan portfolio of each bank subsidiary and, at this point, does not feel that the increase in nonperforming loans is any indication of a systemic problem but is more likely a result of a shift in the economy in some of Heartland's markets. Loan officers at

the Heartland banks are placing more emphasis on the workout of weaker credits and the generation of deposit growth at this phase in the credit cycle.

Net charge-offs during the third quarter of 2007 were \$1.9 million compared to \$2.9 million and \$362 thousand during the second and first quarters of 2007, respectively. The increased charge-offs during the second and third quarters of 2007 were largely attributable to one credit at Galena State Bank and two credits at Wisconsin Community Bank. Citizens Finance Co., Heartland's finance subsidiary, recorded net charge-offs of \$969 thousand during the first nine months of 2007 compared to \$720 thousand during the first nine months of 2006. Although Heartland may periodically experience a charge-off of more significance on an individual credit, management feels the credit culture at Heartland and its subsidiary banks remains solid. Because of the net realizable value of collateral, guarantees and other factors, management expects losses on Heartland's nonperforming loans for the remainder of 2007 to be less than the amounts experienced during the second and third quarters of the year.

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)

	Nine Months Ended September 30,	
	2007	2006
Balance at beginning of period	\$ 29,981	\$ 27,791
Provision for loan and lease losses from continuing operations	6,769	4,040
Provision for loan and lease losses from discontinued operations	-	(5)
Recoveries on loans and leases previously charged off	1,362	948
Loans and leases charged off	(6,536)	(2,658)
Additions related to acquired bank	-	591
Reduction related to discontinued operations	(138)	(23)
Balance at end of period	\$ 31,438	\$ 30,684
Net charge offs to average loans and leases	0.23%	0.08%

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

NONPERFORMING ASSETS

(Dollars in thousands)

	As of September 30,		As of December 31,	
	2007	2006	2006	2005
Nonaccrual loans and leases	\$ 30,286	\$ 10,699	\$ 8,104	\$ 14,877
Loan and leases contractually past due 90 days or more	69	6,359	315	115
Total nonperforming loans and leases	30,355	17,058	8,419	14,992
Other real estate	2,129	1,450	1,575	1,586
Other repossessed assets	392	355	349	471
Total nonperforming assets	\$ 32,876	\$ 18,863	\$ 10,343	\$ 17,049
Nonperforming loans and leases to total loans and	1.33%	0.80%	0.39%	0.77%

leases

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 20% of total assets at September 30, 2007, and at December 31, 2006. Total available for sale securities as of September 30, 2007, were \$643.7 million, an increase of \$29.7 million or 5% from December 31, 2006.

The composition of the securities portfolio was shifted from an emphasis in U.S. government corporations and agencies to mortgage-backed securities during 2007 as the spread on mortgage-backed securities had widened in comparison to government agency securities. The percentage of U.S. government corporations and agencies securities was 48% at year-end 2006 compared to 39% at September 30, 2007. The percentage of mortgage-backed securities was 22% at year-end 2006 compared to 31% at September 30, 2007. The table below presents the composition of the available for sale securities portfolio by major category as of September 30, 2007, and December 31, 2006. All of Heartland's U.S. government corporations and agencies securities and more than 90% of its mortgage-backed securities are issuances of government-sponsored enterprises.

SECURITIES AVAILABLE FOR SALE PORTFOLIO COMPOSITION

(Dollars in thousands)

	September 30, 2007		December 31, 2006	
	Amount	Percent	Amount	Percent
U.S. government corporations and agencies	\$ 253,558	39.39%	\$ 296,823	48.35%
Mortgage-backed securities	196,474	30.53	134,057	21.83
Obligation of states and political subdivisions	153,101	23.79	135,681	22.10
Other securities	40,452	6.29	47,389	7.72
Total securities available for sale	\$ 643,655	100.00%	\$ 613,950	100.00%

DEPOSITS AND BORROWED FUNDS

Total deposits at September 30, 2007, were \$2.42 billion, an increase of \$109.6 million or 6% annualized since year-end 2006. The sale of the Broadus branch of Rocky Mountain Bank included deposits of \$30.2 million. Growth in deposits was weighted more heavily in Heartland's Western markets. Demand deposits experienced a \$3.8 million or 1% annualized decline of which \$3.4 million was attributable to the Broadus branch sale. Savings deposit balances experienced a \$27.9 million or 5% annualized increase despite the \$10.6 million in savings deposits lost as part of the Broadus branch sale. The increase in savings deposits primarily resulted from the promotion of a new money market product, as well as additional temporary deposits by a municipality in the Galena State Bank & Trust market. Time deposits, excluding brokered time deposits, increased \$70.0 million or 9% annualized since year-end 2006 with over half of the growth at the Midwestern banks where depositors tend to be more desirous of the term deposit product. Included in the Broadus branch sale were \$16.2 million in time deposits. Brokered time deposit balances increased \$15.5 million during the first nine months of the year, primarily to replace the reduction in balances at Rocky Mountain Bank as a result of the Broadus branch sale. At September 30, 2007, brokered time deposits totaled \$116.1 million or 5% of total deposits compared to \$100.6 million or 4% of total deposits at year-end 2006.

Short-term borrowings generally include federal funds purchased, treasury tax and loan note options, securities sold under agreement to repurchase and short-term Federal Home Loan Bank ("FHLB") advances. These funding alternatives are utilized in varying degrees depending on their pricing and availability. At of September 30, 2007, the amount of short-term borrowings was \$256.8 million compared to \$275.7 million at year-end 2006.

All of the bank subsidiaries provide 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, nor does it create an expense relating to FDIC premiums on deposits. Although the aggregate balance of these retail repurchase agreements is subject to variation, the account relationships represented by these balances are principally local. These balances were \$190.8 million at September 30, 2007, compared to \$225.9 million at year-end 2006. The sale of the Broadus branch of Rocky Mountain Bank included repurchase agreement balances of \$1.1 million.

Also included in short-term borrowings is the revolving credit line Heartland has with four unaffiliated banks. Under this unsecured revolving credit line, Heartland may borrow up to \$60.0 million at any one time. At September 30, 2007, a total of \$7.5 million was outstanding on this credit line compared to \$35.0 million at December 31, 2006. These borrowings were paid down during the second quarter of 2007 with the proceeds received on the completion of two trust preferred securities offerings.

Other borrowings include all debt arrangements Heartland and its subsidiaries have entered into with original maturities that extend beyond one year. At of September 30, 2007, the amount of other borrowings was \$268.7 million, an increase of \$44.2 million or 20% since year-end 2006. Other borrowings include the \$50.0 million structured wholesale repurchase agreement entered into in August of 2006 and the balances outstanding on trust preferred capital securities issued by Heartland. On March 19, 2007, Heartland redeemed \$8.0 million of variable rate cumulative trust preferred securities representing undivided beneficial interests in Heartland Statutory Trust II. On June 21, 2007, Heartland completed an offering of \$20.0 million fixed/variable rate trust preferred securities. On June 26, 2007, Heartland completed a second offering of \$20.0 million variable rate trust preferred securities. On October 1, 2007, Heartland redeemed \$5.0 million of variable rate cumulative trust preferred securities representing undivided beneficial interests in Heartland Financial Capital Trust II. A schedule of Heartland's trust preferred offerings outstanding as of September 30, 2007, is as follows:

(Dollars in thousands)

	Amount Issued	Issuance Date	Interest Rate	Interest Rate as of 9/30/07	Maturity Date	Callable Date
\$	5,000	08/07/00	10.60%	10.60%	09/07/2030	09/07/2010
	5,000	06/27/02	3.65% over Libor	9.01%	06/30/2032	09/30/2007
	20,000	10/10/03	8.25%	8.25%	10/10/2033	10/10/2008
	25,000	03/17/04	2.75% over Libor	8.11%	03/17/2034	03/17/2009
			1.33% over Libor			
	20,000	01/31/06	Libor	6.69%	04/07/2036	04/07/2011
	20,000	06/21/07	6.75%	6.75%	09/15/2037	06/15/2012
			1.48% over Libor			
	20,000	06/26/07	Libor	6.84%	09/01/2037	09/01/2012
\$	115,000					

Also in other borrowings are the bank subsidiaries' borrowings from the FHLB. All of the bank subsidiaries own FHLB stock in either Chicago, Dallas, Des Moines, Seattle or San Francisco, enabling them to borrow funds from their respective FHLB for short- or long-term purposes under a variety of programs. FHLB borrowings at September 30, 2007, totaled \$103.7 million, an increase of \$22.4 million or 28% from the December 31, 2006, FHLB borrowings of \$81.3 million. Included in the \$103.7 million of FHLB borrowings at September 30, 2007, was \$12.0 million classified as short-term borrowings on Heartland's consolidated balance sheet. These advances were used to fund a

portion of the fixed-rate commercial loan growth experienced. Total FHLB borrowings at September 30, 2007, had an average rate of 4.58% and an average maturity of 2.92 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 September 30, 2007, and December 31, 2006, commitments to extend credit aggregated \$656.9 million and \$651.3 million, and standby letters of credit aggregated \$38.0 million and \$35.8 million, respectively.

Contractual obligations and other commitments were presented in Heartland's 2006 Annual Report on Form 10-K. There have been no material changes in Heartland's contractual obligations and other commitments since that report was filed. The timing and resolution of the \$1.5 million unrealized tax benefits associated with the adoption of FASB Interpretation No. 48 can not be reasonably estimated at this time.

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%, 6% and 4%, 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)

	September 30, 2007		December 31, 2006	
	Amount	Ratio	Amount	Ratio
Risk-Based Capital Ratios ¹				
Tier 1 capital	\$ 247,947	9.56%	\$ 232,702	9.32%
Tier 1 capital minimum requirement	103,723	4.00%	99,878	4.00%
Excess	\$ 144,224	5.56%	\$ 132,824	5.32%
Total capital	\$ 325,050	12.54%	\$ 279,112	11.18%
Total capital minimum requirement	207,447	8.00%	199,757	8.00%

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Excess	\$	117,603	4.54%	\$	79,355	3.18%
Total risk-adjusted assets	\$	2,593,084		\$	2,496,960	
Leverage Capital Ratios ²						
Tier 1 capital	\$	247,947	7.92%	\$	232,702	7.74%
Tier 1 capital minimum requirement ³		125,258	4.00%		120,255	4.00%
Excess	\$	122,689	3.92%	\$	112,447	3.74%
Average adjusted assets (less goodwill and other intangible assets)	\$	3,131,443		\$	3,006,374	

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

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

Commitments for capital expenditures are an important factor in evaluating capital adequacy. During the third quarter of 2007, Heartland announced its intention to enter the Minneapolis, Minnesota market through the formation of a new bank to be known as Minnesota Bank & Trust. While the new bank is being organized, Heartland will initially operate a loan production office through Dubuque Bank and Trust Company, which is expected to open by year-end 2007. The capital structure of this new bank will be very similar to that used when Summit Bank & Trust was formed. Heartland's initial investment will be \$12.8 million, or 80%, of the targeted \$16.0 million initial capital. In November of 2007, 10% of Heartland's investment, along with 10% of the subscribing minority shareholders, had been deposited into an escrow account. All minority stockholders entered into a stock transfer agreement that imposes certain restrictions on the sale, transfer or other disposition of their shares in Minnesota Bank & Trust and allows, but does not require, Heartland to repurchase the shares from investors five years from the date of opening. Applications are in the process of being filed with the appropriate federal and state regulators with opening targeted for first quarter 2008 provided the necessary regulatory approvals are obtained.

On June 26, 2007, Heartland completed an offering of \$20.0 million of variable rate cumulative trust preferred securities representing undivided beneficial interests in Heartland Financial Statutory Trust VII. The proceeds from the offering were used by the trust to purchase junior subordinated debentures from Heartland. Interest is payable quarterly on March 1, June 1, September 1 and December 1 of each year. The debentures will mature and the trust preferred securities must be redeemed on September 1, 2037. On or after September 1, 2012, the debentures are redeemable at par. For regulatory purposes, all \$20.0 million qualified as Tier 2 capital.

On June 21, 2007, Heartland completed an offering of \$20.0 million of fixed/variable rate cumulative trust preferred securities representing undivided beneficial interests in Heartland Financial Statutory Trust VI. The proceeds from the offering were used by the trust to purchase junior subordinated debentures from Heartland. Interest is payable quarterly on March 15, June 15, September 15 and December 15 of each year. The debentures will mature and the trust preferred securities must be redeemed on September 15, 2037. Heartland has the option to shorten the maturity date to a date not earlier than June 15, 2012. If the debentures are redeemed between June 15, 2012, and June 15, 2017, Heartland may be required to pay a "make-whole" premium. On or after June 15, 2017, the debentures are redeemable at par. For regulatory purposes, all \$20.0 million qualified as Tier 2 capital. The proceeds on both these new trust preferred securities issuances has been used as a permanent source of funding for general corporate purposes, including replacement for the redemption of \$8.0 million of higher priced trust preferred securities in March 2007 and the redemption of another \$5.0 million of trust preferred securities on October 1, 2007, and future

acquisitions.

In August of 2005, Heartland announced the addition of a loan production office in Denver, Colorado with the intention to use this office as a springboard to opening a full-service state chartered bank in this market. The bank began operations as Summit Bank & Trust on November 1, 2006. The capital structure of this new bank is very similar to that used when Arizona Bank & Trust was formed. Heartland's initial investment was \$12.0 million, or 80%, of the \$15.0 million initial capital. All minority stockholders entered into a stock transfer agreement that imposes certain restrictions on the sale, transfer or other disposition of their shares in Summit Bank & Trust and requires Heartland to repurchase the shares from investors five years from the date of opening. The stock will be valued by an independent third party appraiser with the required purchase by Heartland at the appraised value, not to exceed 18x earnings, or a minimum return of 6% on the original investment amount, whichever is greater. Through September 30, 2007, Heartland accrued the amount due to the minority shareholders at 6%. The obligation to repay the original investment is payable in cash or Heartland stock or a combination of cash and stock at the option of the minority shareholder. The remainder of the obligation to the minority shareholders is payable in cash or Heartland stock or a combination of cash and stock at the option of Heartland.

In February of 2003, Heartland entered into an agreement with a group of Arizona business leaders to establish a new bank in Mesa. The new bank began operations on August 18, 2003, as Arizona Bank & Trust. Heartland's initial investment in Arizona Bank & Trust was \$12.0 million, which reflected an ownership percentage of 86%. After completion of the Bank of the Southwest acquisition, Heartland's ownership percentage had increased to 90%. All minority stockholders have entered into a stock transfer agreement that imposes certain restrictions on the sale, transfer or other disposition of their shares and requires Heartland to repurchase the shares from the investors five years from the date of opening. The stock will be valued by an independent third party appraiser with the required purchase by Heartland at the appraised value, not to exceed 18x earnings, or a minimum return of 6% on the original investment amount, whichever is greater. Through September 30, 2007, Heartland accrued the amount due to the minority shareholders at 6%. The obligation to repay the original investment is payable in cash or Heartland stock or a combination of cash and stock at the option of the minority shareholder. The remainder of the obligation to the minority shareholders is payable in cash or Heartland stock or a combination of cash and stock at the option of Heartland.

Heartland continues to explore opportunities to expand its umbrella of independent community banks through mergers and acquisitions as well as *de novo* and branching opportunities. Although the vast majority of its expansion has been in the West, Heartland continues to pursue attractive growth markets wherever it can identify professional and experienced banking talent. Future expenditures relating to expansion efforts, in addition to those identified above, are not estimable at this time.

LIQUIDITY

Liquidity refers to Heartland's ability to maintain a cash flow, which 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.

Investing activities from continuing operations used cash of \$187.1 million during the first nine months of 2007 compared to \$207.0 million during the first nine months of 2006. The proceeds from securities sales, paydowns and maturities was \$155.7 million during the first nine months of 2007 compared to \$69.1 million during the first nine months of 2006. Purchases of securities used cash of \$184.2 million during the first nine months of 2007 while \$123.7 million was used for securities purchases during the first nine months of 2006. A larger portion of the proceeds from securities sales, paydowns and maturities was used to fund loan growth during the first nine months of 2007. The net increase in loans and leases was \$121.5 million during the first nine months of 2007 compared to \$120.9 million

during the first nine months of 2006.

Financing activities from continuing operations provided cash of \$158.6 million during the first nine months of 2007 compared to \$166.3 million during the first nine months of 2006. During the first nine months of 2007, there was a net increase in deposit accounts of \$140.3 million compared to \$131.4 million during 2006. Activity in short-term borrowings used cash of \$17.1 million during the first nine months of 2007 compared to providing of cash of \$17.0 million during the first nine months of 2006. Cash proceeds from other borrowings were \$62.1 million during the first nine months of 2007 compared to \$71.7 million during the first nine months of 2006. Repayment of other borrowings used cash of \$17.9 million during the first nine months of 2007 compared to \$47.3 million during the first nine months of 2006.

Total cash provided by operating activities from continuing operations was \$20.8 million during the first nine months of 2007 compared to \$13.7 million during the first nine months of 2006. A large portion of this change was the result of proceeds on sales of loans in excess of cash used for the origination of loans for sale. Cash used for the payment of income taxes was \$16.7 million during the first nine months of 2007 compared to \$8.1 million during the first nine months of 2006. The larger payment in 2007 resulted from the sale of ULTEA during the fourth quarter of 2006.

The totals previously discussed did not include the cash flows related to the discontinued operations at the Broadus branch and ULTEA. Net cash provided from investing activities of discontinued operations of the Broadus branch was \$22.6 million during the first nine months of 2007. For the first nine months of 2006, the investing activities from discontinued operations used cash of \$12.8 million and includes the Broadus branch and ULTEA. During the first nine months of 2007, financing activities from the discontinued operations of the Broadus branch used cash of \$32.5 million. During the same period in 2006, the discontinued operations of both the Broadus branch and ULTEA used cash from financing activities of \$5.5 million. Relative to operating activities, cash provided from the discontinued operations of the Broadus branch was \$10 thousand during the first nine months of 2007. For the same period in 2006, the discontinued operations of both Broadus and ULTEA provided cash from operating activities of \$9.9 million.

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.

Heartland's short-term borrowing balances are dependent on commercial cash management and smaller correspondent bank relationships and, as such, will normally fluctuate. Heartland believes these balances, on average, to be stable sources of funds; however, it intends to rely on deposit growth and additional FHLB borrowings in the future.

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 September 30, 2007, Heartland's revolving credit agreement with third-party banks provided a maximum borrowing capacity of \$60.0 million, of which \$7.5 million had been borrowed. The revolving credit agreement contains specific covenants which, among other things, limit dividend payments and restrict the sale of assets by Heartland under certain circumstances. Also contained within the agreement are certain financial covenants, including the maintenance by Heartland of a maximum nonperforming assets to total loans ratio, minimum return on average assets ratio and maximum funded debt to total equity capital ratio. In addition, Heartland and each of its bank subsidiaries must remain well capitalized, as defined from time to time by the federal banking regulators. At September 30, 2007, Heartland was in compliance with the covenants contained in the credit agreement.

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 at the banks and, on a consolidated basis, by the Heartland 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 Heartland's and each of its bank subsidiaries' balance sheet risk profile is performed. Included in these reviews are interest rate sensitivity analyses, which simulate changes in net interest income in response to various interest rate scenarios. This analysis considers 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. Although management has entered into derivative financial instruments to mitigate the exposure Heartland's net interest margin has in a downward rate environment, it does not believe that Heartland's primary market risk exposures and how those exposures have been managed to-date in 2007 changed significantly when compared to 2006.

The core interest rate risk analysis utilized by Heartland examines the balance sheet under rates up/down scenarios that are neither too modest nor too extreme. All rate changes are ramped over a 12-month horizon based upon a parallel yield curve shift 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 margin. 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 as growth assumptions can make interest rate risk. The most recent reviews at September 30, 2007 and 2006, provided the following results:

	2007		2006	
	Net Interest Margin (in thousands)	% Change From Base	Net Interest Margin (in thousands)	% Change From Base
<u>Year 1</u>				
Down 200 Basis Points	\$ 100,545	(3.35)%	\$ 96,210	(3.38)%
Base	\$ 104,034		\$ 99,579	
Up 200 Basis Points	\$ 103,814	(0.21)%	\$ 98,382	(1.20)%
<u>Year 2</u>				
Down 200 Basis Points	\$ 97,776	(6.02)%	\$ 93,756	(5.84)%
Base	\$ 106,694	2.56 %	\$ 101,937	2.37 %
Up 200 Basis Points	\$ 106,101	1.99 %	\$ 99,526	(0.06)%

Heartland's use of derivative financial instruments relates to the management of the risk that changes in interest rates will affect its future interest income or interest expense. Heartland is exposed to credit-related losses in the event of nonperformance by the counterparties to its derivative instruments, which has been minimized by entering into the contracts with large, stable financial institutions. The estimated fair market values of these derivative instruments are presented in Note 3 to the consolidated financial statements.

ITEM 4. CONTROLS AND PROCEDURES

As required by Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, Heartland's management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Heartland's disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that Heartland's disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of September 30, 2007. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by Heartland in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Heartland's management, including the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in Heartland's internal control over financial reporting that occurred during the quarter ended September 30, 2007, 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 is 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

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 2006 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.

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 September 30, 2007, of equity securities that are registered by Heartland pursuant to Section 12 of the Exchange Act:

	(a)	(b)	(c)	(d)
Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs ⁽¹⁾
07/01/07-07/31/07	40,000	\$21.69	40,000	\$609,828
08/01/07-08/31/07	12,578	\$18.00	12,578	\$2,768,111
09/01/07-09/30/07	20,247	\$19.69	20,247	\$2,683,296
Total:	72,825	\$20.50	72,825	N/A

(1) Prior to its meeting on April 17, 2007, Heartland's board of directors had authorized management to acquire and hold \$5.0 million as treasury shares at any one time. Effective April 17, 2007, Heartland's board of directors authorized management to acquire and hold up to 250,000 shares of common stock as treasury shares at any one time.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibits

10.1 Subscription and Shareholder Agreement between Heartland Financial USA, Inc. and Investors in Minnesota Bank & Trust dated as of September 21, 2007.

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.

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

By: Lynn B. Fuller
President and Chief Executive Officer

Principal Financial and
Accounting Officer

By: John K. Schmidt
Executive Vice President
and Chief Financial Officer

Dated: November 9, 2007