

HEARTLAND FINANCIAL USA INC
Form 10-Q
May 10, 2006

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

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

For quarterly period ended March 31, 2006

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 x No**
o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
Large accelerated filer Accelerated filer x 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 o No x**

Indicate the number of shares outstanding of each of the classes of Registrant's common stock as of the latest practicable date: As of May 8, 2006, the Registrant had outstanding 16,555,714 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)

| | March 31, 2006 (Unaudited) | | December 31, 2005 |
|---|-------------------------------|-----------|-------------------|
| ASSETS | | | |
| Cash and due from banks | \$ 35,018 | \$ | 40,422 |
| Federal funds sold and other short-term investments | 13,337 | | 40,599 |
| Cash and cash equivalents | 48,355 | | 81,021 |
| Time deposits in other financial institutions | - | | - |
| Securities: | | | |
| Trading, at fair value | 511 | | 515 |
| Available for sale, at fair value (cost of \$522,758 at March 31, 2006, and \$528,647 at December 31, 2005) | 519,551 | | 527,252 |
| Loans held for sale | 38,885 | | 40,745 |
| Gross loans and leases: | | | |
| Loans and leases | 1,990,852 | | 1,953,066 |
| Allowance for loan and lease losses | (28,674) | | (27,791) |
| Loans and leases, net | 1,962,178 | | 1,925,275 |
| Assets under operating leases | 39,634 | | 40,644 |
| Premises, furniture and equipment, net | 102,462 | | 92,769 |
| Other real estate, net | 2,612 | | 1,586 |
| Goodwill | 35,398 | | 35,398 |
| Intangible assets, net | 8,958 | | 9,159 |
| Bank owned life insurance | 33,124 | | 32,804 |
| Other assets | 31,093 | | 31,164 |
| TOTAL ASSETS | \$ 2,822,761 | \$ | 2,818,332 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| LIABILITIES: | | | |
| Deposits: | | | |
| Demand | \$ 334,940 | \$ | 352,707 |
| Savings | 778,960 | | 754,360 |
| Time | 1,017,955 | | 1,011,111 |
| Total deposits | 2,131,855 | | 2,118,178 |
| Short-term borrowings | 232,506 | | 255,623 |
| Other borrowings | 232,025 | | 220,871 |
| Accrued expenses and other liabilities | 36,243 | | 35,848 |
| TOTAL LIABILITIES | 2,632,629 | | 2,630,520 |
| 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 16,547,885 shares at March 31, 2006, and 16,547,482 shares at December 31, 2005) | 16,548 | 16,547 |
| Capital surplus | 37,671 | 40,256 |
| Retained earnings | 138,107 | 135,112 |
| Accumulated other comprehensive loss | (2,176) | (1,011) |
| Treasury stock at cost (806 shares at March 31, 2006, and 157,067 shares at December 31, 2005) | (18) | (3,092) |
| TOTAL STOCKHOLDERS' EQUITY | 190,132 | 187,812 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 2,822,761 | \$ 2,818,332 |

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 | |
|---|--------------------|----------------|
| | March 31, 2006 | March 31, 2005 |
| INTEREST INCOME: | | |
| Interest and fees on loans and leases | \$ 37,918 | \$ 29,988 |
| Interest on securities: | | |
| Taxable | 3,883 | 3,531 |
| Nontaxable | 1,428 | 1,325 |
| Interest on federal funds sold and other short-term investments | 174 | 47 |
| Interest on interest bearing deposits in other financial institutions | 5 | 68 |
| TOTAL INTEREST INCOME | 43,408 | 34,959 |
| INTEREST EXPENSE: | | |
| Interest on deposits | 13,087 | 9,182 |
| Interest on short-term borrowings | 2,451 | 1,264 |
| Interest on other borrowings | 3,044 | 2,506 |
| TOTAL INTEREST EXPENSE | 18,582 | 12,952 |
| NET INTEREST INCOME | 24,826 | 22,007 |
| Provision for loan and lease losses | 1,172 | 1,364 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES | 23,654 | 20,643 |
| NONINTEREST INCOME: | | |
| Service charges and fees | 2,601 | 2,240 |
| Loan servicing income | 980 | 658 |
| Trust fees | 1,817 | 1,595 |
| Brokerage commissions | 243 | 223 |
| Insurance commissions | 136 | 137 |
| Securities gains, net | 132 | 53 |
| Gain on trading account securities, net | 33 | 18 |
| Rental income on operating leases | 4,061 | 3,571 |
| Gain on sale of loans | 550 | 532 |
| Valuation adjustment on mortgage servicing rights | - | 16 |
| Income on bank owned life insurance | 293 | 263 |
| Other noninterest income | 339 | 409 |
| TOTAL NONINTEREST INCOME | 11,185 | 9,715 |
| NONINTEREST EXPENSE: | | |
| Salaries and employee benefits | 13,084 | 11,182 |
| Occupancy | 1,793 | 1,626 |
| Furniture and equipment | 1,691 | 1,367 |
| Depreciation on equipment under operating leases | 3,255 | 2,928 |
| Outside services | 2,156 | 1,998 |
| Advertising | 1,124 | 809 |
| Core deposit premium amortization | 228 | 270 |
| Other noninterest expense | 5,225 | 2,571 |

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| | | |
|---|----------|----------|
| TOTAL NONINTEREST EXPENSE | 28,556 | 22,751 |
| INCOME BEFORE INCOME TAXES | 6,283 | 7,607 |
| Income taxes | 1,810 | 2,343 |
| NET INCOME | \$ 4,473 | \$ 5,264 |
| EARNINGS PER COMMON SHARE-BASIC | \$ 0.27 | \$ 0.32 |
| EARNINGS PER COMMON SHARE - DILUTED | \$ 0.27 | \$ 0.32 |
| CASH DIVIDENDS DECLARED PER COMMON SHARE | \$ 0.09 | \$ 0.08 |

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 (Loss) | Treasury Stock | Total |
|---|-----------------|--------------------|----------------------|---|-------------------|------------|
| Balance at January 1, 2005 | \$ 16,547 | \$ 40,446 | \$ 117,800 | \$ 2,889 | \$ (1,900) | \$ 175,782 |
| Net income | | | 5,264 | | | 5,264 |
| Unrealized gain on securities available for sale arising during the period | | | | (6,986) | | (6,986) |
| Reclassification adjustment for net security gains realized in net income | | | | (53) | | (53) |
| Unrealized gain on derivatives arising during the period, net of realized losses of \$116 | | | | 337 | | 337 |
| Income taxes | | | | 2,556 | | 2,556 |
| Comprehensive income | | | | | | 1,118 |
| Cash dividends declared: | | | | | | |
| Common, \$.08 per share | | | (1,318) | | | (1,318) |
| Purchase of 87,697 shares of common stock | | | | | (1,786) | (1,786) |
| Issuance of 127,721 shares of common stock | | (143) | | | 2,346 | 2,203 |
| Balance at March 31, 2005 | \$ 16,547 | \$ 40,303 | \$ 121,746 | \$ (1,257) | \$ (1,340) | \$ 175,999 |
| Balance at January 1, 2006 | \$ 16,547 | \$ 40,256 | \$ 135,112 | \$ (1,011) | \$ (3,092) | \$ 187,812 |
| Net income | | | 4,473 | | | 4,473 |
| Unrealized loss on securities available for sale arising during the period | | | | (1,680) | | (1,680) |
| Reclassification adjustment for net | | | | (132) | | (132) |

| | | | | | | | |
|---|-----------|-----------|------------|------------|---------|------------|---------|
| security gains realized in net income | | | | | | | |
| Unrealized gain on derivatives arising during the period, net of realized losses of \$7 | | | | (55) | | | (55) |
| Income taxes | | | | 702 | | | 702 |
| Comprehensive income | | | | | | | 3,308 |
| Cash dividends declared: | | | | | | | |
| Common, \$.09 per share | | | (1,478) | | | | (1,478) |
| Purchase of 55,126 shares of common stock | | | | | (1,177) | | (1,177) |
| Issuance of 211,790 shares of common stock | 1 | (2,844) | | | 4,251 | | 1,408 |
| Commitments to issue common stock | | 259 | | | | | 259 |
| Balance at March 31, 2006 | \$ 16,548 | \$ 37,671 | \$ 138,107 | \$ (2,176) | \$ (18) | \$ 190,132 | |

See accompanying notes to consolidated financial statements.

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

| | Three Months Ended | |
|--|--------------------|----------------|
| | March 31, 2006 | March 31, 2005 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 4,473 | \$ 5,264 |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: | | |
| Depreciation and amortization | 5,228 | 4,681 |
| Provision for loan and lease losses | 1,172 | 1,364 |
| Net amortization of premium on securities | 321 | 814 |
| Securities gains, net | (132) | (53) |
| (Increase) decrease in trading account securities | 4 | (18) |
| Stock-based compensation | 259 | - |
| Loans originated for sale | (62,792) | (57,648) |
| Proceeds on sales of loans | 65,202 | 48,631 |
| Net gain on sales of loans | (550) | (532) |
| Increase in accrued interest receivable | (95) | (418) |
| Increase in accrued interest payable | 1,447 | 1,342 |
| Other, net | (470) | (5,742) |
| NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES | 14,067 | (2,315) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from the sale of securities available for sale | 229 | 13,146 |
| Proceeds from the maturity of and principal paydowns on securities available for sale | 15,320 | 34,412 |
| Purchase of securities available for sale | (9,829) | (26,282) |
| Net increase in loans and leases | (39,002) | (10,341) |
| Increase in assets under operating leases | (2,245) | (5,119) |
| Capital expenditures | (10,800) | (7,259) |
| Proceeds on sale of OREO and other repossessed assets | 266 | 136 |
| NET CASH USED BY INVESTING ACTIVITIES | (46,061) | (1,307) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase (decrease) in demand deposits and savings accounts | 6,833 | (8,472) |
| Net increase in time deposit accounts | 6,844 | 15,201 |
| Net decrease in short-term borrowings | (23,117) | (10,394) |
| Proceeds from other borrowings | 20,648 | 30,863 |
| Repayments of other borrowings | (9,494) | (11,633) |
| Purchase of treasury stock | (1,177) | (1,786) |
| Proceeds from issuance of common stock | 269 | 945 |
| Dividends paid | (1,478) | (1,318) |
| | (672) | 13,406 |

NET CASH PROVIDED (USED) BY
FINANCING ACTIVITIES

| | | | | |
|--|----|----------|----|--------|
| Net increase (decrease) in cash and cash equivalents | | (32,666) | | 9,784 |
| Cash and cash equivalents at beginning of year | | 81,021 | | 73,749 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ | 48,355 | \$ | 83,533 |
| Supplemental disclosures: | | | | |
| Cash paid for income/franchise taxes | \$ | 1,824 | \$ | 617 |
| Cash paid for interest | \$ | 20,029 | \$ | 14,294 |

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 financial statements for the fiscal year ended December 31, 2005, included in Heartland Financial USA, Inc.'s ("Heartland") Form 10-K filed with the Securities and Exchange Commission on March 10, 2006. 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 have been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and have been prepared pursuant to the rules and regulations for reporting on Form 10-Q and Rule 10-01 of Regulation S-X. Such information reflects all adjustments (consisting of normal recurring adjustments), that are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of the interim period ended March 31, 2006, are not necessarily indicative of the results expected for the year ending December 31, 2006.

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 periods ended March 31, 2006 and 2005, are shown in the tables below:

| (Dollars in thousands) | Three Months Ended | |
|---|--------------------|----------|
| | 3/31/06 | 3/31/05 |
| Net income | \$ 4,473 | \$ 5,264 |
| Weighted average common shares outstanding for basic earnings per share (000's) | 16,430 | 16,479 |
| Assumed incremental common shares issued upon exercise of stock options (000's) | 208 | 226 |
| Weighted average common shares for diluted earnings per share (000's) | 16,638 | 16,705 |
| Earnings per common share - basic | \$ 0.27 | \$ 0.32 |
| Earnings per common share - diluted | \$ 0.27 | \$ 0.32 |

Stock-Based Compensation

Effective January 1, 2006, Heartland adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004) (FAS 123R), *Share-Based Payment* using the "modified prospective" transition method. FAS 123R requires the measurement of the cost of employee services received in exchange for an award of equity instruments based upon the fair value of the award on the grant date. The cost of the award is recognized in the income statement over the vesting period of the award. Under the "modified prospective" transition method, awards that are granted, modified or settled beginning at the date of adoption are measured and accounted for in accordance with FAS 123R. In addition, expense must be recognized in the income statement for unvested awards that were granted prior to the date of adoption. The expense will be based on the fair value determined at the grant date. The impact of the adoption of FAS 123R on Heartland's financial statements for the year ending on December 31, 2006, is expected to be a reduction in earnings per share of \$0.02.

Heartland's 2005 Long-Term Incentive Plan provides for the grant of non-qualified and incentive stock options, stock appreciation rights ("SARS"), stock awards and cash incentive awards. All employees and directors of, and service providers to, Heartland or its subsidiaries are eligible to become participants in the 2005 Long-Term Incentive Plan, except that non-employees may not be granted incentive stock options. Under the terms of the 2005 Long-Term Incentive Plan, 1,000,000 shares have been reserved for issuance. A summary of the principal features is provided in Heartland's 2005 Proxy Statement.

On May 18, 2005, stock awards totaling 136,500 shares were granted to key policy-making employees. These awards were granted at no cost to the employee. These awards are contingent upon the achievement of performance objectives through December 31, 2009, and vest on December 31, 2011. Compensation expense is being recognized ratably over the vesting period.

Options have been granted with an exercise equal to the fair market value of Heartland stock on the date of grant and expire 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 2005 Long-Term Incentive Plan was adopted on May 18, 2005, which replaced the 2003 Stock Option Plan. The 2003 Stock Option Plan had previously replaced the 1993 Stock Option Plan.

Information concerning the issuance of stock options is presented in the following table:

| | 2006 | |
|---|---------------|---|
| | Shares | Weighted- Average Exercise Price |
| Outstanding at January 1, 2006 | 796,650 | \$ 12.70 |
| Granted | 130,750 | 21.60 |
| Exercised | (8,450) | 8.38 |
| Forfeited | (7,400) | 16.04 |
| Outstanding at March 31, 2006 | 911,550 | \$ 13.99 |
| Weighted-average fair value of options granted during the three-month period ended March 31, 2006 | \$5.65 | |

At March 31, 2006, the vested options totaled 475,675 shares with a weighted average exercise price of \$10.18 per share and a weighted average remaining contractual life of 3.01 years. The intrinsic value for the vested options as of March 31, 2006, was \$6.4 million. The intrinsic value for the total of all options exercised during the quarter ended March 31, 2006, was \$129 thousand, and the total fair value of shares vested during the quarter ended March 31, 2006, was \$119 thousand.

At March 31, 2006, shares available for issuance under the 2005 Long-Term Incentive Plan totaled 743,360.

The fair value of the 2006 stock options granted was estimated utilizing the Black Scholes valuation model. The grant date fair value for the 2006 options was \$21.60. Significant assumptions include:

| | 2006 |
|-------------------------|-------------|
| Risk-free interest rate | 4.52% |
| Expected option life | 7 years |
| Expected volatility | 22.00% |
| Expected dividends | 2.00% |