HEARTLAND FINANCIAL USA INC
Form 10-Q
May 10, 2012

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, 2012

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

For transition period __________ to __________

Commission File Number: 001-15393

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

Delaware
(State or other jurisdiction of incorporation or organization)

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

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

(563) 589-2000
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	..	Accelerated Filer	x
Non-accelerated filer	..	Smaller reporting company	..

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the classes of Registrant's common stock as of the latest practicable date: As of May 8, 2012, the Registrant had outstanding 16,487,731 shares of common stock, $1.00 par value per share.

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

PART I

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

	March 31, 2012 (Unaudited)	December 31, 2011
ASSETS		
Cash and due from banks	$144,632	$126,680
Federal funds sold and other short-term investments	5,490	3,154
Cash and cash equivalents	150,122	129,834
Securities:		
Trading, at fair value	330	333
Available for sale, at fair value (cost of $1,135,679 at March 31, 2012, and $1,242,460 at December 31, 2011)	1,165,108	1,267,999
Held to maturity, at cost (fair value of $57,441 at March 31, 2012, and $57,486 at December 31, 2011)	56,471	58,260
Loans held for sale	103,460	53,528
Loans and leases receivable:		
Held to maturity	2,532,419	2,481,284
Loans covered by loss share agreements	11,360	13,347
Allowance for loan and lease losses	(39,362)	(36,808)
Loans and leases receivable, net	2,504,417	2,457,823
Premises, furniture and equipment, net	111,946	110,206
Other real estate, net	38,934	44,387
Goodwill, net	25,909	25,909
Other intangible assets, net	13,109	12,960
Cash surrender value on life insurance	72,159	67,084
FDIC indemnification asset	1,270	1,343
Other assets	69,616	75,392
TOTAL ASSETS	$4,312,851	$4,305,058
LIABILITIES AND EQUITY		
LIABILITIES:		
Deposits:		
Demand	$771,421	$737,323
Savings	1,731,399	1,678,154
Time	772,939	794,636
Total deposits	3,275,759	3,210,113
Short-term borrowings	229,533	270,081
Other borrowings	377,362	372,820
Accrued expenses and other liabilities	64,154	99,151
TOTAL LIABILITIES	3,946,808	3,952,165
STOCKHOLDERS' EQUITY:		
Preferred stock (par value $1 per share; authorized 20,604 at March 31, 2012 and December 31, 2011; none issued or outstanding)	—	—
Series A Junior Participating preferred stock (par value $1 per share; authorized 16,000 shares; none issued or outstanding)	—	—

Series C Fixed Rate Non-Cumulative Perpetual preferred stock (par value $1 per share; liquidation value $81.7 million at March 31, 2012 and December 31, 2011; authorized, issued and outstanding 81,698 shares at March 31, 2012 and December 31, 2011)	81,698	81,698
Common stock (par value $1 per share; authorized 25,000,000 shares; issued 16,611,671 shares)	16,612	16,612
Capital surplus	43,885	43,333
Retained earnings	208,353	198,182
Accumulated other comprehensive income	14,418	12,147
Treasury stock at cost (125,132 shares at March 31, 2012, and 126,881 shares at December 31, 2011)	(1,572)	(1,754)
TOTAL STOCKHOLDERS' EQUITY	363,394	350,218
Noncontrolling interest	2,649	2,675
TOTAL EQUITY	366,043	352,893
TOTAL LIABILITIES AND EQUITY	$4,312,851	$4,305,058

See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	March 31, 2012	March 31, 2011
INTEREST INCOME:		
Interest and fees on loans and leases	$38,399	$36,966
Interest on securities:		
Taxable	7,572	7,411
Nontaxable	2,271	3,564
Interest on interest bearing deposits in other financial institutions	—	1
TOTAL INTEREST INCOME	48,242	47,942
INTEREST EXPENSE:		
Interest on deposits	5,775	8,026
Interest on short-term borrowings	213	259
Interest on other borrowings	4,061	3,936
TOTAL INTEREST EXPENSE	10,049	12,221
NET INTEREST INCOME	38,193	35,721
Provision for loan and lease losses	2,354	10,009
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	35,839	25,712
NONINTEREST INCOME:		
Service charges and fees	3,584	3,361
Loan servicing income	1,760	1,549
Trust fees	2,613	2,479
Brokerage and insurance commissions	910	848
Securities gains, net	3,943	2,089
Gain (loss) on trading account securities	(3)	216
Impairment loss on securities	(981)	—
Gains on sale of loans	8,502	1,402
Valuation adjustment on mortgage servicing rights	13	—
Income on bank owned life insurance	482	403
Other noninterest income	2,565	261
TOTAL NONINTEREST INCOME	23,388	12,608
NONINTEREST EXPENSES:		
Salaries and employee benefits	23,996	18,186
Occupancy	2,482	2,386
Furniture and equipment	1,446	1,409
Professional fees	2,760	3,019
FDIC insurance assessments	864	1,345
Advertising	1,071	850
Intangible assets amortization	131	146
Net loss on repossessed assets	2,904	1,632
Other noninterest expenses	4,486	3,914
TOTAL NONINTEREST EXPENSES	40,140	32,887
INCOME BEFORE INCOME TAXES	19,087	5,433
Income taxes	6,272	1,212
NET INCOME	12,815	4,221

Net income available to noncontrolling interest, net of tax	26	16
NET INCOME ATTRIBUTABLE TO HEARTLAND	12,841	4,237
Preferred dividends and discount	(1,021)	(1,336)
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$11,820	$2,901
EARNINGS PER COMMON SHARE - BASIC	$0.72	$0.18
EARNINGS PER COMMON SHARE - DILUTED	$0.71	$0.18
CASH DIVIDENDS DECLARED PER COMMON SHARE	$0.10	$0.10

See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	March 31, 2012	March 31, 2011
NET INCOME	$12,815	$4,221
OTHER COMPREHENSIVE INCOME		
Securities:		
Net change in unrealized gain (loss) on securities available for sale	6,852	(1,065)
Reclassification adjustment for net gains realized in net income	(2,962)	(2,089)
Net change in non-credit related other than temporary impairment	(683)	—
Income taxes	(1,200)	1,176
Other comprehensive income on securities available for sale	2,007	(1,978)
Derivatives used in cash flow hedging relationships:		
Unrealized gain on derivatives	(73)	238
Reclassification adjustment for net losses on derivatives realized in net income	494	445
Income taxes	(157)	(233)
Other comprehensive income on cash flow hedges	264	450
Other comprehensive income	2,271	(1,528)
Comprehensive income	15,086	2,693
Less: comprehensive income attributable to noncontrolling interest	26	16
COMPREHENSIVE INCOME ATTRIBUTABLE TO HEARTLAND	$15,112	$2,709

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

	Three Months Ended	
	March 31, 2012	March 31, 2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$12,815	$4,221
Adjustments to reconcile net income to net cash (used) provided by operating activities:		
Depreciation and amortization	1,753	1,945
Provision for loan and lease losses	2,354	10,009
Net amortization of premium on securities	3,413	2,921
Securities gains, net	(3,943)	(2,089)
(Increase) decrease in trading account securities	3	(216)
Impairment loss on securities	981	—
Stock based compensation	759	312
Loans originated for sale	(273,974)	(95,660)
Proceeds on sales of loans held for sale	232,544	81,475
Net gains on sales of loans held for sale	(8,502)	(1,402)
(Increase) decrease in accrued interest receivable	779	(268)
Decrease in prepaid expenses	707	1,090
Decrease in accrued interest payable	(634)	(901)
Valuation adjustment on mortgage servicing rights	(13)	—
Other, net	953	(244)
NET CASH (USED) PROVIDED BY OPERATING ACTIVITIES	(30,005)	1,193
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the sale of securities available for sale	124,364	165,336
Proceeds from the maturity of and principal paydowns on securities available for sale	76,453	77,536
Proceeds from the maturity of and principal paydowns on securities held to maturity	371	220
Purchase of securities available for sale	(124,246)	(226,801)
Net increase in loans and leases	(57,734)	(2,248)
Purchase of bank owned life insurance policies	(4,571)	(3,140)
Capital expenditures	(3,403)	(1,359)
Proceeds on sale of OREO and other repossessed assets	12,114	5,216
NET CASH PROVIDED BY INVESTING ACTIVITIES	23,348	14,760
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits and savings accounts	87,343	67,858
Net decrease in time deposit accounts	(21,697)	(19,532)
Net decrease in short-term borrowings	(40,548)	(40,930)
Proceeds from other borrowings	10,126	3,054
Repayments of other borrowings	(5,584)	(300)
Purchase of treasury stock	(308)	(289)
Proceeds from issuance of common stock	260	485
Excess tax benefits on exercised stock options	23	66
Dividends paid	(2,670)	(2,659)
NET CASH PROVIDED BY FINANCING ACTIVITIES	26,945	7,753
Net increase in cash and cash equivalents	20,288	23,706

Cash and cash equivalents at beginning of year	129,834	62,572
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$150,122	$86,278
Supplemental disclosures:		
Cash paid for income/franchise taxes	$290	$592
Cash paid for interest	$10,683	$13,122
Loans transferred to OREO	$8,722	$8,973
Purchases of securities available for sale, accrued, not paid	$24,871	$—

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
CONSOLATED STATEMENTS OF CHANGES IN EQUITY (Unaudited)
(Dollars in thousands, except per share data)

	Heartland Financial USA, Inc. Stockholders' Equity							
	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Non-controlling Interest	Total Equity
Balance at January 1, 2011	$78,483	$16,612	$44,628	$184,525	$ 8,517	$(3,674)	$ 2,693	$331,784
Comprehensive income				4,237	(1,528)		(16)	2,693
Cumulative preferred dividends accrued and discount accretion	315			(315)				—
Cash dividends declared:								
Preferred, $12.50 per share				(1,021)				(1,021)
Common, $0.10 per share				(1,638)				(1,638)
Purchase of 48,215 shares of common stock						(289)		(289)
Issuance of 41,388 shares of common stock			(354)			905		551
Commitments to issue common stock			312					312
Balance at March 31, 2011	$78,798	$16,612	$44,586	$185,788	$ 6,989	$(3,058)	$ 2,677	$332,392
Balance at January 1, 2012	$81,698	$16,612	$43,333	$198,182	$ 12,147	$(1,754)	$ 2,675	$352,893
Comprehensive income				12,841	2,271		(26)	15,086
Cash dividends declared:								
Preferred, $12.50 per share				(1,021)				(1,021)
Common, $0.10 per share				(1,649)				(1,649)
Purchase of 19,805 shares of common stock						(308)		(308)
Issuance of 21,554 shares of common stock			(207)			490		283

Commitments to issue common stock			759					759
Balance at March 31, 2012	$81,698	$16,612	$43,885	$208,353	$ 14,418	$(1,572)	$ 2,649	$366,043

See accompanying notes to consolidated financial statements.

HEARTLAND FINANCIAL USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION

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

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

Heartland evaluated subsequent events through the filing date of its quarterly report on Form 10-Q with the SEC.

Earnings Per Share

Basic earnings per share is determined using net income available to common stockholders and weighted average common shares outstanding. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average common shares and assumed incremental common shares issued. Amounts used in the determination of basic and diluted earnings per share for the three-month periods ended March 31, 2012 and 2011, are shown in the table below:

	Three Months Ended	
(Dollars and number of shares in thousands, except per share data)	March 31, 2012	March 31, 2011
Net income attributable to Heartland	$12,841	$4,237
Preferred dividends and discount	(1,021)	(1,336)
Net income available to common stockholders	$11,820	$2,901
Weighted average common shares outstanding for basic earnings per share	16,490	16,408
Assumed incremental common shares issued upon exercise of stock options	240	149
Weighted average common shares for diluted earnings per share	16,730	16,557
Earnings per common share — basic	$0.72	$0.18
Earnings per common share — diluted	$0.71	$0.18
Number of antidilutive stock options excluded from diluted earnings per share computation	509	562

Stock-Based Compensation

Prior to 2009, options were typically granted annually with an expiration date ten years after the date of grant. Vesting was generally over a five-year service period with portions of a grant becoming exercisable at three years, four years and five years after the date of grant. A summary of the status of the stock options as of March 31, 2012 and 2011, and changes during the three months ended March 31, 2012 and 2011, follows:

2012	2011
Shares	Shares

		Weighted-Average Exercise Price		Weighted-Average Exercise Price
Outstanding at January 1	570,762	$21.06	672,721	$20.27
Granted	—	—	—	—
Exercised	(12,500)	9.89	(30,250)	10.03
Forfeited	(5,250)	20.62	—	—
Outstanding at March 31	553,012	$21.32	642,471	$20.76
Options exercisable at March 31	505,295	$21.58	499,370	$20.44

At March 31, 2012, the vested options totaled 505,295 shares with a weighted average exercise price of $21.58 per share and a weighted average remaining contractual life of 3.73 years. The intrinsic value for the vested options as of March 31, 2012, was $240 thousand. The intrinsic value for the total of all options exercised during the three months ended March 31, 2012, was $93 thousand. The total fair value of shares under stock options and awards that vested during the three months ended March 31, 2012, was $759 thousand. At March 31, 2012, shares available for issuance under the 2005 Long-Term Incentive Plan totaled 168,263.

No options were granted during the first three months of 2012 and 2011. Cash received from options exercised for the three months ended March 31, 2012, was $124 thousand, with a related tax benefit of $23 thousand. Cash received from options exercised for the three months ended March 31, 2011, was $303 thousand, with a related tax benefit of $66 thousand.

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

In addition to the RSUs referenced in the preceding paragraph, performance-based RSUs totaling 49,801 were granted to key policy-making employees on January 17, 2012, and 21,200 on October 11, 2011. These RSUs were granted at no cost to the employee and represent the right to receive shares of Heartland common stock at a specified date in the future based first on performance measures tied to Heartland's earnings and assets on December 31 of the grant year, and then on time-based vesting conditions. For the grants in 2011, vesting occurs on December 31, 2013, and for the grants in 2012, vesting occurs on December 31, 2014. The performance-based RSUs will be settled in common stock upon vesting; will not be entitled to dividends until vested; will terminate upon termination of employment, but will continue to vest after retirement if the employee has attained age 62 and has provided ten years of service to Heartland for those granted in 2011 and five years of service for those granted in 2012.

Total compensation costs recorded for stock options, RSUs and restricted stock awards were $759 thousand and $312 thousand for the three months ended March 31, 2012 and 2011, respectively. As of March 31, 2012, there were $4.3 million of total unrecognized compensation costs related to the 2005 Long-Term Incentive Plan for stock options, RSUs and restricted stock awards which are expected to be recognized through 2016.

Effect of New Financial Accounting Standards

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

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

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

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

NOTE 2: SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Estimated Fair Value
March 31, 2012					
Securities available for sale:					
U.S. government corporations and agencies	$47,133	$1,048	$(65	)	$48,116
Mortgage-backed securities	777,611	17,712	(3,658	)	791,665
Obligations of states and political subdivisions	263,524	16,259	(958	)	278,825
Corporate debt securities	26,307	129	(1,642	)	24,794
Total debt securities	1,114,575	35,148	(6,323	)	1,143,400
Equity securities	21,104	604	—		21,708
Total	$1,135,679	$35,752	$(6,323	)	$1,165,108
December 31, 2011					
Securities available for sale:					
U.S. government corporations and agencies	$104,719	$2,428	$—		$107,147
Mortgage-backed securities	815,408	14,643	(4,997	)	825,054
Obligations of states and political subdivisions	272,660	14,983	(973	)	286,670
Corporate debt securities	26,284	29	(1,060	)	25,253
Total debt securities	1,219,071	32,083	(7,030	)	1,244,124
Equity securities	23,389	486	—		23,875
Total	$1,242,460	$32,569	$(7,030	)	$1,267,999

At March 31, 2012, the amortized cost of the available for sale securities is net of $184 thousand of credit related other-than temporary impairment. At December 31, 2011, no other-than-temporary impairment was recorded.

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2012				
Securities held to maturity:				
Mortgage-backed securities	$7,342	$260	$—	$7,602
Obligations of states and political subdivisions	49,129	721	(11)	49,839
Total	$56,471	$981	$(11)	$57,441
December 31, 2011				
Securities held to maturity:				